PREM 19/992

PART 24

MT

CONFIDENTIAL FILING

Economic Strategy
Pay and Prices Monthly Economic Report
Economic Project
Treasury Weekly brief

ECONOMIC POLICY

PART 1: MAY 1979

PART 24: JUNE 1983

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~15.6.83~~							
~~20.6.83~~							
~~27.6.83~~							
~~11.7.83~~							
~~15.7.83~~							
~~20.7.83~~							
~~22.7.83~~							
~~29.7.83~~							
25.8.83							
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PREM 19/992

PART 24 ends:-

E(A)(83) 8 25/8

PART 25 begins:-

TF to MCS 6/9

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(A)(83)3	27.6.83
E(A)(83)7	28.7.83
E(A)(83)8	25.8.83

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed CWayland Date 19 March 2013

PREM Records Team

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Prime Minister

MS 29/7

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Michael Scholar Esq
Private Secretary
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29 July 1983

Dear Michael

... I am enclosing a copy of the latest Pay Brief.

Copies also go to the Private Secretaries to Members of E(S), E(PSP) and E(A)

Yours sincerely

Felicity Everiss

MS F M EVERISS
Private Secretary

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PAY BRIEF: POSITION IN MID-JULY 1983

SETTLEMENTS

1. Since the June pay brief 160 settlements covering 778,000 employees, with operative dates after 31 July 1982, have been recorded. In the private sector (150 settlements covering 386,000 employees) the weighted average level of settlements in the last month is just under 5½%. The average in the public sector (10 settlements covering 392,000 employees) is just under 5%. Important settlements in the private sector are Chemical Industries Assoc (62,000) at 5.5%, Food Manufacture JIC (40,000) at 4½%-6%, Wholesale Grocery Trade E&W (70,000) at 5.3%-6.4% and Norwich Union (8,300) at 6%-7%. The principal settlements in the public sector are a deferred increase for British Rail (136,000) giving 3.75% in the first year (4.5% in a full year), a staged increase for British Telecom (162,000) of 5.6% in the first year (6.1% when fully implemented), Top Salaries (1,800) of 5.85% in the first year (11.9 % in a full year) and a 27½% increase for Members of Parliament (650) to be paid over 5 years in equal increments of £798 (5½%).

2. The cumulative average level of settlements for the whole economy this round (1059 settlements covering 10,329,000 employees) is 5½%. About 9/10 of the employees about whom the Department expects to receive information have reached settlements.

3. In the private sector the cumulative average is just under 6% (995 settlements covering 4,686,000 employees). The average for manufacturing is just under 5½% and for non-manufacturing is 6%. On average, settlements are 1 to 1½ percentage points below those agreed in the same period last year, with manufacturing just under 1% less and non-manufacturing about 1½% less. In this pay round over 9/10 of employees have settled in a 4% to 8% range with about ½ of settlements and 7/10 of employees at 5%-6%. The pattern is similar in both manufacturing and in non-manufacturing. About 1 in 5 of employees with settlements in both rounds have agreed higher increases than in the previous round.

4. In the public sector (64 settlements covering 5,643,000 employees) the cumulative average is just under 5½%. The average in the public trading sector is just over 5½% and in the services sector is just over 5%. Only the Armed

Forces, Doctors and Dentists, Members of Parliament and Water Service manuals and craftsmen have been awarded increases above those for last year.

5. Coverage: The limitations of the Department's coverage of settlements were explained in the April pay brief (para 5).

6. Twenty-six Wages Councils covering 2,705,000 employees have either made or decided to make orders to come into effect during the current pay round. The weighted average increase in representative minimum rates is 6%, with manufacturing at just under 5½% and non-manufacturing at just over 6%. If these are added to settlements for this round, using rates as a proxy for earnings and DE estimates for the numbers of workers affected, the cumulative average for the private sector remains unchanged at just under 6%, with both manufacturing and non-manufacturing also unchanged at just under 5½% and about 6% respectively. For the 1983/84 pay round, a proposal has been made for increases, depending on grade, ranging from 6.8% to 7.3% for adults (18 and over) and 9.1% to 9.7% for aged 16 in Licensed Residential Establishments (6 October - 555,300).

NEGOTIATIONS

7. In the PUBLIC SECTOR, Gas Supply, staff (1 June - 57,600) have rejected an offer of 4.5% on salaries for junior staff and 5% for adults. The unions have referred the claim for a 9.5% increase on salaries to ACAS under the procedural agreement which provides for unilateral access to binding arbitration. The management for British Shipbuilders (1 April - 64,000) maintain that the company cannot afford a national increase, but that there is scope for local productivity bargaining The claim is for a substantial increase, 35 hour week, extra 1 week holiday and other benefits. The unions are threatening industrial action over proposed redundancies (9,000). A meeting has been arranged for 22 August. Unions representing Civil Service, industrials (1 July - 135,200) are recommending acceptance of a 4.86% offer. A reply is expected by early August. Local Authority Chief Executives and Chief Officers (1 July - 3,609) have rejected an offer of 4.9% increase on salaries. Chief Executives have referred their claim for a substantial increase to arbitration and Chief Officers are expected to follow when the procedural 4 weeks conciliation period has been completed. Both groups have unilateral access to arbitration. For the 1983/84 pay round, the Home Secretary has approved increases in pay for Polic (1 September - 135,800) of 8.4% and 7.7% for superintending ranks (2,200). Other important groups with early settlement dates, where talks have yet to begin, are Coalmining, manuals (1 November - 175,000), Local Authority,manuals (4 November -

1,000,000) and Fire Services (7 November - 40,500).

8. In the PRIVATE SECTOR, the unions representing ICI, manuals (2 June - 38,000) have consulted members on a 5.5% offer with a recommendation to accept. The outcome is expected soon. Important groups with settlement dates early in the 1983/84 pay round are Vauxhall Motors, manuals (14 September - 15,600), British Leyland, manual (1 November - 37,000), Engineering (1 November - 1,500,000), Ford manuals (24 November 50,000), Oil Tanker Drivers (17 November - 9,000) and British Clothing Industries Assoc (1 December - 140,000).

EARNINGS

9. In May the year on year increase in average earnings for the whole economy was 8.4% compared with 8.2% in April. The May increase was affected by temporary factors, mainly the timing of settlements. The underlying increase in May was 7¼%, the same as in April, compared with 10% in May 1982.

PRICES

10. In June the year on year increase in retail prices was 3.7%, the same as in May, compared with 9.2% in June 1982.

TAX AND PRICE INDEX

11. In June the year on year increase in the tax and price index was 3.1% compared with 3.2% in May and 9.4% in June 1982. The index measures the increase in gross taxable income needed to compensate taxpayers - whether working, unemployed or retired - for any increase in retail prices. It also takes account of any changes in direct taxes (including employee's National Insurance contributions).

REAL DISPOSABLE INCOME

12 Real disposable income - taking account of the changes in earnings, prices and taxes - of a married man on average adult male earnings with a non-working wife and two children under 11 (with no other tax liabilities or allowances and not contracted out of the State Pension Scheme) rose by about 4½% in the 3 month period ending May compared with the corresponding period a year earlier.

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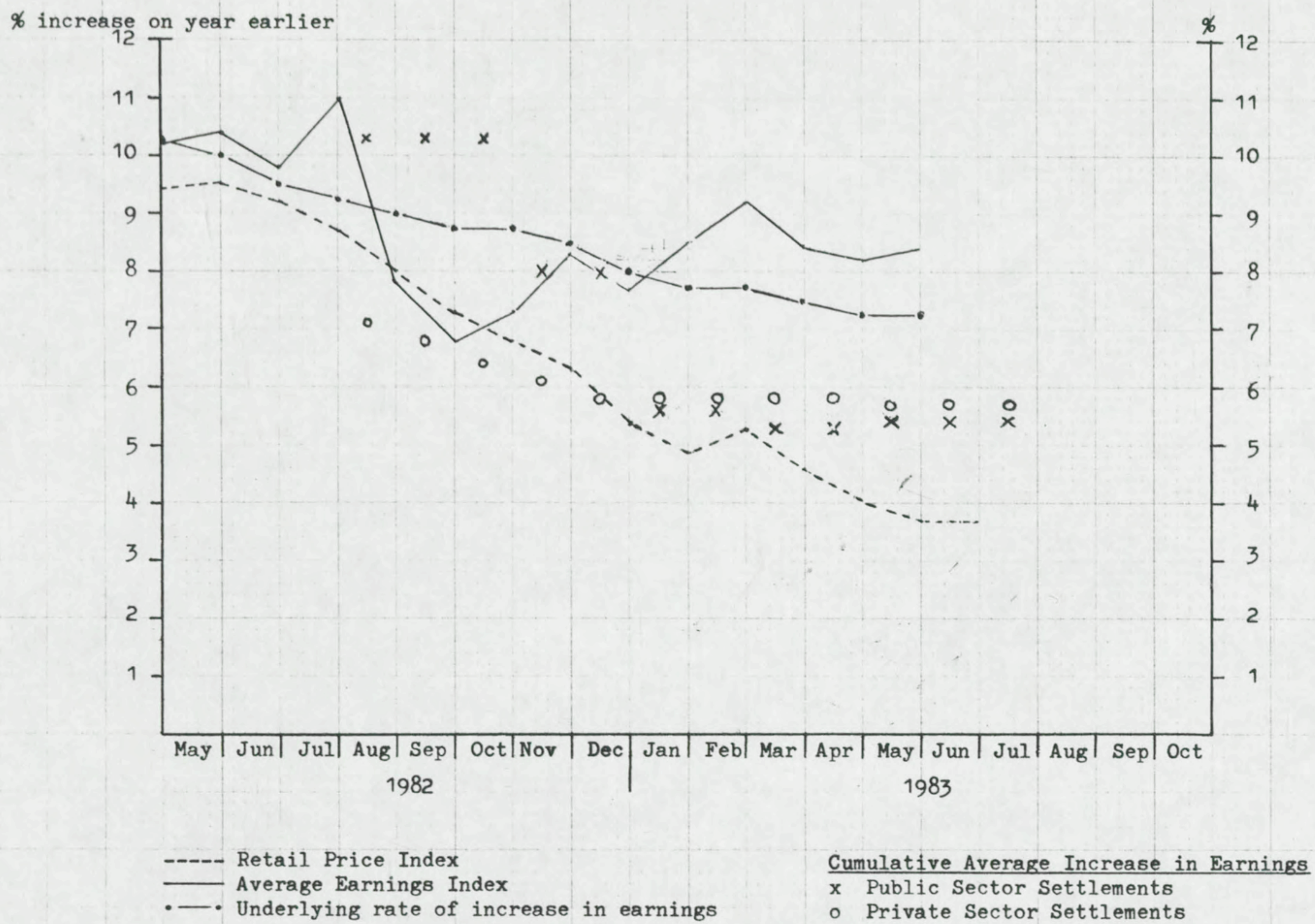
APPENDIX

TRENDS IN EARNINGS AND PRICES



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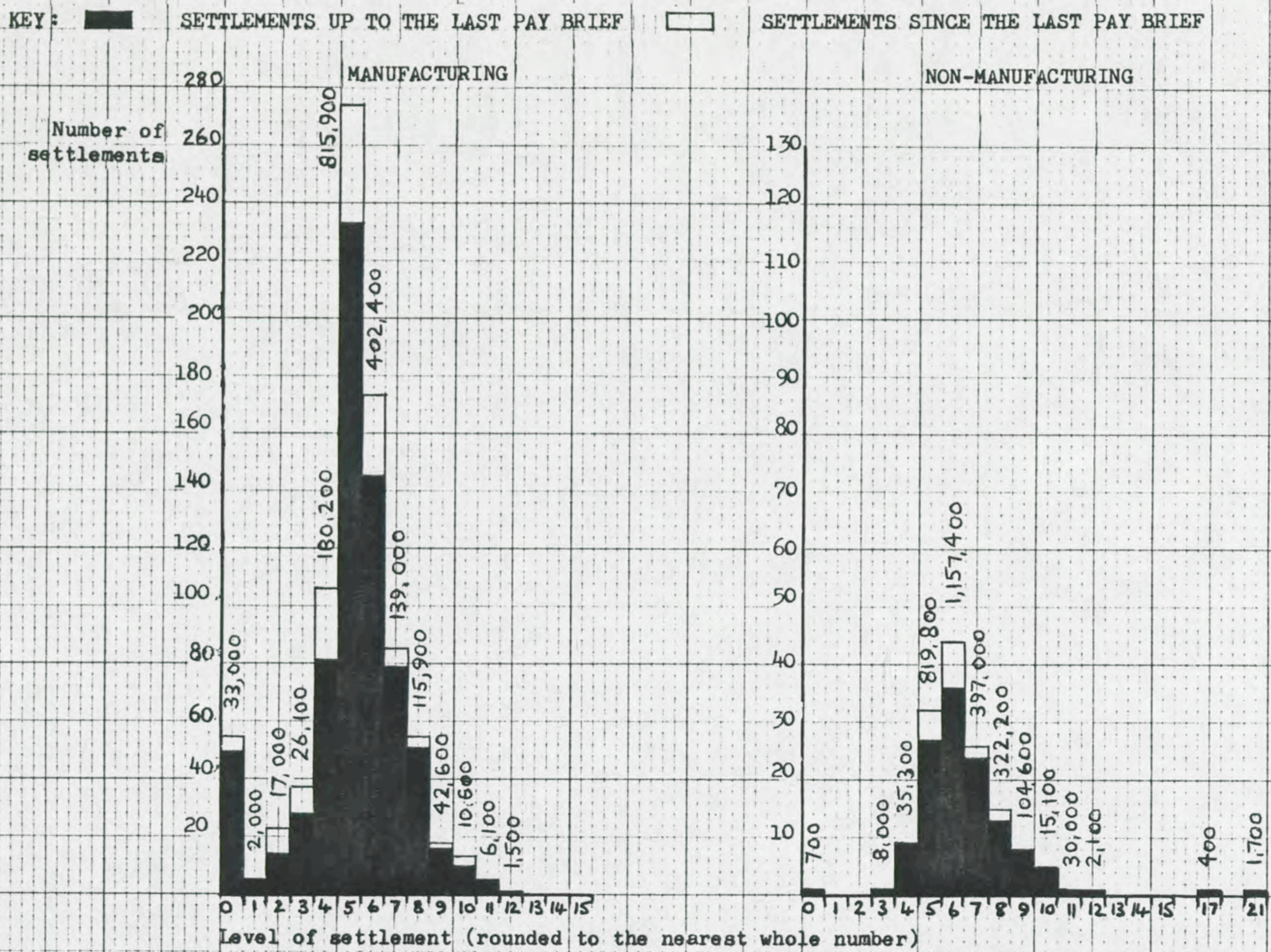
DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1982

APPENDIX



E.R.

NOTE - THE NUMBER OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

SECRET

Original filed on Economic Policy: Public Expenditure Pt 23. copied to Econ Pol Strategy Pt 24 & Civil Service Long Term Policy Pt 13.

2

Ref. A083/2146

PRIME MINISTER

Economic Outlook and Public Expenditure
(C(83) 23-26)

BACKGROUND

On 21 July the Cabinet will, as is customary at this time of year, have its first collective discussion of the current Public Expenditure Survey against the background of an assessment by the Chancellor of the Exchequer of the prospects for the economy. There are four papers on the agenda:

(i) C(83) 26: the Chancellor of the Exchequer's memorandum on economic prospects.

(ii) C(83) 23: the Chief Secretary's main memorandum on public expenditure, both in 1984-85 and the two succeeding years, and in the longer term.

(iii) C(83) 24: a memorandum by the Chief Secretary on Civil Service numbers.

(iv) C(83) 25: a memorandum by the Chief Secretary on contracting out and privatisation.

2. Because of the gap imposed by the General Election the usual detailed PESC Report is not yet available. But that should not hamper the Cabinet's discussion: the aim at this stage is to lay down broad guidelines and not to discuss individual programmes in detail.

Economic Prospects

3. C(83) 26 surveys the economic scene in broad terms. It sees some encouraging developments on prices and on unemployment, but draws attention to the risks, particularly on the overseas front because of the high budget deficit in the United States. On the domestic side, it recalls the recent disturbing trends in the money supply, public expenditure and borrowing which lay behind the measures announced on 7 July. It implies that the modest fiscal adjustment of £1½ billion in 1984-85 foreshadowed in this year's

Financial Statement and Budget Report is at risk. The highest level of public expenditure that can be afforded is that published in this year's Public Expenditure White Paper (Cmnd 8789). Even then there will be a risk that taxes may still have to be put up next year.

Public Expenditure: Current Survey

4. C(83) 23 has two main sets of proposals: one set for the current survey period and one for the longer term. The main figures relevant to the survey period are as follows.

	£ billion		
	1984-85	1985-86	1986-87
Cmnd 8789			
Programmes	125.3	130.4	
Planning reserve	3.0	3.0	
Net sales of assets	-1.5	-0.5	
Other adjustments	-0.4	-0.7	
Planning total	126.4	132.3	
Survey baseline for 1986-87			137.5
Change on previous year	5.8%	4.7%	4.0%
1983 Survey			
Agreed changes*	0.7	1.1	
Departmental bids	5.4	5.8	7.0
Prospective addition to planning total/baseline	6.1	6.9	7.0

*Mainly due to changed economic assumptions.

5. The Chief Secretary proposes that his objective in the bilateral discussions with spending Ministers which customarily lead up to final decisions by the Cabinet in the autumn should be to hold to the published planning totals for 1984-85 and 1985-86 and to keep the total at approximately the same real level in 1986-87: I understand that this implies a planning total in 1986-87 of £140.3 billion.

6. The Chief Secretary proposes to maintain the planning reserve (also [redacted] referred to as the "contingency reserve" -

see paragraph 11 below) at £3 billion rather than, as in recent surveys, to draw it down in order to meet agreed additional bids. He also indicates that unavoidable bids in 1984-85 are likely to total £2½ billion. I understand that this is made up as follows.

	£ billion
Agreed changes	0.7
Local authority current expenditure	0.5
Social security	0.2
Defence	
Price increases	0.1
1983 AFPRB award	0.1
NHS: 1983 DDRB award and family practitioner service	0.2
Agricultural price support	0.4
Other	0.3
	2.5

It follows that to get back to the planning figure for 1984-85, not only must the whole of the remaining bids be rejected, but also a net £2½ billion of savings must be found. At its meeting on 14 July the Ministerial Sub-Committee on Economic Affairs (E(A)) agreed to aim for savings of about £1 billion on the external financing requirements of the nationalised industries (ie that the industries' bids for an additional £½ billion of external finance should be rejected and that, in addition, reductions below the baseline of £½ billion should be secured). But even if that should prove realistically attainable, it will leave £1½ billion to come from Departmental programmes. The Chief Secretary considers that similar reductions are required in the remaining years of the survey.

Public Expenditure: Longer Term

7. The Chief Secretary also draws attention to the threat to the Government's tax objectives in the longer term presented by high levels of public expenditure. A combination of 2½ per cent a year economic growth and holding public expenditure constant in real terms to 1988-89 - ie extending the Chief Secretary's proposals for the survey period to the end of the maximum life of the present Parliament - would still leave the ratio of taxation to gross

domestic product above the level of 1978-79. The Chief Secretary proposes that the Cabinet should endorse a target of holding total public expenditure constant in real terms up to 1988-89. He would then circulate in September a set of programme figures constructed on the basis of this target for discussion by the Cabinet. The programme figures, as amended in the light of that discussion, would then inform the remaining stages of the survey. The beginning of a new Parliament is clearly a good time for establishing a trend for public expenditure beyond the short term.

Civil Service Numbers

Flag B

8. C(83) 24 refers back to the Cabinet discussion of last December (CC(82) 53rd Conclusions, Minute 8), when it was agreed to identify and quantify the scope for reducing Civil Service manpower between 1984 and 1988. It reports that there is already a fair prospect of reducing the size of the Civil Service to 605,000 by 1 April 1988 (although this depends critically on the hiving-off of the Royal Ordnance Factories), and proposes that one of the aims in the bilateral discussions of public expenditure between now and the autumn should be to identify further savings, with the aim of at least getting below 600,000.

Contracting Out and Privatisation

9. C(83) 25 is essentially a progress report coupled with a general request to members of the Cabinet to keep up the pressure to reduce the size of the public sector. It proposals a further report in a year's time.

MAIN ISSUES

10. The main issues before the Cabinet arise on C(83) 23. They are:

(i) Does the Cabinet endorse the Chief Secretary's proposed aims for the current Public Expenditure Survey?

(ii) Does the Cabinet agree with the Chief Secretary's proposals for handling longer-term prospects?

Although they should require less extensive discussion, you will also wish the Cabinet to consider:

(iii) Are the Chief Secretary's proposals on Civil Service numbers, and contracting out and privatisation, acceptable?

The Public Expenditure Survey

11. It seems unlikely that many members of the Cabinet will argue that the Government should now abandon the aim of holding to the published planning figures for 1984-85 and 1985-86, or should plan for large real increases in expenditure in 1986-87. The main points likely to be raised in discussion are probably the following:

Economic Prospects. Some members of the Cabinet may express surprise that the improved prospects for output and inflation should not have more favourable effects on the prospects for public expenditure. In isolation, they are obviously beneficial But they need to be weighed against other, less favourable factors such as less buoyant revenue, to which the Chancellor draws attention in C(83) 26. And experience this year shows the vulnerability of economic forecasts and the importance of caution in managing public expenditure.

Pay. It may be argued that if the Government sets, and can adhere to, a low public service pay factor for 1984-85, the prospects for public expenditure will be easier. That will be a matter for discussion and decision in September. But although the pay factor may influence the level of public service settlements, it does not determine them. In any case this should not be allowed to distract discussions from the immediate question before the Cabinet, which is the overall objective of the survey.

Contingency Reserve. It is likely to be argued that a contingency reserve of £3 billion is excessive. Cmnd 8789 said that the reserve of £2.5 billion in 1981-82 and £2.4 billion in 1982-83 were "unnecessarily large"; and although this year's reserve of £1.5 billion is tight, there are no signs yet that it is likely to be overspent. The argument is partly a matter of terminology. Strictly speaking, the contingency reserve for a financial year current or immediately in prospect is a control device. Only increases in expenditure which are within the control of Ministers are charged against it: overruns on demand-determined programmes or overspending by local authorities, for example, are not so charged. The Chief Secretary is effectively arguing for a £3 billion reserve in a broader sense: a safety margin against all forms of excess expenditure. Not only are there the inevitable uncertainties about demand-determined expenditure. There are also items - such as our contribution to the European Community and local authority current expenditure - for which the figures eventually published are likely to represent what the Government wants to happen rather than a central estimate of what will happen. Again, the scheme of end-year flexibility which the Cabinet approved on 7 July will tend to increase expenditure in 1984-85 and later years. All these are arguments for a substantial "contingency reserve" in the broader sense mentioned above.

Sales of Assets. It may be suggested that sales of assets should be increased. But the published plans already take credit for significant sales. More sales, even if they could be achieved, would not affect the long-term balance between expenditure, revenue and borrowing. Even the Chancellor's announcement on 7 July that the Government was planning an extra £500 million of disposals in the current financial year attracted unfavourable comment in the media.

Years after 1984-85. The Chief Secretary says that reductions of "at least the same order" will be required in 1985-86 and 1986-87 as in 1984-85. But that is not immediately apparent from the figures. Agreed changes in 1985-86 total only £1.1 billion; and the Treasury have not indicated at official level that they regard any significant part of the Departmental bids of £5.8 billion in 1985-86 and £7.0 billion in 1986-87 as unavoidable. Moreover, E(A) agreed to seek about £1 billion savings from the nationalised industries in each year. It may therefore be argued that it is unnecessary to do more in respect of Departmental programmes than to require the withdrawal of additional bids. It will be for the Chief Secretary to defend his proposals in detail. But if there is dispute it will probably be best to concentrate on the need to agree on measures which give reasonable assurance that the overall totals approved by the Cabinet can be delivered.

Public Expenditure in the Longer Term

12. In discussion of the longer term you will wish to avoid at this stage any major dispute on specific issues of substance (for example, over the scope for real growth in defence expenditure or the future of the Health Service). At this stage the Cabinet are being asked merely to agree in principle to work towards an overall expenditure target for 1988-89. There will be opportunities in the autumn to discuss the Chief Secretary's projections and to confront the difficult issues about priorities which may arise.

13. There may be pressure for "alternative assumptions" to be used. Some Ministers may argue that the assumptions suggested by the Chief Secretary are pessimistic and that more optimistic assumptions should be taken. The Chief Secretary is likely to point out that, judging by the experience of recent years, economic growth of 2½ per cent a year would be an above-average performance; and that, even on that basis, he does not envisage getting the relevant tax burden down to the level of 1978-79. There might indeed be a case for inviting the Chief Secretary to explore alternative scenarios (though the number of them would obviously need to be strictly limited) biased towards less favourable economic assumptions, and with more ambitious targets for reducing taxation.

Civil Service Numbers

14. It is unlikely that there will be any substantial disagreement with the proposals in C(83) 24. The Chief Secretary is merely asking for "rather larger reductions than those so far on offer" with the aim of bringing the total some way below 600,000. He will be pursuing these matters in his bilaterals.

15. Pressure on numbers focuses Departments on improving management (and the scrutinies show there is still scope for reduction). A figure of around 600,000 comes out of the survey of Departments. Over four years that would be an average of 1.2 per cent per annum. That is perhaps a realistic figure, given the reductions that will already have been achieved. But it is

relatively modest - particularly given that it includes the hiving-off of the Royal Ordnance Factories, which accounts for part of the reduced numbers. If we are not going to set a lower target, we shall need to keep up and even step up the other pressures for improving efficiency and productivity in the Civil Service.

Contracting Out and Privatisation

16. Again, there is unlikely to be much disagreement with the proposals in C(83) 25. The Chief Secretary is seeking only the Cabinet's endorsement for maintaining the effort. You will probably wish to underline the political importance of continuing to make progress.

17. Reductions in Civil Service numbers are likely to require some measures of "hiving-off". A Community Directive (on "Acquired Rights") appears to impose constraints on staff savings during certain types of "hiving-off". It may be suggested that these constraints may be a serious obstacle to reducing staff numbers at an acceptable cost. You will not wish to pursue this point in detail: the Chief Secretary is already considering the scope and effect of the Directive.

HANDLING

18. You will wish to invite the Chancellor of the Exchequer to open the discussion by describing the economic background and prospects and the Chief Secretary, Treasury, to follow this up with a more detailed account of his proposals on public expenditure. All members of the Cabinet will wish to contribute to the subsequent discussion.

CONCLUSIONS

19. You will wish the Cabinet to reach conclusions on the following.

(i) Does the Cabinet endorse the Chief Secretary's proposals for the current Public Expenditure Survey on:

(a) the public expenditure totals and therefore the savings to be found;

(b) taking the survey forward by the customary process of bilateral meetings and a report to the Cabinet in the autumn?

(ii) Does the Cabinet endorse the Chief Secretary's proposals:

(a) on the longer-term aims for public expenditure;

(b) for a discussion of this in September which would, among other things, set a framework for the proposed bilaterals?

(iii) Does the Cabinet endorse the proposals in paragraph 9 of C(83) 24 on Civil Service numbers?

(iv) Does the Cabinet endorse the proposals in paragraph 10 of C(83) 25 on contracting out and privatisation?

20. If so, the Cabinet will need to authorise the Chief Secretary to proceed with his discussions of public expenditure and manpower accordingly.

ROBERT ARMSTRONG

ROBERT ARMSTRONG

20 July 1983

1/1

PPS/CHANCELLOR

file list reference CA/01

copied to:

Mr Salveson (for transmission to No.10)
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PS/FST
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PS/Foreign Secretary
PS/Secretary of State for Education and Science
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PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
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PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Trade and Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Parliamentary Secretary to the Treasury
Other Ministers with an interest and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 11 July, are sidelined. On present information, next week's will be the last before the Recess. During the Recess the Brief will be circulated approximately once a month instead of weekly.

M M Deyes

M M DEYES

RIGA

R I G ALLEN

18 July 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Chancellor's speech in Debate on Address 29 June - his first major statement on economic policy as Chancellor.]

Intend to consolidate and build on progress already made in creating conditions for sustainable recovery. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. Government should put more emphasis on reducing unemployment, less on reducing inflation?

No trade-off exists between inflation and unemployment in long term. Government has important role in easing transition to low inflation-high employment economy. But to reduce unemployment on a lasting basis need is to continue fight against inflation, keep costs under control and improve productivity.

3. Future of MTFS?

Government will continue to set a framework of sound money, with an appropriate balance between fiscal and monetary policies. Heart of approach will remain the medium-term financial strategy.

4. Chancellor's expenditure statement 7 July

[Chancellor announced measures to prevent overspending in 1983-84; (i) reduction of 1 per cent in 1983-84 pay and central government administration cash limits; 2 per cent in remainder; reduction of 2 per cent in nationalised industry EFLs effect to remove £500 million of spending beyond planned total, (2) increase in asset sales programme by further £500 million; (3) new scheme for end-year cash limits flexibility which could reduce spending by some £100 million in current year.]

7 July measures not "savage cuts"; designed to bring total public spending closer to planned path. Not to have taken these measures would imply a lack of Government commitment to its own financial strategy, and undermined recovery. [See also Sections H and K].

5. Haven't markets given the measures the thumbs down?

No. Not taking any action would have been irresponsible and seen as such by the markets. Moreover, markets have been affected, and continue to be so, by worries about foreign developments such as US interest rates.

6. Government deliberately engineered pre-Election boom?

There was no pre-Election boom. For 1982-83, though less underspending than expected at Budget time, only two extremely minor breaches of cash limits, and year ended with large part of Contingency Reserve unspent. Budget measures themselves involved only relatively small increase in public expenditure for 1983-84 compared with February White Paper, and did not add to planning total - met entirely from Contingency Reserve. So far as wider economy is concerned, pace of recovery has been moderate not excessive.

7. Government sleight of hand with public spending (Contingency Reserve, shortfall allowance) to make room for Budget tax cuts?

[Suggested in The Economist 15 July.]

No. See K15-16.

8. Government panicked into taking 7 July measures?

See H8-10.

9. Measures deflationary? Effect on jobs?

Short term adjustments may be necessary on some programmes. But the effect will be much less than the damage which would be caused by allowing public expenditure to rise above planned levels.

10. Were 7 July measures in 'secret Manifesto'?

There is no secret Manifesto. The published Manifesto set out Government's intentions fully and frankly. Their policy decisions will be consistent with these.

11. Further cuts ahead?

[Much Press speculation about 21 July Cabinet - alleging £5 billion public spending bids equivalent to extra 5p on income tax.]

See K1 and 13.

12. Current economic situation

Modest recovery is under way. GDP up 3½ per cent since mid-1981. Industrial production at highest level for three years. Restocking now taking place. Private investment and retail sales ~~recovering~~ (June figure - showing further rise - published 18 July recovering). Other indicators - including recent CBI reports and CSO cyclical indicators - also point in direction of continued recovery. With inflation lower and evidence (especially US) that world economy is picking up, good prospects that recovery will be sustained. (See also Sections B and T.)

13. 'New Treasury forecast' shows GDP 2½ per cent growth in 1983?

[Press reports of Chancellor's 29 June speech.]

No new forecast will be published until autumn. Chancellor simply said during 29 June Debate that prospects - both for output and inflation - were a little brighter than expected at time of Budget, with GDP growing 'up to 2½ per cent' this year and inflation rising temporarily to '5 or 6 per cent' by the end of year. No more than slight amplification of earlier comments by previous Chancellor. [Latest OECD assessment see B3.]

14. Developments in US?

See T4-7.

2.29

BULL POINTS 18 July 1983

Output and Demand

- Total output (GDP) up 3½ per cent on mid-1981.

- Industrial output in three months to May up 3½ per cent on spring 1981 trough. At highest level for nearly three years.

- Manufacturing production increased 1½-2 per cent between April and May and at highest level since October 1981 (in three months to May was ½ per cent up on previous three months).

- Consumers' expenditure in 1983 Q1 3 per cent up on a year earlier.

- Retail sales at record level and in second quarter were 6½ per cent up on year earlier.

- £700 million destocking in 1982H2; turn round to £100 million restocking in 1983Q1.

Prospects

- CBI (June) Enquiry balances showed (i) total order books strongest since November 1979; (ii) positive output expectations for fifth successive month; (iii) excessive finished goods stocks lowest since November 1979; (iv) expectations for increase in domestic prices still historically low.

- Fixed investment (private sector) set to rise 3-4 per cent in both 1983 and 1984.

- CSO's cyclical indicators point to continuing upswing in the business cycle.

- Outside forecasts recently suggest higher GDP growth this year than Budget estimate [NB Chancellor said 29 June that he expected an increase of "up to 2½ per cent".]

Financial Strategy

- Government borrowing amongst lowest in industrialised world.

- Short-term interest rates down about 7 points since autumn 1981.

- Official external foreign currency debt down from $22 billion in May 1979 to than around $12 billion at end-June 1983. Remaining debt now smaller in relation to imports than at any time since Second World War.

Inflation, Costs and Profits

- RPI inflation 3.7 per cent (June) - not bettered since March 1968. [NB Chancellor said 29 June some temporary rise to 5-6 per cent by end-1983.]

- Wholesale output price increase in June (0.2 per cent) lowest monthly increase for 2½ years.

- Output per head (manufacturing) risen 16½ per cent since end-1980 and at record levels. Output per head and output per hour now 9 and 12 per cent above previous cyclical peak in H1 1979. Manufacturers' unit wage and salary costs up 3½ per cent in 3 months to April on year earlier. (Would be lower still with NIS cut).

- Cost competitiveness (manufacturing) improved around 20 per cent since early 1981 (assuming £ effective of 84).

- Non-oil ICC's profits nearly 20 per cent above level in 1980 and 1981. (50 per cent up for oil ICC's.) Real profitability also improving slightly.

- Company liquidity at best level since mid-1979.

Labour Market

- Working days lost in May (110,000), well below average in first four months of 1983 (476,000). 5.3 million days lost last year was well below 12 million average of preceding 10 years.

Freedom, Enterprise and Initiative

- Many controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls.

- Further 13 enterprise zones announced in 1982 (total now 24).

- Civil Service now under 650,000 (1 April 1983) - cut of 11½ per cent since Government took office. On target to achieve smallest Civil Service since war by 1984 (630,000). LA manpower (GB) cut by 106,000 (4½ per cent) between June 1979 and December 1982.

- Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost ½ million public sector tenants bought their houses since May 1979; further ¼ million in process of buying.

B ECONOMIC ACTIVITY AND PROSPECTS

[See also Commentary - at end of Brief - on recent UK economic developments including latest CBI Inquiry.]

1. Evidence for recovery?

[GDP (Output) - the best short-term indicator of the three GDP measures - rose ½ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; GDP(Average) now 3½ per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production total and manufacturing in three months ending May was ½ per cent up on previous three; underlying industrial output now around 3½ per cent above 1981 Q2 trough (largely due to oil and gas).]

Total output (GDP) and industrial production have recovered 3½ per cent since spring of 1981. Manufacturing production three months to May increased ½ per cent on previous three; expectations (eg recent CBI reports, CSO leading indicators) are for further increases. Consumers' expenditure in 1983 Q1 up 3 per cent on year earlier. Retail sales at record level - 6½ per cent higher in second quarter compared with year earlier. De-stocking in second half 1983 (£730 million at 1975 prices) has been turned round into modest restocking (£100 million) in first quarter this year.

2. UK suffered worse recession than major competitors?

[Between 1979 and 1982 (on national definitions - not strictly comparable) output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (average measure) fall of over 3½ per cent.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most against difficult international trade background. Growing signs of world recovery - particularly in US - should make going easier.

3. Latest OECD forecast?

Latest OECD assessment (published 12 July) confirms recovery getting under way in UK and more widely (see also T2). In line with other major forecasters, OECD are now a little more optimistic on growth prospects for this year - though still at pessimistic end of range - and expect growth to increase next year; expect unemployment to level out from mid-1983. Consumer price inflation expected to rise to 6¾ per cent in second half 1983, but fall to 5¼ per cent in second half 1984.

4. Is recovery sustainable?

Even against very difficult world background modest recovery has occurred; many indicators point to continuing growth, likely to be up to 2½ per cent this year. Longer term prospects look good so long as we stick to sound financial policies and work for greater competitiveness, efficiency and enterprise. Containment of costs also of crucial importance if lower inflation to be translated into lasting growth and jobs. Much progress already made (lower inflation and interest rates, improvements in productivity and competitiveness and encouragement of competitive market forces); need to consolidate further. [IF PRESSED On publication of revised growth forecast see A13]

5. Latest construction and engineering industry indicators suggest recovery over?

[Construction output and orders have fallen in recent months. Housing starts have fallen in last three months but still well up on year ago. Total engineering orders fell 1 per cent in 1983 Q1 compared with previous quarter, reflecting continuing weakness of domestic orders. NB Figures for construction orders in May and engineering industries in April to be published on Wednesday 20 July, Friday 22 July respectively.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4, some pause not surprising. But not too much weight should be placed on one quarter's figures, particularly when set against background of general recovery. Engineering export orders have rose in 1983 Q1 and latest forecast by EEF expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984.

7. Recent manufacturing investment performance weak? Outlook remains depressed?

[Total fixed investment in 1983 Q1 3 per cent up on 1982 H2 level but manufacturing investment (including leasing) in 1983 Q1 down over 4 per cent on previous quarter. Latest DTI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. Outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984.]

Though manufacturing investment remains disappointing it accounts for only small proportion of total; in other sectors (eg distributive and service) performance has been stronger, so that total fixed investment rose almost 4 per cent in 1983 Q1.

7. Trade figures suggest that recovery will hit balance of payments 'stop' just as in past?

May figures affected by 'erratic' items and oil. Recent rise in imports and form it has taken are consistent with other indicators of industrial recovery (see also Section G).

8. High real interest rates choking off recovery?

Real interest rates are high whilst economy adjusts to low levels of inflation - just as real interest rates were negative when inflation was accelerating in 1970s. Real interest rates in UK not particularly high by international standards. Expect some fall in real interest rates in developed countries as inflation brought firmly under control.

9. Productivity growth falling off in manufacturing sector?
[Report in The Times 14 July on academic research which says productivity growth will slow to 2 per cent unless there is substantial recovery in investment.]

Slight drop in productivity growth last year. But output per head gains still impressive - up 4½ per cent in year to three months ended April 1983; and overall improvement of around 16½ per cent since end 1980. Some slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Also, manufacturing output now rising. Overall performance since 1981 better than could have been expected on past experience.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[June fall in 'headline' total largely reflects favourable seasonal factors and distortions due to administrative changes announced in Budget. Vacancies are on a slowly rising trend. Overtime worked remains broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	1982			1983		
	June	Sep	Dec	Apr*	May*	June*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.05	2.98
Adult sa unemployment (millions)	2.77	2.87	2.95	3.02	2.97	2.97
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+13 [+23]	-10 [+24]	-18 [+22]
Vacancies (000s)**	105	107	118	135	131	139

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

Fall in 'headline' total is welcome but mainly reflects special factors. Over next few months these factors will tend to go into reverse and 'headline' total will probably rise. However there are signs that upward trend has eased slightly. Vacancies have been rising and other indicators of economic recovery give grounds for cautious optimism about unemployment prospects.

2. How can Chancellor say jobs are plentiful?

[Chancellor said in 'Face the Press' 5 July: 'I think there are many jobs of an unskilled nature which .... are available to be done at a particular wage.']

Although unemployment is high it would be wrong to think that job opportunities do not exist, particularly if job seeks are willing to accept realistic wage offers and price themselves into jobs. Total job changes are running at around 6 million a year - about 25,000 per working day. [NB These include movements of people from one job to another as well as the unemployed taking up jobs.] Number of people ceasing to be unemployed is averaging about 377,000 a month [NB most of them to take up jobs, though some for other reasons eg taking retirement.]

3. Official figures incomplete account of true level of UK unemployment?

Gross exaggerations of scale of unemployment are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed. Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Estimates in June Department of Employment Gazette show that, in 1981, these groups broadly offset each other.

4. Budget measures just Government attempts to 'fiddle' the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First two of these removed around 122,000 from June unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

5. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.' Guardian 31 May: Mr Lawson reported as saying '... in my judgement all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment.] Government Actuary Report published 5 July assumed 2.9 million unemployment (GB, excluding school leavers) for 1983-84 - close to present levels.]

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies. As 1983 PEWP made clear: 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

6. Unemployment in UK worse compared with other countries?

[On standardised definitions in May 1983 UK unemployment on new basis was 13.8 per cent (compared with 5.5 per cent in 1979), Canada 12.3 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.1 per cent (compared 5.9 per cent), Germany 7.8 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was greater in Netherlands (over 26 per cent - rise of 3½ points in unemployment rate in May), Germany (nearly 29 per cent - 2 points in May), and Canada (21½ per cent - 2 points in May) than in UK (11½ per cent - 1.3 points in June (allowing for Budget changes)).

7. Cost of unemployment? £17 billion?

[Unemployment and supplementary benefits to people counted as unemployed currently expected to total about £5·7 billion in 1983-84 (provisional DHSS estimate in 1983 PEWP).]

Government always willing to answer questions about direct cost to Exchequer of benefits paid to unemployed. But larger figures sometimes quoted, purporting to take account of income tax and national insurance contributions foregone, unhelpful because fail to address central issue of how to reduce unemployment. Government itself cannot determine level of unemployment. Its role is to set appropriate framework in which opportunities for new jobs emerge.

8. Government don't care about unemployment? Should do something about it?

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Cuts in NIS have reduced tax on jobs. Also Government creating sound foundations for sustainable growth in employment by (i) maintaining firm financial policies designed to reduce inflation and interest rates further (ii) encouraging competition, enterprise and initiative by number of 'supply side' measures. But Governments cannot do everything. Much depends on world developments and private sector's ability to hold down costs and improve competitiveness.

9. Unemployment benefits disincentive to job seeking? Going to be cut in real terms?

See M5 and 7.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in June, compared 3.7 per cent in May, 4.0 per cent in April and 9.2 per cent in June 1982].

12 monthly rate of inflation (3.7 per cent in June) - still at lowest level for over 15 years (compared 3.4 per cent in March 1968). [CAUTION: Expected to rise in July, reflecting (a) arithmetical consequence of stability in 1982 - see 2 below (b) effect of mortgage rate increase and petrol price rise - see 3 below - coming into July index.]

2. Inflation increasing in second half of year?

RPI scarcely rose at all between June and September last year. As matter of simple arithmetic likely to be increase in 12 month change over corresponding period in 1983. Made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year - perhaps to about 6 per cent. If anything progress since then better than expected. As Chancellor said on 29 June, there is and will be no sudden resurgence of inflation of the sort we have seen in the past.

3. Effect of exchange rate/higher mortgage rates/petrol price rises on RPI?

[1¼ percentage points increase in mortgage interest rate (to 11¼ per cent) announced by Building Societies' Association on 22 June will add around 0.4 per cent to RPI, mainly coming through in July. Petrol price rise since 1 July 4.6p a gallon will add only around 0.1 per cent to RPI.]

Exchange rate/mortgage rate/petrol price rise factors amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS), likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies. Taking all factors into account, outcome could still be better than Budget forecast, with retail price inflation of 5-6 per cent by 1983 Q4.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2 (6 per cent). Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. Comparison with competitors

[May figures UK inflation 3.7 per cent compared 3.0 per cent in West Germany, 4.7 per cent (annual charge of new index) in US, 9.0 per cent in France, 16.4 per cent in Italy, 5.4 per cent in Canada, and 2.0 per cent in Japan; 5.3 per cent weighted average major six countries.]

UK inflation now lower than average of major OECD 6 and well below France and Italy but still some way to go to match West Germany and Japan.

6. TPI increase

12 monthly increase in TPI (3.1 per cent) in year to June 1983, over ½ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

PAY

7. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.7 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase 7¼ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings in April 8.2 per cent, compared 4.0 per cent RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. 2-3 per cent settlements in next pay round?

[Report in The Times 28 June following PM's meeting with CBI previous day.]

Not yet been decided whether Government's plans for next financial year will be calculated on basis of explicit 'pay factor'. However there will be continuing need in next pay round for still lower pay settlements consistent with improved job prospects industry concerned. The lower pay settlements are, the better.

10. Government proposals for MPs and Ministers' pay increase

[TSRB Report No 20 recommended increases in Ministerial salaries ranging from 18 per cent to 71 per cent, and £19,000 a year salary for MPs - representing increase of 31 per cent over level set in June 1982. Government proposed instead a flat 4 per cent increase for all

Ministers and office holders, and a salary for MPs of £15,090 - an increase of 4 per cent - coupled with improved allowances and previous provisions. Government currently considering whether or not to accept amendment tabled by Mr Du Cann which would give MPs 5.5 per cent increase this year.]

TSRB produced its recommendation in the light of salaries paid to legislators elsewhere, and to other groups in this country. It could hardly have advised on any other basis. But the Government do not believe that these considerations are binding. More important factors are low levels of settlements being accepted by many ordinary people, and need for low pay settlements to continue.

11. Pay proposals for senior civil servants, high ranking officials in the Armed Forces and the judiciary

[Speculation in Sunday Press that Government will 'trim' increase recommended by the Top Salaries Review Board.]

TSRB recommendations still under consideration. Government will take decision in light of result of Debate on Tuesday 19 July on MPs pay.

12. Government and wages councils?

Government has frequently made clear that has serious misgivings about perpetuation of minimum wage fixing machinery. Scope for action constrained (until 1985-86) by International Labour Organisation Convention 26. Not our practice to dishonour international treaty obligations. However, Government is continuing to look searchingly at operation of wages councils and will consider all options for future of the system.

E MONETARY AND FINANCIAL POLICY

1. Is money supply growth out of control?

[Full money and banking figures for banking June published 14 July. M1, £M3 and PSL2 increased by 1.7, 1.7, and 1.1 per cent respectively, bringing annualised rates of growth in target period to 17.6, 15.8 per cent and 17.9 per cent respectively compared target range of 7-11 per cent.]

High rates of growth in target period so far reflect recent high level of public borrowing, particularly around turn of financial year. (Expressing this growth at annual rate exaggerates the effect.) Growth over past 12 months has been more moderate. Other monetary aggregates (in particular, non-interest bearing deposits) have grown more slowly. Target range applies to year as whole, not just few months.

2. How can you say you are pursuing sound financial policies, when the money supply is growing fast?

Chancellor has made clear that underlying trend in inflation has been firmly downwards, and that intention is to keep it so. Chancellor has also reaffirmed determination to keep firm control on PSBR: measures announced 7 July demonstrate commitment to that objective.

3. Why cut interest rates last month when clear that money supply growing rapidly?

Reduction in the Bank's dealing rates last month followed a fall in market interbank rates. These adjustments were warranted by wider evidence of financial conditions.

4. Will interest rates now have to go up?

We do not expect them to. Interest rate decisions are taken in light of monetary conditions generally. Real interest rates remain high and exchange rate has been firm. But prospects for interest rates depend on conditions in rest of world as well as UK.

5. Will Government be able to continue appropriate funding policy without rise in interest rates?

Funding policy reflects variety of objectives, not simply forecast level of PSBR. Suggestions Government cannot fund borrowing needs by borrowing from public not supported by recent facts.

6. New National Savings initiative impending?

[J Irving in Sunday Times predicts 'surprise package' from NS in response to growth of variety of other savings schemes.]

Terms of National Savings are kept under constant review.

7. Don't 7 July measures imply rigidity in pursuit of monetary targets?

No, pragmatic response to real problem. Prompt action on public borrowing helps ease pressure on interest rates.

8. Didn't financial markets respond badly to 7 July measures?

See A5

9. Why is bank lending growing so fast?

[Sterling bank lending to UK private sector grew £1580 million in banking June, compared with underlying trend of around £1 billion a month in past few months.]

June increase could be erratic. But some upturn in lending associated with recovery was to be expected.

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Following General Election sterling fell on profit-taking and in reaction to the fall in base rates but has since steadied in effective terms. Over past week dollar has strengthened considerably against all currencies because of fears of tightening in US monetary policy (see T6); sterling has been on sidelines.

	28 March (oil crisis 'low')	31 May (pre Election 'high')	22 June (post-Election 'low')	15 July noon
$/£	1.4535	1.6061	1.5311	1.5210
DM/£	3.5361	4.0525	3.8613	3.9514
Y/£	348.72	383.79	363.56	366.64
£ effective	78.1	87.8	83.7	84.6

3. Fall in reserves in June?

Underlying fall ($178 million) over month when effective rate of £ fell from 87.8 to 84.3 roughly matches underlying rise of $233 million in May when £ rose from 84.2 to 87.8. Demonstrates evenhandedness and modest nature of our intervention policy.

3. Improve UK competitiveness directly by engineering further fall in exchange rate?

[Article discussing competitiveness was published in June EPR on 13 July.]

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset effects. Confidence would collapse and jobs be destroyed. CBI at June Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

4. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Thus for example between 1970 and 1980 West Germany's cost competitiveness deteriorated 20 per cent but she maintained her 20 per cent of main manufacturing countries' exports; Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars:

their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

5. Situation has been made less stable by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in face of strong market movements. They did not control leads and lags in trade payments, nor movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations.)

6. Join EMS exchange rate mechanism (ERM)?

Difficulties over membership remain. In particular, sterling as major internationally traded currency is still being affected by oil and other factors in different way from D mark. Membership of ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

7. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

1. May trade figures and current account

[Current account deficit just over £300 million in May, compared just over £100 million in April; cumulative current account surplus in first five months of 1983 £33 million, but £717 million surplus in last six months.]

Trade figures erratic month to month. Picture in May further confused because main reason for deterioration in current account was large increase (some £190 million) in imports of identifiable erratic items - precious stones, ships, aircraft and North Sea installations.

2. Trade in manufactures in deficit?

[Trade in manufactures was in deficit some £660 million in first quarter - on balance of payments basis. (NOT FOR USE Deficit on bop basis for year to May was roughly £1½ billion.) In 1982 trade in manufactures was £2½ billion in surplus.]

Deterioration in balance on manufactured trade not in itself cause for concern: a natural counterpart of improved oil balance we have enjoyed in recent years. Oil has enabled us to import more: if we had not done so it is true that we would have had even larger current account surpluses, but there would also have been larger offsetting capital outflows - is that what Opposition want? With low level of domestic inflation and prospects of reviving markets overseas, industry now has opportunity to increase level of exports and to improve market shares at home and abroad - provided costs kept under firm control. Important to remember level of manufactured exports: every day about £120 million worth of British manufactured goods leave for markets all over world.

3. Deteriorating oil balance?

Balance on trade in oil has fallen back to last autumn's levels following unusually high surpluses over the winter. Several reasons for high surpluses last winter; one was high level of domestic oil production, which has fallen back a bit since the spring; others were milder than usual winter weather and heavy drawing on stocks by UK companies, both of which tended to reduce imports and divert domestic production into exports.

4. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI Industrial Trends reports show encouraging improvement in order books and expectations of rise in deliveries over next few months.

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Recent rise in imports and form it has taken is consistent with other indications of economic revival. Increases seem to be concentrated in goods for use by industry (materials, fuels, capital equipment) rather than for consumption. May figures are in line with this overall view.

6. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which had been in particularly large surplus (£1.1 billion) in 1981.

7. Abolition of exchange controls has led to huge capital outflows?

The net capital outflows in recent years simply reflect - as a matter of arithmetic - the large current account surplus. Just as a country in deficit has to borrow abroad, a country in surplus improves its international balance sheet. Our balance between overseas assets and liabilities is in a better state than it has been for years - and this will provide a useful source of overseas revenue for the future. [Our net overseas assets were £37.7 bn at the end of 1982 compared with £12.7 bn at the end of 1979.]

8. Portfolio investment overseas continuing at a high level?

Most overseas portfolio investment is made by the institutions who invest money on behalf of people who contribute to pension funds and life insurance. It is their duty to seek to earn the best possible return on the sums with which they are entrusted. They will be prepared to invest more in the UK if the profitability of doing so improves. And that means continuing to increase productivity and control costs.

9. Overseas direct investment replaces UK investment?

[Proportion of institutional funds invested in UK company securities is at present slightly lower than in 1978, before exchange controls removed.]

Overseas investment cash benefit UK companies by building up links with companies abroad, and helping to establish footholds in markets overseas: 30 per cent of UK exports are sent to associated companies overseas.

10. Current account 1983 forecasts

[FSBR forecast £1½ billion current account surplus in 1983 (down from £4 billion in 1982. Latest LBS forecast shows small deficit (£0.8 billion).]

Next forecast to be published will be in Autumn, as usual. Will incorporate Treasury's latest assessment of prospects for current account at time when outlook will have become clearer. [NOT FOR USE: Although Treasury have updated Budget forecast it is not for publication.

Suggests however that small deficit on current account more likely than surplus forecast in FSBR.]

11. Possible current account deficit constraint on economic policy?

Current account is bound to fluctuate from year to year: in 1981 had surplus of £6 billion, in 1982 of £4 billion. Some deterioration to be expected at this stage of the recovery. But in an era of floating exchange rates, current account does not impose constraint on policy of the kind it did when we were defending a fixed rate. (Current account flows may to some extent be reflected in markets' valuation of £ and exchange rate is one of factors taken into account in assessment of financial conditions, as explained in MTFS.)

12. If current account surplus slumps this year, how will the flow of overseas investment be financed?

[Current account surplus of only £33 million in first 5 months of 1983.]

Investment overseas can be financed in a variety of ways. Some is financed in foreign currency borrowed overseas and out of the earnings of overseas subsidiaries. To the extent that it is financed by capital flows from the UK these will need to be offset by capital inflows and the current account.

TRADE POLICY

13. Protectionism

[Foreign Secretary pressing US on attitude to steel.]

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P6.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers'. They emphasised importance of working through GATT.

14. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

15. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

H FISCAL POLICY AND THE PSBR

[NB PSBR 1983 Q2 figures to be published Thursday 21 July.]

1. Does Government plan to tighten/weaken fiscal policy?

[Chancellor's speech in Debate on Address reaffirmed need to reduce monetary growth and keep PSBR low.]

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal policy?

[Aim is to achieve trend reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. PSBR has been reduced. Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - lower PSBR over run of years implies lower interest rates - still holds true.

5. OECD paper says fiscal policy too tight?

[Paper by OECD economists discussed in The Times 14 July (M Prest) shows some fiscal contraction of cyclically adjusted PSBR (see 15 below) in UK. Document notes that not necessarily OECD official view.]

Have reduced PSBR, but wrong to describe this as responsible for recession. Difficult reconcile OECD's paper reference to big fiscal contraction in 1982 with buoyant domestic demand in that year.

6. Why did 1982-83 PSBR overshoot?

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

7. PSBR artificially low in Budget?

No. See K15-16.

8. PSBR out of control? New measures reflect Treasury panic?

[Press reports of internal forecast pointing to £3 billion PSBR overshoot this year. LBS forecast £1.9 billion spending overrun this year (before 7 July statement).]

Whatever figures may or may not show, indications that spending and borrowing were running higher than expected were unsettling markets. Measures prudent reaction to recent developments.

9. £600 million spending package too small relative to PSBR forecasting errors and likely size of overshoot?

[FSBR quotes £4 billion margin of error on Budget forecasts for PSBR. Guardian 8 July talks of £3 billion overshoot in internal Treasury forecast.]

Developments in spending and borrowing will continue to be monitored closely. Must remember scope for action diminishes as year progresses so prudent to take some corrective action now. (See also K3).

10. June quarter PSBR figures will show 7 July measures unnecessary?

[Raphael and Keegan in Sunday Times predict figure of £2 billion - seasonally adjusted. NB Not appropriate multiply by four to arrive at annual outturn.]

Separate briefing being provided with April-June quarter figures to be published 21 July.

11. What do latest CGBR figures mean for PSBR?

[CGBR in April to June £5.5 billion compared with £3.1 billion in 1982-83.]

Too early to say. Budget PSBR forecast is £8.2 billion. Next published forecast in the autumn.

12. What is new PSBR forecast?

Not sensible publish revised PSBR forecasts so early in financial year - average margin of error on Budget forecast £4 billion in either direction. Must await Autumn Statement.

13. Do PSBR overshoots mean higher interest rates?

Yes, lower PSBRs do lead to lower interest rates. But effect of overshoots limited because they do not signal change of strategy. PSBR over a run of years is what really counts.

14. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

15. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

J TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also M7). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes. Objectives will be pursued within framework of responsible fiscal and monetary policies; without firm control of public expenditure there will be no room for significant tax cuts.

2. In view of action on public expenditure, why not drop Summer Finance Bill to save money?

Bill fulfils firm Manifesto commitment. To abandon it would increase the tax burden and require recovery of tax from about 1 million people who have already benefited from Budget proposals; administrative difficulties would mean substantial proportion of tax due could not be recovered until 1984-85.

3. What happens to proposals announced in Budget but not in summer Finance Bill?

As Chancellor indicated in Debate on Address, Government urgently reviewing these proposals so that can announce as soon as possible and in as much detail as possible what action intend to take on each of them. Question of commencement dates is being considered as part of this review.

4. What will happen on freeports?

Government remains committed to establishment of freeports in UK on experimental basis. An announcement inviting applications from potential operators will be made before the Recess and all bids will be fully and carefully considered. Legislation will be included in a future Finance Bill, and there will be no delay in the eventual establishment of freeports.

5. All benefits of new Bill go to the well-off?

Need to be seen in context of Budget proposals as a whole. Bill does no more than apply same percentage increase (14 per cent) to higher rate bands and investment income surcharge threshold as to personal allowances. No bias in favour of higher paid - tax cut at all income levels.

6. Increase in mortgage interest relief limit unnecessary?

£25,000 limit was set in 1974 by Labour Government. Increasing evidence that old limit was beginning to hinder growing number of families who want to buy their first home or move.

(In London about a quarter of first-time buyers with new building society mortgages have mortgages of over £25,000 - Q4 1982 figures.) Increase will also help construction industry.

7. Increase in mortgage interest relief limit increases competition for funds and pushes up interest rates?

[Points made by Mr Richard Wainwright during short debate on 30 June on Resolutions for Finance Bill.]

First increase since £25,000 limit introduced in 1974. Had that figure been increased in line with RPI it would now stand at around £80,000. If parties opposite don't want to help house buyers, they should say so openly.

8. Increasing subsidies to home owners while reducing them to council tenants?

True that subsidies to local authorities have dropped. But direct help to tenants (ie including Housing Benefit) has more than doubled since 1979 - increase of over £1 billion.

9. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in income tax allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

10. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession and need for responsible fiscal and monetary policies. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

11. Government's own figures prove average family now pays more tax than in 1978-79?

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax net of child benefit in 1983-84 than they did in 1978-79.

12. Budget benefits for lower paid

Budget provided help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

13. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rose in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out. Following is based on 1983-84 earnings levels taking, for illustrative purposes, the 6½ per cent earnings increase for 1983-84 used by Government Actuary.]

Tax reductions will be greater than effect of increase in NICs for all but a small minority. [IF PRESSED: Those who will lose out are married contracted out at about 1½ times average earnings and single contracted out at between ¾ and 1½ times average earnings.]

14. RPDI figures belie Government claim that after-tax incomes rising?

[RPDI in 1983 Q1 published 29 June]

Important distinguish between take-home pay of those in work from RPDI which includes income from other sources. Moreover, latest RPDI figures relate to period before effects of last Budget had been felt.

15. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut (see J15). Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

16. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Prime Minister said (23 June) during Debate on Queen's Speech that Government hoped to abolish NIS (cost £1.2 billion in full year) during present Parliament.

17. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

Committee has produced long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to UK and are not amenable to easy solutions. Manifesto (see J1) accorded high priority to the traps, and Government will be examining draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings. (See also M7)

18. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

19. Rossminster

Attorney General in Written PQ on 30 June said that no criminal proceedings were to be brought following raids on Rossminster by Inland Revenue officials four years ago. Inland Revenue will deal with liabilities for tax, interest and penalties that have come to light in course of investigation.

20. Treasury VAT deal to buy heritage bodies' silence?

[Guardian and D Telegraph stories 5 and 6 July.]

Government made it clear to heritage 'lobby' from outset that this relief not precursor of any wider relief for heritage items. This was fully appreciated by bodies most directly concerned.

21. European Court's judgement on wine and beer duties?

Court's decision will be taken into account when rates of excise duties are reviewed before 1984 Budget.

22. Unitary taxation developments in US?

Government totally opposed to this method of taxation, which is contrary to international practice, and are taking immediate steps at highest level to press US Government for legislation to prevent its application by individual States to British companies operating in US. Chancellor wrote to Treasury Secretary Regan on 12 July.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Has Government altered intentions for public spending 1984-85?

Public spending plans published before Budget are starting point for this year's public expenditure survey, now starting. Decisions to be taken in survey will take account of latest information and forecasts.

2. Chancellor's announcement 7 July - what caused the problem?

A number of factors. Net provision for shortfall in the Budget now looks excessive. In part, may be caused by corrective action last October, to increase capital expenditure. But that was only part of the story. Cumulative effects of three years of squeezes in a cash planning system may have something to do with it.

3. £1 billion package of measures too small when PSBR set to overshoot by £3 billion?

[The Times has alleged that internal Treasury forecast shows PSBR for 1983-84 over £11 billion; and speculates on further cuts in autumn of up to £2 billion.]

For obvious reasons Treasury does not comment on speculation about internal forecasts. Not sensible to publish revised forecasts of PSBR so early in financial year - average margin of error on Budget forecast £4 billion in either direction - autumn will be the time to do this. Nevertheless, indications that spending and borrowing were running higher than expected had been unsettling markets; need for some corrective action was clear. Developments in spending and borrowing will continue to be monitored closely, so that further action can be taken if necessary.

4. Why were measures announced now rather than before 9 June? When did need become evident?

In early June we did not have sufficient information on which to make a judgement. Since then a clearer, though obviously still uncertain, picture has emerged - on public spending, borrowing and money supply - and we judged that the time was right to reassure markets that Government remains firmly committed to its financial strategy.

5. Where will the retrenchment fall?

Details will be announced shortly.

6. How will health expenditure be affected?

Health spending in total is expected to remain broadly at level in PEWP.

7. <u>What are implications for spending plans of ½ per cent growth assumption already circulated to NHS</u>?

Health authorities have been told to draw up their 10 year strategic plans on assumption that resources for hospital and community health services will grow at rate of around ½ per cent a year in real terms. Has been made clear that this is <u>not</u> a commitment and that their plans must be flexible enough to cope with more or fewer resources. Government will be reviewing all plans for next 3 years, including those for health, in the public expenditure survey.

8. <u>Special problems of defence</u>?

With a budget of £16,000 million this year MOD has far more room for manoeuvre than others, it has grown by over 20 per cent <u>real terms</u> since 1979 and cannot be absolved from wider economic considerations. Even <u>after</u> a cash limit cut of this order, defence expenditure (Falklands exclusive) should increase this year by more than 3 per cent in real terms. Our defence effort is surpassed by none of our European allies. In absolute terms our annual spend is second only to the US; as a proportion of GDP and per capita, UK defence expenditure is higher than any other major European ally.

9. <u>Why pick on cash-limited programmes, when the trouble seems elsewhere</u>?

Because it is the best way of achieving results. Do not mean to exclude action on the demand-determined programmes. Where Ministers can take action should do so. But the biggest problems are on agricultural support, Family Practitioner services and on social security benefits. Even if we decided to do something in these areas, they take time to respond.

10. <u>Does this mean laying off staff</u>?

Will be for each department to decide how to implement cuts. But large-scale redundancies unlikely. Laying off staff takes time (6 months notice) and actually adds to first year costs (redundancy etc). Should be possible to do by reduced recruitment, and reduction in casual staff.

11. <u>Capital/current split: Will this make the situation worse</u>?

It may do. But we are exempting local authority capital and 2 per cent elsewhere is not a great deal. Every area has to make a contribution.

12. <u>End-year flexibility: why capital only not current</u>?

Make haste slowly. Most of the pressure arises on capital, because it is more difficult to predict exact timing of expenditure.

13. Implications of Chancellor's statement for later years? More cuts on way?

Government has taken action to bring expenditure in 1983-84 closer to course laid down in White Paper. Measures to improve financial control have also been taken. Decisions in survey will also take account of latest developments. Wrong to draw conclusions that corrective action this year means expenditure out of control.

14. Effects of end year flexibility on 1984-85?

Will be bigger than this year because Departments will carry forward unspent balances. Will be taken into account during this year's Public Expenditure Survey.

15. 1983-84 Contingency Reserve too tightly budgeted to allow lower PSBR forecast? [Economist article 15 July.]

No. Budget forecast was based on the best information available at time. True that Contingency Reserve this year is smaller than in either of previous two. But in both these years it proved to be unnecessarily large.

16. Was an excessive allowance for shortfall made in 1983-84 PSBR forecast? [Economist article 15 July.]

It would appear that allowance for shortfall was excessive, but only three months of year have gone. Allowance for shortfall has been made in seven out of last nine White Papers, and Budget forecast was based on best information available at time.

17. What proposals have Government for improving monitoring and control systems to avoid such 'panic measures' again?

Government are always searching for ways of improving its monitoring and control systems. But should point out that thanks to existing arrangements that problem become apparent sufficiently early in year for corrective action to be taken.

18. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments and health authorities to reclaim VAT on contracted out services thus removing a disincentive to contracting out.

LOCAL GOVERNMENT

19. Local Authority overspending, and grant penalties

LAs warned last year that 1983-84 rate support grants would be held back from overspenders. Action by respective Secretaries of State: in England budgets exceeded guidance figures by £¾ billion - Supplementary RSG Report has been laid proposing holdback of £280 million of RSG: in Wales budgets exceed guidance by £21 million - Supplementary Report proposes holdback of £12.6 million; in Scotland under selective action four LAs directed to reduce rates because of excessive; unreasonable budgets and general grant abatement may also be proposed. [Note GLC not included in English holdback - GLC budget so high in relation to assessed need that loses all grant under normal distribution arrangements before holdback calculation.]

20. Grant penalties reaction to money supply/public expenditure overshoot?

Government has intended all along to take holdback action, as appropriate on basis of budgets, before Summer Recess. Holdback arrangements integral to RSG settlements and action now being taken holds no surprises for LAs. No significance in coincidence of timing with money supply figures/Chancellor's public expenditure statement.

21. End-year flexibility: why exclude local authorities?

Because case for including them is much less strong. Individually they already have more flexibility than we are now proposing to give to central government departments. And inclusion would mean a higher cost.

22. RSG settlements 1984-85?

Government recognises that authorities prefer long notice of broad features of settlement; announcements of grant will be made in due course.

23. Why no cut back in LA capital spending in Chancellor's 7 July statement?

Because we want to avoid giving LAs confusing signals. We have only recently taken steps to give LAs a more stable basis for planning and implemented other measures to encourage them to spend closer to Government's plans. (See 24 below.) Excluding LA capital spending also means that the package does not bear too heavily on the construction industry.

24. LA capital underspending

Latest estimates suggest LA capital cash limits underspent by a little under £1 billion in 1982-83. Disappointing because it follows underspending of £¾ billion in 1981-82, but represents significant improvement on £1½ billion underspending forecast last autumn. Steps then taken to reduce underspend: PM wrote to LA associations; LAs invited to apply for extra allocations (about £½ billion issued), and allowed to spend without limit on improvement grants. These measures seem to have been very successful. Steps taken to reduce risk of underspending in 1983-84: new rules on receipts (measures announced 15 March by Environment Secretary to ease transitional problems, LAs can spend above allocations on improvement grants, and eligible expenditure limits raised in Budget by 20 per cent, also new 'enveloping' provisions announced in Budget. LAs also given guidance about level of allocation for 1984-85 to help them plan ahead.

25. Control of Local Authority rates

Bill will be introduced early in 1984 giving power to curb rate increases of selected overspending LAs in England and Wales from 1985-86. Selection will be on basis of past performance. Powers already exist in Scotland. Bill will also provide fall-back powers to be used if it proves necessary for general limit on rate increases. Wide consultation will precede legislation. Will publish White Paper shortly.

26. Business Rates

Rates now biggest single tax paid by industry. Excessive increases damage jobs. Bill (see K 25) will also require LAs to consult representatives of non-domestic ratepayers before setting rates, and will derate empty industrial property. In meantime, considering reducing statutory maximum non-domestic empty premises rate. Also, rate level below which business ratepayer may pay by instalments will be raised.

27. Other rates reforms

Propose to make each main rating and precepting authority provide annual statement to each ratepayer. Council tenants paying inclusive rents will receive separate advice of rates level.

28. Reform of Local Government Structure

Propose to simplify structure by abolishing upper tier in London and areas of metropolitan counties. Functions to be transferred to lower tier or assumed by new joint boards comprised of nominated elected members of lower tier. ILEA also to be replaced by joint board. Special arrangements for London Transport. White Paper with details this autumn. Wide consultation, including staff, before legislation. Bill to be introduced early next Session; aim for changeover on 1 April 1986.

FALKLANDS EXPENDITURE

29. What has defending Falklands cost so far and foreseeable future cost?

[£215 million to be spent on new airfield - announcement on 27 June]

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion). Cost of new airfield will be contained within this provision.

30. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10½ million spent in 1982-83; further £5 million expected to be spent in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

31. Cost of paying compensation for war damage

No final figure as claims still being processed. But bulk of claims for civilian compensation settled in 1982-83 at £2.3 million. Remainder expected to be settled in 1983-84. Total expected to be in region of £3½ million.

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1979, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K12.)

3. Civil service efficiency?

Civil Service unions say drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments have explored option cuts of 5 per cent and 10 per cent and stated needs for extra staff. No decisions have been taken.

5. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative. With General Election intervening now uncertain whether original target of July 1983 for publication can be met.

6. 1983 Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] At a meeting of the Joint Co-ordinating Committee on 14 July, the trade unions agreed to put to their members an offer of 4.86 per cent. (This is in line with the non-industrial civil servants' pay settlement agreed earlier this year.) A formal response is not expected till 5 August.

7. Civil Service pay in 1984-85?

[Press speculation about possible civil service pay cash limit.]

No decision has been taken on provision for pay in central government cash limits for 1984-85.

8. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

9. Top Salaries Review Body recommendations

See Section D.

M SOCIAL SECURITY

1. Next November's uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, Government has reverted to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May. Social Services Secretary put detailed proposals to Parliament on 23 June.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May - which was 3.7 per cent. Supplementary benefit will be uprated in line with increase in RPI less housing ie 4.3 per cent. Social Services Secretary gave detailed proposals to Parliament on 23 June for individual benefits. (Public Service pensions, under current legislation, will be uprated in line with State retirement pension.) Certain benefits, like Child Benefit, to be increased by substantially more.

2. 3.7 per cent uprating fails to price-protect pensions?

[Opposition will argue that inflation in year to November was forecast at 6 per cent at Budget time (although signs we are doing slightly better than this).]

No. Pensioners and other beneficiaries retain 2.7 per cent real increase in pensions given at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6 minus 2.7 = 3.3 per cent uprating. So beneficiaries better off under new system. In addition, under historic method, inflation in year from May 1983 automatically taken into account in 1984 uprating.

3. Cost of upratings?

Improvements Government has announced will add about £1½ billion to social security budget in full year but are within Government's expenditure plans as announced in last Budget.

4. Summer Supplementary Estimates totalling over £500 million?

[Following Budget announcement of reversion to historic basis for upratings the then CST promised Parliament that revised social security benefit Estimates would be presented. Four Supplementaries presented 8 July totalling £507.6 million (including £202 million on supplementary benefit and £215.6 million on housing benefit).]

In light of decision to revert to historic basis for uprating benefits, and fact that Main Estimates had been based on conventional Public Expenditure White Paper assumptions about upratings and prices, we promised to issue amended Estimates. This now done. We have taken opportunity to incorporate Budget and other changes.

5. Future price protection and uprating of benefits for the unemployed?

[Manifesto renewed undertaking given for period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit. Speculation in Observer and Sunday Times 3 July about de-indexing unemployment benefit; Chancellor pressed on 'Face the Press' programme; issue raised again with PM at Question Time 5 July.]

Manifesto renewed pledge, which was more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. Imprudent in present circumstances to promise more eg by extending pledge. But at November 1983 uprating both 'pledged' and 'unpledged' benefits will be price-protected. And in last Parliament most 'unpledged' benefits increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, substantially so. Unemployment benefit will be increased by 8.2 per cent, and worth more than at General Election 1979. Question of what November 1984 rates will be does not arise till next year.

6. Future of Child Benefit?

There are, as Social Services Secretary said on 27 June, no plans to change child benefit. However, as with all benefits, it must remain subject to examination for efficiency and effectiveness.

7. Present level of unemployment benefit disincentive to work?

[Question put to Chancellor on 'Face the Press' 3 July. Further discussion in Press.]

In certain circumstances benefits paid to unemployed can exceed net earnings they can expect to receive when in work. This must be matter for concern. Situation not solely caused by level of unemployment benefit, but must be borne in mind when considering future increases in that benefit.

8. Pensions to cost more than expected?

[Government Actuary's Report on cost of 1983 uprating, issued 5 July, says pensioners living longer than expected. No details in Report about numbers, but could be additional half million pensioners by end decade.]

1981 Census data shows that pensioners are living longer than actuaries expected. This affects benefit expenditure; nevertheless in 1983-84 National Insurance Fund deficit now expected to be £49 million less than calculated in November 1983. Implications for future years will be examined in course of this year's Public Expenditure Survey.

9. <u>Improvements in 1983 besides uprating?</u>

Substantial and wide-ranging improvements, including restoration of UB abatement, removal of 'invalidity trap' and increase in Child Benefit to highest ever real level, designed to aid most groups of beneficiaries.

N EUROPEAN COMMUNITY

[NB Budget Council meeting on 20-21 July. Separate briefing will be provided]

1. UK refunds for 1983

Stuttgart European Council agreed to net refunds of some £440 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly two-thirds. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. No risk-sharing arrangements for 1983?

No. The arrangement provides for a fixed net refund.

4. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

5. UK objectives on EC budget for longer-term?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a modest scale.

6. Will UK agree to new 'own resources'?

HMG remains unconvinced of case for increasing the Community's 'own resources'.

7. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guidelines on its rate of growth. Key measures remain price restraint and curbs on surplus production.

8. UK Government response to Commission request for advance to meet cash crisis?

Commission has right to invite these advances. We agreed, in view of current cash position, that an advance of £113 million should be made on 20 June. This decision and the necessary arrangements were announced in Parliament on 23 June (Hansard WA 3 and 4).

9. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

10. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of growth of guarantee expenditure.

11. Costs of CAP to UK consumers

Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to reduction in the cost of food to consumers could well involve increased costs to taxpayers.

12. Join European Monetary System exchange rate mechanism?

See F6.

P INDUSTRY

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Government's reaction to Geoffrey Chandler's call to TUC and CBI to work together to improve industrial performance

[In The Guardian 13 July, Sir Geoffrey Chandler argued that 'No party has a monopoly of industrial savvy'. He called for CBI and TUC to come together, disengage politically, and work for re-industrialisation of Britain.]

Agree with much of what Geoffrey Chandler said. TUC, CBI and Government do need to discuss how industrial performance might be improved. NEDC, of which Sir Geoffrey was until recently a member, is one forum where the parties can get together on a regular basis to discuss economic and industrial issues of mutual interest. At first Council meeting attended by incoming Chancellor on 4 July, he spoke about need for the Council to concentrate on well-focussed, specific industrial issues, where a measure of agreement was possible on what should be done to improve performance. This sensible and constructive approach, in line with what Sir Geoffrey Chandler was recommending.

3. Company Sector

[NB 1983 Q1 figures of ICCs capital account and borrowing requirement to be published Wednesday 20 July.]

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £2 billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[In 1983 Q1 gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, were nearly 20 per cent above their average 1980 and 1981 levels; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. Manufacturing rate of return up from 2 per cent in 1981 to 3½ per cent in 1982.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

4. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

5. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

6. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

7. Loan Guarantee Scheme?

[Nearly 10,400 guarantees already issued - about half to new businesses. Total lending under scheme over £340 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

8. New Enterprise Zones

Eleven zones have now been in existence since 1981. Thirteen second-round zones, now agreed for UK and Northern Ireland, are going through necessary pre-designation stages. These zones will come into operation during summer (Wellingborough on 25 July being one of first). Research so far on first round of enterprise zones has shown that in general they appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. Approach to improving nationalised industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. EFLs for 1983-84 currently total £2.5 billion (but see 3 below).

3. 2 per cent cut in EFLs

[Chancellor's statement on 7 July included reduction of 2 per cent (£57 million) in total provision for EFLs of nationalised industries in 1983-84, allocated in proportion to their turnover.]

Nationalised industries must make their contribution to keeping public expenditure within planning total. This reduction will encourage the industries to increase efficiency and make further improvements in control of current costs. Effect of reduction for individual industries will be announced as soon as possible.

INVESTMENT

4. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

5. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

6. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to June 1983 3.4 per cent, compared RPI increase of 4.0 per cent. This was lowest 12 monthly increase since November 1973 (3.3 per cent).]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

7. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

8. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

9. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

10. Future privatisation?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

11. Broaden the Scope of the privatisation programme?

[Professors Beesley and Littlechild in an article in the Lloyds Bank Review, reported in the Times, argue that privatisation should be extended to include electricity, coal, rail and the Post Office.]

The Government welcomes the latest contribution to the privatisation debate by Professors Beesley and Littlechild, and their arguments will be carefully studied. No nationalised industry is outside the scope of the privatisation programme, and each case will be considered on its own merits.

12. Special asset sales in 1982-83?

Receipts totalling nearly £½ billion (£488 million). Major sales included Britoil (£334 million receipts in 1982-83 and £293 million in 1983-84) and Associated British Ports (£46 million).

13. What measures included in increase in asset sales programme in 1983-84?

[On 7 July Chancellor announced increase of £500 million in Special Sales of Assets target for 1983-84. New target is thus £1250 million.]

Not practice to disclose details of composition of targets for special sales of assets, because price information is commercially sensitive and timing of sales dependent on market conditions. Government's privatisation plans are outlined in the Manifesto [see also 10 Future Privatisations].

14. What plans included in special asset sale targets for future years?

[PEWP 1983 has targets of £1500 million in 1984-85 and £500 million in 1985-86.]
See 12 above.

15. Action in this Session of Parliament?

Queen's Speech specifically refers to re-introduction of British Telecom legislation and proposals to transform Royal Ordnance Factories into Companies Act companies as precursor to introducing private capital. British Telecom largest privatisation ever. Legislation to permit other privatisations will be introduced as and when needed.

16. Employee share-ownership?

Many shares in previous privatisations have been bought by companies' own employees and managers which is truest public ownership of all. Around 100,000 employees have taken up shares in privatised companies. Employees, for example, given free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil, ABP); preference in allocation of shares (BAe, C&W, Amersham, Britoil, BP, ABP); provision for matching shares - one for each share subscribed for - (BAe, Amersham, Britoil, BP, ABP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company (NFC). Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. OPEC meeting in Helsinki

[OPEC Ministers satisfied that London agreement on prices and production is holding.]

Stability in oil market beneficial to all. Pleased that indications are that OPEC will continue to sustain London agreement. As regards N Sea production, HMG does not control production levels and UK Continental Shelf prices are market-determined.

2. North Sea oil prices?

[BNOC have proposed no change in N Sea prices in Q3.]

BNOC proposal of unchanged prices in third quarter reflects stability restored to oil market since OPEC March agreement. Whether this stability continues will depend on OPEC. North Sea prices a matter for BNOC who will continue to monitor market developments, and act accordingly.

3. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

4. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

5. Fall in North Sea output after 1985? Effect on revenues?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about impact decline might have on economy. Effect on revenues will be muted because of tendency of revenues to lag behind output.

6. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields has been reintroduced. Bill containing provisions for PRT expenditure relief on shared assets will be introduced in autumn.

7. Benefits of North Sea should be used to strengthen economy?

Without North Sea revenue taxes would be higher or public expenditure lower. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

8. Are we really any better off for North Sea oil?

We are clearly better off for North Sea oil than we would have been without it. At today's prices, the cost of extracting it is far below the cost of buying oil on the world market. But this was not always true. At pre-1974 prices, it would have been cheaper to import oil and devote resources used in developing the North Sea to produce exports.

9. Revenues from oil being frittered away on consumption/unemployment benefits?

[Opposition spokesman on trade, Mr John Smith MP, has repeatedly accused Government of 'frittering away' on unemployment benefit the £20½ billion on North Sea revenues received since May 1979.]

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. World recovery under way?

[Recovery in N America, particularly in US (see ~~25~~ 4 below) now becoming established. Elsewhere earlier signs of upturn have flattened out. IMF and OECD forecast 2 per cent growth in major countries this year, with OECD seeing 3½ per cent growth next year.]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). Most forecasters expect recovery to accelerate during course of this year (with output rising by perhaps 2 per cent) and to continue into next year.

2. Assessement in OECD Economic Outlook July 1983 (published 12 July)?

[OECD now forecasts recovery strengthening, with major industrial countries growing by 2 per cent this year followed by 3½ per cent growth next. Total OECD unemployment may continue rising despite fall in US. Inflation forecast to fall to 5 per cent this year compared with 1982, although may turn up in 1984. OECD stresses world interdependence and need for greater co-operation.]

Welcome OECD's confirmation of better recovery prospects and for further fall in inflation this year (broadly in line with FSBR). OECD's forecast for 1984 sees recovery gathering pace. OECD rightly emphasises importance of investment recovery and need to reduce structural rigidities. Support call for increased international cooperation, also a major theme of recent Summit.

3. Latest inflation figures

[Consumer price inflation down from a year ago in most major economies, apart from Italy and Japan on latest available figures: US (from 6.7 to 3.5 per cent), UK (9.2 to 3.7 per cent), Canada (11.8 to 5.4 per cent) France (13.8 to 9.0 per cent), Germany (5.8 to 2.4 per cent). It has risen slightly in Italy (from 15.2 to 16.0 per cent) and Japan (from 2.3 to 2.7 per cent).]

UK performance in bringing down inflation in past year one of the best among our major trading partners. Lower inflation has helped lay basis for recovery now emerging in UK and rest of world.

4. Prospects for US economy?

[Administration have revised upward (for second time) their short term forecasts. Now expect growth of 5½ per cent in year to 1983 Q4 compared 4.7 per cent expected previously. Preliminary estimates suggest that GNP rose strongly by about 1½ per cent in second quarter after rising ½ per cent in first quarter and falling sharply at end of 1982.]

Welcome further signs of strengthening activity in US. Essential for world recovery that this trend continue. But uncertain outlook concerning budget deficit continues to threaten recovery in medium run.

5. US budget

[First budget resolution for FY 84 has now been agreed by both Houses of Congress. This provides for 5 per cent growth in defence spending and additional taxes of $12 billion contributing to budget deficit of $170-179 billion compared with Administration's initial proposals of $190 billion (though this does not take account of recent revision to growth forecasts). Proposals by House of Representatives to limit benefit from 10 per cent cut in income tax scheduled for July (last of three) has been rejected by Senate, so alternative way needed to finance expenditure increases in budget resolution.]

Share widely expressed concern over size of potential budget deficit. Disappointed that so far Administration and Congress failed to agree exactly how budget deficit should be reduced. Essential that prospective fiscal deficits put on convincing downward path over medium term otherwise emerging recovery may be jeopardised by higher interest rates.

6. US has tightened monetary policy?

[Level of M1 rose sharply in most recent week by about $5.8 billion and has risen at annual rate of about 14 per cent since 1982 Q4 - well above 4-8 per cent target range. M2 and M3 remain at the top or just above their target range. Minutes of May Federal Open Market Committee (just released) reveal Fed has tightened policy slightly in recent weeks.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates; Fed is keen to sustain recovery, has successfully reduced inflation to only 3½ per cent and remains solidly committed to preventing any resurgence. (See also 9 below.)

7. US interest rates

[Interest rates have edged up - partly result of and partly in anticipation of tighter fed policies. Volcker to present Fed's mid-year policy review in Congress this week.]

Difficult to foresee future level of interest rates which are mainly market determined. Fed following cautious policies in face of monetary conditions which are difficult to interpret. Lack of agreement over ways to reduce budget deficit is continuing cause for concern over future interest rate trends.

8. International debt

[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil) falls in interest rates since last summer, recent rises in commodity prices and expected growth in world trade during this year will help to improve underlying conditions.

9. Brazil about to reach agreement with IMF?

[Brazilian Government has announced additional package of measures including further changes in wage indexation. BIS has not extended repayment date of $400 million loan instalment but has not called on guarantees given by member central banks.]

Welcome package of measures announced by Brazilian Government and improved prospects for discussions with IMF. No reason to believe that satisfactory agreement will not be reached.

10. UK support for international lending to Argentina?

Government supports central role IMF is playing in resolution of Latin American debt problems. Their programme for Argentina is part of this, and disbursement of the standby depends on the Argentines meeting the performance criteria. UK membership of the IMF Board enables us to take part in periodic reviews of progress and to ensure that conditionality is being met.

11. What would HMG do if assistance were agreed although discriminary to restrictions remained?

Do not think we should be prepared to entertain this sort of defensively conceived hypothesis. Our voting strength on the Board of course does not put this matter under our direct control. Can give assurance that principle of non-discrimination is taken very seriously by Managing Director and Board as whole.

12. IMF legislation?

[International Monetary Arrangements Bill passed all its Commons stages on Monday 11 July. Royal Assent expected before summer Recess. IMF Quota Order has been approved and signed.]

Legislative progress achieved means that UK is among first of industrial countries to have agreed to increase in IMF resources.

13. Fund running out of money?

[The Times 27 June suggested Fund would need to raise additional resources to meet commitments over next few years.]

Fund still has undisbursed resources. New resources from Eighth Quota Review, brought forward under chairmanship of previous Chancellor, should be available early next year, together with enlarged GAB if conditions warrant.

14. New 'Bretton Woods'?

[Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.]

UK will play full part in considering with our partners conditions for improving international monetary system. UK view is that prudent policies among major countries offer best prospects for stable and durable system. Premature conference which ended in disagreement would be damaging.

2.37

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 18 JULY 1983

Financial Conditions

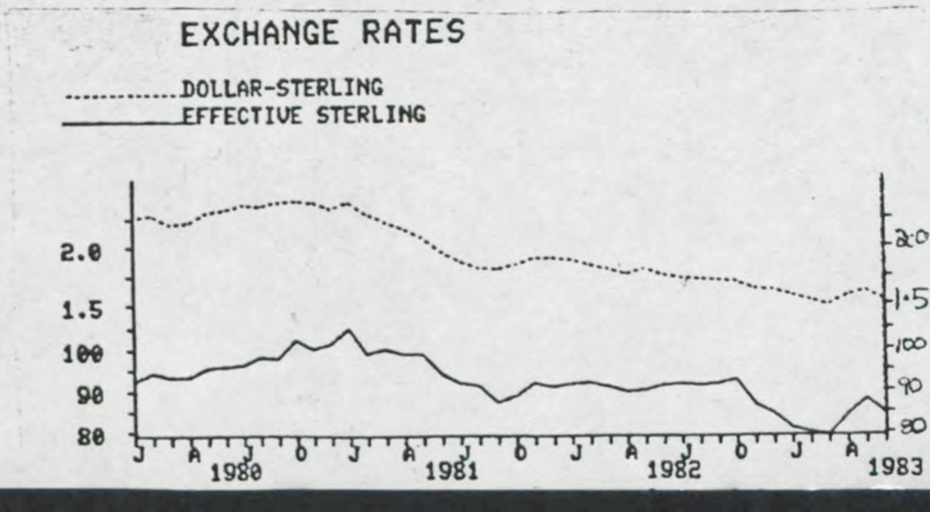
1. In the four months to June the monetary target aggregates have grown at a rate well above the 7-11 per cent range, partly reflecting high public borrowing. The high June £M3 increase reflected a particularly high level of bank lending to the private sector.

Banking Months	M1	£M3	PSL2
			% changes, seasonally adjusted
March	1.2	1.0	1.7
April	1.1	1.7	2.1
May	1.5	0.6	0.6
June	1.7	1.7	1.1
<u>Annual % change (to June)</u>			
Target period	17.6	15.8	17.9
Last 12 months	14.5	11.7	12.0

On 7 July the Chancellor announced a set of public expenditure measures which would reduce this year's likely public expenditure outturn by over £1 billion. These measures do not imply any reduction in the PEWP planning total of £119.6 billion but rather an adjustment to bring actual spending closer to the planned path. The provisional estimate of the CGBR in June was £2.5 billion bringing the cumulative total since April 1st to £5.5 billion.

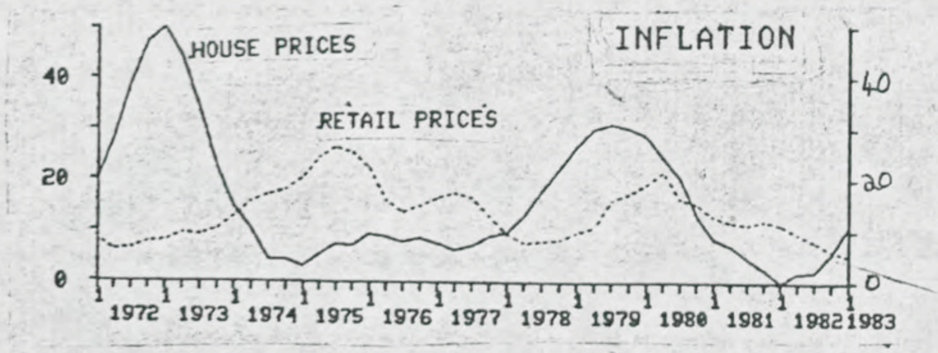
2. Bank base rates were reduced to 9½ per cent on 15 June. They are now at their lowest level for five years, apart from the period last autumn when they briefly fell to 9 per cent. The Building Societies announced on 22 June a 1¼ per cent increase in the mortgage rate, to 11¼ per cent, effective from 1 July. Apart from the last six months, mortgage rates are still at their lowest level since the summer of 1978.

3. The <u>effective exchange rate</u> is now around 85 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.



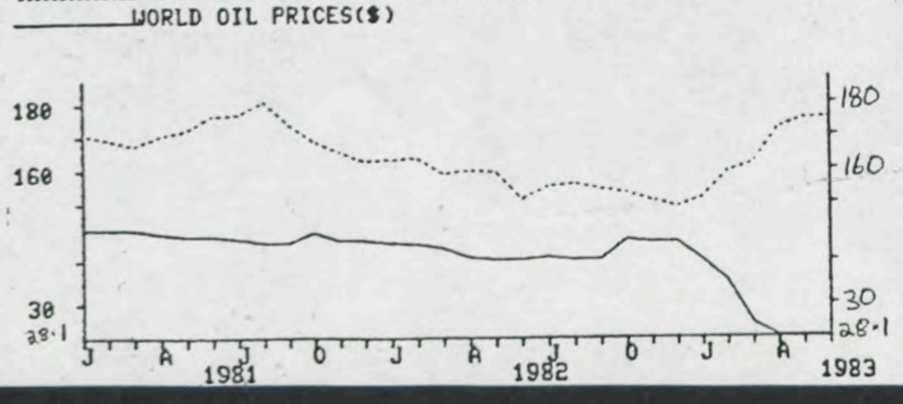
Inflation and Costs

4. RPI inflation was unchanged at 3.7 per cent in June, and has not been bettered for over fifteen years. UK inflation is also lower than the 'Major 6' average although remains higher than in West Germany (2½ per cent), US (3½ per cent) and Japan (2 per cent). As some of last year's favourable influences are removed from the 12-monthly comparison inflation is expected to rise to 5-6 per cent towards the end of the year. The mortgage rate increase will add about 0.4 per cent to the July RPI (published in August). If petrol price rises stick at their present level of around 4 or 5 pence per gallon this will add 0.1 per cent to the RPI. In the year to June wholesale output prices (excluding petroleum products) rose by 5.7 per cent. Materials and fuel prices rose by 4.4 per cent. The prices of assets such as houses have shown more rapid increases but these are not high by historical standards.



5. Average settlements in manufacturing are currently running at about 5-6 per cent some 1½ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was 7¼ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round. Wage moderation, coupled with productivity gains (in the three months ending April manufacturing output per head was 4½ per cent higher than a year earlier) have brought down the increase in manufacturers' unit wage and salary costs to around 3½ per cent in the year to the three months ending April. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge.

6. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index though the increases in May and June were relatively modest.. World oil prices appear to have stabilised in the last few months.



Company Finances

7. Nominal profits (for both oil and non-oil firms) of industrial and commercial companies were little changed in the first quarter and are well up on their 1980 and 1981 levels though the improvement is from an historically low level and following real declines because of inflation. This improvement is reflected in increases in pre-tax real rates of return, particularly in manufacturing, and in a strengthening of the company sector's financial position.

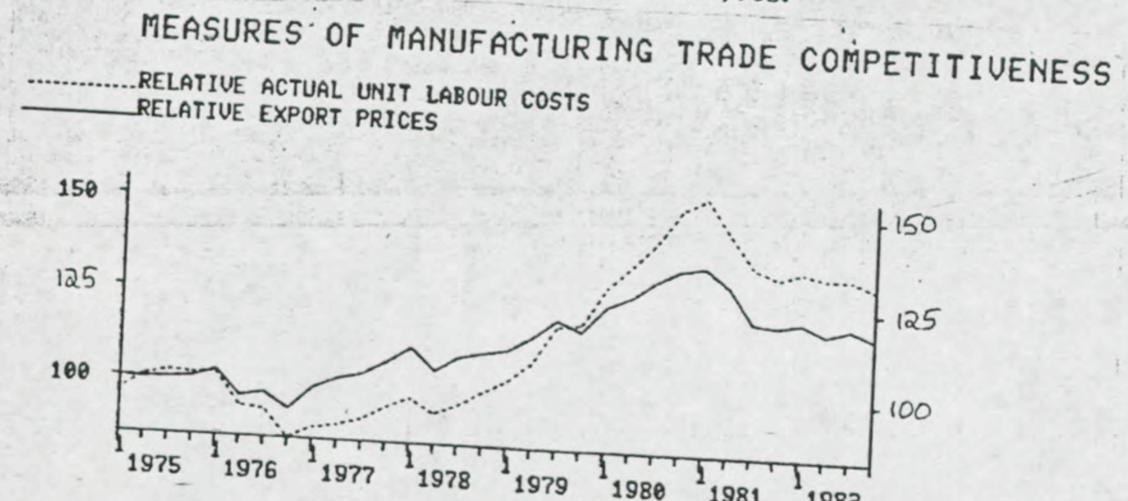
REAL NET PRE-TAX RATES OF RETURN

	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	3½

The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

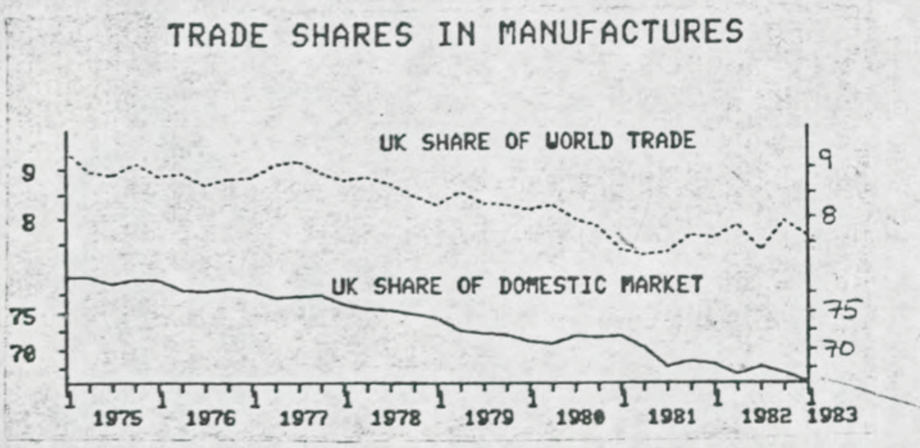
Competitiveness and Trade

8. Manufacturing trade competitiveness can be measured in a number of ways although the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (largely reflecting the lower exchange rate) though remaining substantially worse than in the mid-1970s.



NB. Upward movements in the indices represent lower competitiveness.

9. The deficit on the current account increased from a revised £110 million in April to £302 million in May. However, the figures remain very erratic and it is hard to discern any clear trends. The main reason for the deterioration was the large increase in imports of erratic items (precious stones, ships, aircraft and North Sea installations) and of oil. Though this was partly offset by a marked reduction in imports of finished manufactures - particularly consumer goods other than cars. The underlying volume of non-oil exports has remained broadly flat in the last six months. Recent rises in import volumes are consistent with the turnround in stockbuilding and the underlying increase in output. Trade performance in manufactures in overseas and domestic markets is illustrated in the chart below.



Domestic Demand

10. In 1982 real domestic demand - using the expenditure components of GDP - was almost 3 per cent higher than a year earlier. In the first quarter of this year there was growth of almost 2½ per cent largely resulting from the turnround in stockbuilding.

11. Much of the recovery in total domestic demand during 1982 reflected the growth consumer spending, partly reflecting lower inflation and the summer 1982 abolition of HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Consumers' expenditure fell back slightly in 1983 Q1 but is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

Year-on-year % changes

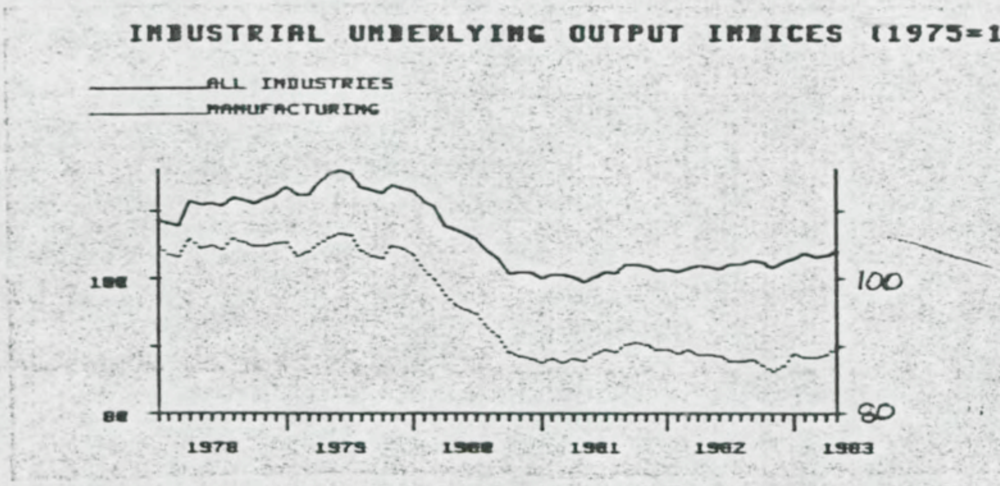
		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.0	4.3
	Q2	na	6.4*

* provisional

12. Total fixed investment rose sharply in the first quarter of 1983. Upward trends in distribution and services have offset the continued fall in manufacturing. After substantial destocking (over £700 million at 1975 prices) in the second half of 1982 modest restocking (of £95 million) resumed in the first quarter of this year. Manufacturers reduced stocks further in 1983 Q1, but at a much slower rate than in 1982 H2.

Output and Unemployment

13. Total output (GDP(O)) rose by ½ per cent between 1982 Q4 and 1983 Q1; GDP(A) is no 3½ per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is 3½ per cent above its spring 1981 trough, with more than half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.



Housebuilding has been particularly buoyant although, as expected starts have fallen back in April and May from their high first quarter level. This followed a change in the unusually fayaourable weather conditions at the beginning of the year. An additional factor may be the tightness of building societies' funds and much reduced bank lending.

14. An international comparison of increases in production (seasonally adjusted and excluding construction) is given below:

Change March to May 1983 (* = Feb to April) from:

	Average 1979	Same 3 months in 1982	Previous 3 months
UK	-8%	+1%	+1%
* France	-4%	-	-
W Germany	-5%	-4%	+2%
* Japan	+7%	-	+1%
USA	-7%	+1%	+4%

15. However, the underlying level of unemployment is still rising - though the upward trend may have eased slightly. In June, the UK total (not seasonally adjusted) was 2.98 million (12.5 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). However, the figures are distorted by the effects of the measures announced at Budget-time (automatic credits and long-term supplementary benefit for men over 60). Allowing for these measures, the adult total rose by 19,000. Notified vacancies rose by 8,000 in June to 139,000 and remain on a slowly rising trend. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.

Recent forward indicators

16. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. Total engineering orders fell 1 per cent in 1983 Q1 compared with the previous quarter, but export orders rose by over 26 per cent on the same comparison and latest forecast published by the Engineering Employers Federation expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984. The volume of new construction orders fell back 3 per cent in the three months ending April.

17. The encouraging message of the CBI's April Industrial Trends Survey was further confirmed in their May and June Enquiries which showed improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output has been positive for five successive months and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The June Enquiry contained encouraging results for consumer goods industries whose recent

production had not matched the buoyancy of consumer spending. The improvement in UK manufacturers' overall confidence (production expectations, order books and stocks) since the end of last year has been the strongest in the European Community, even slightly exceeding the large West German improvement. Between February and April the UK has been the only Community member to record positive balances for production expectations. The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

18. The Government forecast published with the Budget expected inflation to stabilise around the 6 per cent level by the end of 1983 and GDP growth of 2 per cent between 1982 and 1983. Since Budget-time prospects for this year have improved (Chancellor, 29 June, put GDP growth at "up to 2½ per cent" for this year and RPI inflation at "5 to 6 per cent by the end of the year". Recent outside forecasts are in broad agreement expecting GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6 per cent by the end of the year. Consumers' spending and stockbuilding are the main expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth.

Key indicators to be published in week ending 22 July

Mon 18	:	Retail sales (June provisional)
Wed 20	:	Average earnings (May) and wage rates (June)
	:	Construction new orders (May)
	:	Industrial and commercial companies capital account and net borrowing (1st qtr)
Thurs 21	:	Cyclical indicators (June)
	:	PSBR (2nd qtr)
	:	Consumers' expenditure (2nd qtr preliminary estimate)
Fri 22	:	Sales and orders in engineering industries (April)

1/1

Michael

PPS/CHANCELLOR

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copied to:

Mr Salveson (for transmission to No.10)
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PS/Secretary of State for Social Services
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Parliamentary Secretary to the Treasury
Other Ministers with an interest and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 4 July, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

11 July 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Chancellor's speech in Debate on Address 29 June - his first major statement on economic policy as Chancellor.]

Intend to consolidate and build on progress already made in creating conditions for sustainable recovery. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. Shift in policy towards reducing unemployment?

No trade-off exists between inflation and unemployment. Government has important role in easing transition to low inflation-high employment economy. But to reduce unemployment on a lasting basis need is to continue fight against inflation, keep costs under control and improve productivity.

3. Future of MTFS?

Government will continue to set a framework of sound money, with an appropriate balance between fiscal and monetary policies. Heart of approach will remain the medium-term financial strategy.

4. Chancellor's expenditure statement 7 July: Why not abandon Summer Finance Bill instead?

[Chancellor announced measures to prevent overspending in 1983-84; (i) reduction of 1 per cent in 1983-84 pay and central government administration cash limits; 2 per cent in remainder; reduction of 2 per cent in nationalised industry EFLs; effect to remove £500 million of spending beyond planned total, (2) increase in asset sales programme by further £500 million; (3) new scheme for end-year cash limits flexibility which could reduce spending by some £100 million in current year.]

Bill fulfils firm Manifesto commitment. To abandon it would increase the tax burden and require recovery of tax from a large number of people already beginning to benefit from its provisions. 7 July measures not 'savage cuts'; designed to bring total public spending closer to planned path. Not to have taken these measures would imply a lack of Government commitment to its own financial strategy, and undermined recovery. [See also Section J].

5. Haven't markets given the measures the thumbs down?

No. Not taking any action would have been irresponsible and seen as such by the markets. Moreover, recent market developments should be seen in the context of major worries about foreign developments such as US interest rates.

6. Government deliverately engineered pre-Election boom?

There was no pre-Election boom. For 1982-83, though less underspending than expected at Budget time, only two extremely minor breaches of cash limits, and year ended with large part of Contingency Reserve unspent. Budget measures themselves involved only relatively small increase in public expenditure for 1983-84 compared with February White Paper, and did not add to planning total - met entirely from Contingency Reserve. So far as wider economy is concerned, pace of recovery has been moderate not excessive.

7. £1 billion package of measures too small when PSBR set to overshoot by £3 billion?

[Times has alleged that internal Treasury forecast shows PSBR for 1983-84 over £11 billion; and speculates on further cuts in autumn of up to £2 billion.]

For obvious reasons Treasury does not comment on speculation about internal forecasts. Not sensible to publish revised forecasts of PSBR so early in financial year - average margin of error on Budget forecast £4 billion in either direction - autumn will be the time to do this. Nevertheless, indications that spending and borrowing are running higher than expected has been unsettling markets; need for some corrective action was clear. Developments in spending and borrowing will continue to be monitored closely, so that further action can be taken if necessary.

8. Why were measures announced now rather than before 9 June? When did need become evident?

In early June we did not have sufficient information on which to make a judgement. Since then a clearer, though obviously still uncertain, picture has emerged - on public spending, borrowing and money supply - and we judged that the time was right to reassure markets that Government remains firmly committed to its financial strategy.

9. Dogmatic pursuit of monetary targets?

No. This is a strictly pragmatic solution to a real problem. If we had not acted to bring public expenditure and borrowing closer to the Budget figures, strong upward pressure on interest rates could have developed.

10. Measures deflationary? Effect on jobs?

Short term adjustments may be necessary on some programmes. But the effect will be much less than the damage which would be caused by allowing public expenditure to rise above planned levels.

11. Were 7 July measures in 'secret Manifesto'?

There is no secret Manifesto. The published Manifesto set out Government's intentions fully and frankly. Their actions will be consistent with these.

12. Further cuts ahead?

See K11.

13. Tax revenue shortfall expected? Meaning more cuts?

Cannot comment on speculation about internal Treasury forecasts.

14. Current economic situation

Modest recovery is under way. GDP up 3½ per cent since mid-1981. Restocking now taking place. Private investment recovering and retail sales remain buoyant. Other indicators - including recent CBI reports and CSO cyclical indicators - also point in direction of continued gradual recovery. With inflation lower and evidence (eg from US and Germany) that world economy is picking up, good prospects that recovery will be sustained. (See also Section B.)

15. 'New Treasury forecast' shows GDP 2½ per cent growth in 1983?

[Press reports of Chancellor's 29 June speech.]

No new forecast will be published until autumn. Chancellor simply said during 29 June Debate that prospects - both for output and inflation - were a little brighter than expected at time of Budget, with GDP growing 'up to 2½ per cent' this year and inflation rising temporarily to '5 or 6 per cent' by the end of year. No more than slight amplification of earlier comments by previous Chancellor. [On latest LBS forecast, see B4.]

16. New Chancellor's view of international consensus on economic policy? US deficit?

As Chancellor made clear in 29 June speech, Government continues to attach importance to working together with our partners and IMF to ensure convergence on non-inflationary growth and maintenance of a stable monetary system for world as a whole. Within this context, US deficit is a major problem. Important therefore that US administration and Congress should agree on measures to cut deficit. (See also T7.)

17. Chancellor's first meeting with NEDC marks change of emphasis?

Chancellor regards NEDC as important forum with continuing valuable role to play, but does consider some change in emphasis is needed - away from discussion of broad macro-economic issues towards more scrutiny of specific industrial issues.

BULL POINTS

Output and Demand

- Total output (GDP) up 3½ per cent on mid-1981.

- Industrial output in three months to April up 3-3½ per cent on spring 1981 trough.

- Manufacturing production recovered 1 per cent in three months to April on previous three (chemical and allied industries and electrical engineering showing strongest improvement).

- Consumers' expenditure in 1983 Q1 3 per cent up on a year earlier.

- Retail sales in three months to May almost 6 per cent up on year earlier.

- £700 million destocking in 1982H2; turn round to £100 million restocking in 1983Q1.

Prospects

- CBI (June) Enquiry balances showed (i) total order books strongest since November 1979; (ii) positive output expectations for fifth successive month; (iii) excessive finished goods stocks lowest since November 1979; (iv) expectations for increase in domestic prices still historically low.

- Fixed investment (private sector) set to rise 3-4 per cent in both 1983 and 1984.

- CSO's cyclical indicators point to continuing upswing in the business cycle.

- Outside forecasts recently suggest higher GDP growth this year than Budget estimate [NB Chancellor said 29 June that he expected an increase of "up to 2½ per cent".]

Financial Strategy

- Government borrowing amongst lowest in industrialised world.

- Short-term interest rates down about 7 points since autumn 1981.

- Official external foreign currency debt down from $22 billion in May 1979 to less than $12 billion at end-May 1983. Remaining debt now smaller in relation to imports than at any time since Second World War.

Inflation, Costs and Profits

- RPI inflation 3.7 per cent (May) - lowest since March 1968. [NB Chancellor said 29 June some temporary rise to 5-6 per cent by end-1983.]

- Output per head (manufacturing) risen 16½ per cent since end-1980 and at record levels. Output per head and output per hour now 9 and 12 per cent above previous cyclical peak in H1 1979. Manufacturers' unit wage and salary costs up 3½ per cent in 3 months to April on year earlier. (Would be lower still with NIS cut).

- Cost competitiveness (manufacturing) improved around 20 per cent since early 1981 (assuming £ effective of 84).

- Non-oil ICC's profits nearly 20 per cent above level in 1980 and 1981. (50 per cent up for oil ICC's.) Real profitability also improving slightly.

- Company liquidity at best level since mid-1979.

Labour Market

- Working days lost in May (110,000), well below average in first four months of 1983 (476,000). 5.3 million days lost last year was well below 12 million average of preceding 10 years.

Freedom, Enterprise and Initiative

- Many controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls.

- Further 13 enterprise zones announced in 1982 (total now 24).

- Civil Service now sunder 650,000 (1 April 1983) - cut of 11½ per cent since Government took office. On target to achieve smallest Civil Service since war by 1984 (630,000). LA manpower (GB) cut by 106,000 (4½ per cent) between June 1979 and December 1982.

- Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost ½ million public sector tenants bought their houses since May 1979; further ¼ million in process of buying.

B ECONOMIC ACTIVITY AND PROSPECTS

[See also Commentary on recent UK economic developments - at end of Brief. NB Industrial production in May to be published Wednesday 13 July.]

1. Evidence for recovery?

[GDP (0) - the best short-term indicator of the three GDP measures - rose ½ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; GDP(O) now 3½ per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production in three months ending April was 1½ per cent up on previous three; underlying industrial output now around 3-3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1 per cent higher in three months to April than in previous three.]

Total output has recovered 3½ per cent since spring of 1981, and industrial output has recovered around 3-3½ per cent. Manufacturing production three months to April increased 1 per cent on previous three and expectations (eg recent CBI reports, CSO leading indicators) are for further increases. Consumers' expenditure in 1983 Q1 up 3 per cent on year earlier. Retail sales at record level - almost 6 per cent higher in three months to May compared with year earlier. De-stocking in second half 1983 (£730 million at 1975 prices) has been turned round into modest restocking (£100 million) in first quarter this year.

2. UK suffered worse recession than major competitors?

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (average measure) fall of over 3½ per cent - though not strictly comparable measure.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most against difficult international trade background. Growing signs of world recovery - particularly in US - should make going easier.

3. Prospects for UK economy good?

Total output growth of up to 2½ per cent in prospect for this year, and, with world background slowly improving, should be a little easier from now on. Inflation to remain moderate at 5-6 per cent by end of year. [IF PRESSED on publication of revised forecast, see A1~~7~~5.]

4. Latest LBS forecast?

[July forecast expects : 2-2½ per cent growth in 1983 and over 2½ per cent in 1984; inflation to remain moderate at around 6 per cent throughout period; unemployment to show slight downward trend from mid-1984.]

Latest LBS assessment is broadly representative of recent independent forecasts for this year and supports Chancellor's statement (20 June) that this year should see total output growth of 'up to 2½ per cent'.

5. Latest (June) CBI Industrial Trends Inquiry

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, Sir James Cleminson has pointed out that, while Inquiry results are encouraging, not all manufacturing industry has benefited yet from this steady but modest increase in business activity.

6. Is recovery sustainable?

[Mr Shore in Debate 29 June claimed sustained 2½ per cent growth 'wildly improbable'.]

Recovery has been modest but against very difficult world background; many indicators point to continuing growth. Longer term prospects look good so long as we stick to sound financial policies and work for greater competitiveness, efficiency and enterprise. Containment of costs also of crucial importance if lower inflation to be translated into lasting growth and jobs. Much progress already made (lower inflation and interest rates, improvements in productivity and competitiveness and encouragement of competitive market forces); need to consolidate further.

7. Recovery over with stockbuilding and consumption petering out?

[June BEQB 'stimulus from stockbuilding is unlikely to be repeated, nor may there be any immediate resumption of the earlier fast growth of consumer spending. May NIESR Review 'Consumer demand .... now likely to weaken'.]

Retail sales are still at record level and CBI's June Inquiry showed consumer goods firms not pessimistic about output prospects. Inquiry also showed balance of firms with excessive finished goods stocks at lowest level since November 1979. Fixed investment also growing and world recovery should make it easier for exports. Nearly all major outside forecasters see prospects of continuing modest recovery in 1983 (GDP up around 2-2½ per cent), modest price inflation (around 6 per cent by end 1983) and further growth in 1984.

8. Domestic industry missing out on the consumer spending spree?

[For details of consumer spending see Commentary. Buoyancy, particularly of retail sales contrasts sharply with movements in consumer goods production. In three months to April latter was only ½ per cent up on preceding three months and was little changed from its level a year earlier.]

Consumer goods production figures disappointing. However, CBI's June Trends I shows that output expectations are particularly strong for consumer goods sector and May trade figures showed fall in value of consumer goods imports from April level. But scope remains for further improving competitiveness by moderating wage settlements and improving product design, etc.

9. Latest construction and engineering industry indicators suggest recovery over?

[Construction output and orders have fallen in recent months. Housing starts have fallen in last three months but still well up on year ago. Total engineering orders fell 1 per cent in 1983 Q1 compared with previous quarter, reflecting continuing weakness of domestic orders.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4. Some pause not surprising though latest figures are disappointing. But not too much weight should be placed on one quarter's figures, particularly when set against background of general recovery. Engineering export orders have rose in 1983 Q1 and latest forecast by EEF expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984.

10. Hasn't recent investment performance been weak?

[Total fixed investment in 1983 Q1 3 per cent up on 1982 H2 level. Manufacturing investment (including leasing) in 1983 Q1 over 4 per cent down on 1982 Q4 and over 5 per cent down in latest six months compared previous six. But total capital expenditure by manufacturing, distribution and service industries up 1 per cent latest six months compared previous six.]

Manufacturing investment has been disappointing (over 4 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment, likely to recover later this year. Fixed investment in other sectors has been stronger: total fixed investment rose almost 4 per cent in 1983 Q1 on previous quarter, and investment in distributive and service industries (excluding shipping and leased assets) almost 2 per cent on same comparison. And investment in all sectors should respond to significant improvements in company profitability and liquidity (see Section P) and growing signs of sustained recovery.

11. Investment intentions?

Latest DOI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. Outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984. First time since July 1979 that majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

12. Trade figures suggest that recovery will hit balance of payments 'stop' just as in the old days?

May figures affected by 'erratic' items and oil. Recent rise in imports and form it has taken are consistent with other indicators of industrial recovery (see also Section G).

13. High real interest rates choking off recovery?

Real interest rates are high whilst economy adjusts to low levels of inflation - just as real interest rates were negative when inflation was accelerating in 1970s. Real interest rates in UK not particularly high by international standards. Expect some fall in real interest rates in developed countries as inflation brought firmly under control.

14. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 4½ per cent in year to three months ended April 1983; and overall improvement of around 16½ per cent since end 1980. Some slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Also, manufacturing output now rising. Overall performance since 1981 better than could have been expected on past experience.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[June fall in 'headline' total largely reflects favourable seasonal factors and distortions due to administrative changes announced in Budget. Vacancies are on a slowly rising trend. Overtime worked remains broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	1982			1983		
	June	Sep	Dec	Apr*	May*	June*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.05	2.98
Adult sa unemployment (millions)	2.77	2.87	2.95	3.02	2.97	2.97
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+13 [+23]	-10 [+24]	-18 [+22]
Vacancies (000s)**	105	107	118	135	131	139

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

Fall in 'headline' total is welcome but mainly reflects special factors. Over next few months these factors will tend to go into reverse and 'headline' total will probably rise. However there are signs that upward trend has eased slightly. Vacancies have been rising and other indicators of economic recovery give grounds for cautious optimism about unemployment prospects.

2. How can Chancellor say jobs are plentiful?

[Chancellor said in 'Face the Press' 5 July: 'I think there are many jobs of an unskilled nature which .... are available to be done at a particular wage.']

Although unemployment is high it would be wrong to think that job opportunities do not exist. Total job changes are running at around 6 million a year - about 25,000 per working day. [NB These include movements of people from one job to another as well as the unemployed taking up jobs.] Number of people ceasing to be unemployed is averaging about 377,000 a month [NB most of them to take up jobs, though some for other reasons eg taking retirement.]

3. True level of UK unemployment really much higher than published figure?

Gross exaggerations are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed.

4. Official figures take no account of unregistered unemployment/non-claimants?

Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Estimates in June Department of Employment Gazette show that, in 1981, these groups broadly offset each other.

5. Why has Government decided to write-off nearly ½ million unemployed as scroungers? [Reference to June Employment Gazette article].

Estimate of 400,000 on unemployment count not actively seeking work nothing new. Many independent studies have come to broadly same conclusions. These people certainly not all scroungers. Include occupational pensioners and other registered only to obtain national insurance credits (before administrative change announced in Budget), some who would welcome a job if the Jobcentre were able to offer one but are not so concerned as to consider themselves as actively jobseeking (perhaps for age or family reasons), and some who are 'unemployable' or do not believe any jobs are available for them.

6. Budget measures just Government attempts to 'fiddle' the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First two of these removed around 122,000 from June unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

7. Do revised employment estimates represent further fiddling?

[Employment Gazette article on over-estimation of fall in employment since 1981.]

No. Aim is to give best guidance we can to users on what we believe to be position. Article explains why it seems estimates too low, and says estimates incorporating an allowance - assuming unchanged rate of under-estimation - will be published alongside basic figures.

8. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.' 1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84. Guardian 31 May: Mr Lawson reported as saying '... in my judgement all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment.]

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies. As 1983 PEWP made clear: 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

9. Unemployment in UK worse compared with other countries?

[On standardised definitions in April 1983 UK unemployment on new basis was 13.7 per cent (compared with 5.5per cent in 1979), Canada 12.4 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.0 per cent (compared 5.9 per cent), Germany 7.6 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was greater in Netherlands (over 26 per cent - rise of 3½ points in unemployment rate in May), Germany (nearly 40 per cent - 2 points in May), and Canada (21½ per cent - 2 points in May) than in UK (11½ per cent - 1.3 points in June (allowing for Budget changes)).

10 Worse because of overvaluation of sterling?

See F~~3~~4.

11. Cost of unemployment £17 billion?

Government always willing to answer questions about direct cost to Exchequer of benefits paid to unemployed. But larger figures sometimes quoted, purporting to take account of income tax and national insurance contributions foregone, unhelpful because fail to address central issue of how to reduce unemployment. Government itself cannot determine level of unemployment. Its role is to set appropriate framework in which opportunities for new jobs emerge.

12. Exchequer cost of unemployment

Unemployment and supplementary to people counted as unemployed currently expected to total about £57 billion in 1983-84 (provisional DHSS estimate in 1983 PEWP).

13. Government don't care about unemployment? Should do something about it?

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Cuts in NIS have reduced tax on jobs. Also Government creating sound foundations for sustainable growth in employment by (i) maintaining firm financial policies designed to reduce inflation and interest rates further (ii) encouraging competition, enterprise and initiative by number of 'supply side' measures. But Governments cannot do everything. Much depends on world developments and private sector's ability to hold down costs and improve competitiveness.

14. Unemployment benefits disincentive to job seeking? Going to be cut in real terms?

See M7.

D PRICES AND EARNINGS

PRICES

[NB June figures for RPI and TPI to be published Friday 15 July.]

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in May, compared 4.0 per cent in April].

12 monthly rate of inflation again fell sharply in May to 3.7 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year?

RPI scarcely rose at all between June and September last year. As matter of simple arithmetic likely to be increase in 12 month change over corresponding period in 1983. Made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year - perhaps to about 6 per cent. If anything progress since then better than expected. As Chancellor said on 29 June, there is and will be no sudden resurgence of inflation of the sort we have seen in the past.

3. Effect of exchange rate/higher mortgage rates/petrol price rises on RPI?

[1½ percentage points increase in mortgage interest rate (to 11¼ per cent) announced by Building Societies' Association on 22 June will add around 0.4 per cent to RPI, mainly coming through in July. Petrol price rise since 1 July 4.6p a gallon will add only around 0.1 per cent to RPI.]

Exchange rate/mortgage rate/petrol price rise factors amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS), likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies. Taking all factors into account, outcome could still be better than Budget forecast, with retail price inflation of 5-6 per cent by 1983 Q4.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2 (6 per cent). Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. Comparison with competitors

[May figures UK inflation 3.7 per cent compared 3.0 per cent in West Germany, 3.5 per cent in US, 9.0 per cent in France, 16.4 per cent in Italy, 5.4 per cent in Canada, and 2.0 per cent (April figure) in Japan]

UK inflation now lower than average of major OECD 6 and well below France and Italy but still some way to go to match West Germany and Japan.

6. TPI increase

12 monthly increase in TPI (3.2 per cent) over year to May 1983, now ½ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

PAY

7. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.7 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase 7¾ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings in April 8.2 per cent, compared 4.0 per cent RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. 2-3 per cent settlements in next pay round?

[Report in The Times 28 June following PM's meeting with CBI previous day.]

Not yet been decided whether Government's plans for next financial year will be calculated on basis of explicit 'pay factor'. However there will be continuing need in next pay round for still lower pay settlements consistent with improved job prospects industry concerned. The lower pay settlements are, the better.

10. Recommendations of Review Bodies

[Continuing Press speculation about proposals to be made by Government on MPs pay.]

Government published on 12 May its decisions on Reports from Armed Forces Pay Review Body and Doctors' and Dentists Review Body: the recommendations have been accepted. Two reports from Top Salaries Review Body on salaries of higher civil service, senior officers in Armed Forces and judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, are still under consideration.

11. Government and wages councils?

Government has frequently made clear that has serious misgivings about perpetuation of minimum wage fixing machinery. Scope for action constrained (until 1985-86) by International Labour Organisation Convention 26. Not our practice to dishonour international treaty obligations. However, Government is continuing to look searchingly at operation of wages councils and will consider all options for future of the system.

E MONETARY AND FINANCIAL POLICY

[Provisional figures for target monetary aggregates show growth in banking June of 1.7 per cent in £M3 and M1 and 1.1 per cent in PSL2 on the new seasonal adjustments. Annualised rate of growth 15.8 per cent, 17.6 per cent and 17.8 per cent respectively against a target range of 7-11 per cent.]

1. How can you say you are pursuing sound financial policies, when the money supply is growing fast?

We are determined to maintain our financial policy to reduce inflation. High level of growth in money supply seems largely a result of a surge in public borrowing since the turn of the financial year. Chancellor's Statement of 7 July was a prompt and resolute response to this problem. Judgement about financial conditions based on a range of indicators (including exchange rate and real interest rates) do not suggest policy is unduly lax.

2. Why did you cut interest rates last month when it is clear the money supply is growing rapidly?

The reduction in the Bank's dealing rates last month followed a fall in market interbank rates. These adjustments were warranted by wider evidence of financial conditions.

3. Is the money supply out of control?

Early days for new target range. Target range for year as a whole not just a few months. Chancellor had taken steps to meet the problem of high public sector borrowing. Represents evidence of his commitment to financial rectitude.

4. Will interest rates go up?

We do not expect them to.

5. Will Government be able to continue appropriate funding policy without rise in interest rates?

Not the practice to comment on operations in gilts.

6. How have markets responded to 7 July statement?

See A 5

7. Is bank lending quickening?

[Advances by LCB pa r ents and subsidiaries rose £830 million in banking June-rather higher than the previous month. This represents only part of total sterling lending.]

Last month's figure could be erratic. On a longer view, lending this year has clearly slowed since last summer. [IF PRESSED: Some upturn in corporate borrowing to be expected as recovery gathers pace: lending to persons has been relatively stable in recent months.]

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Following General Election sterling fell on profit-taking and in reaction to the fall in base rates. After 7 July statement and expectations that tight monetary and fiscal policies will be maintained, it has recovered.

	28 March (oil crisis 'low')	31 May (pre Election 'high')	8 July noon
$/£	1.4535	1.6061	1.5404
DM/£	3.5361	4.0525	3.9630
Y/£	348.72	383.79	370.31
£ effective	78.1	87.8	85.2

2. Exchange rate policy/Government wants lower exchange rate?

Government has no target for exchange rate although it is taken into account in interpreting domestic monetary conditions in Government's attitude to interest rate movements. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible, whether pound is rising or falling - though intervention cannot hope to prevent movement in face of strong market pressures or, by itself, influence rate in other than short term.

3. Fall in reserves in June?

Underlying fall ($178 million) over month when effective rate of £ fell from 87.8 to 84.3 roughly matches underlying rise of $233 million in May when £ rose from 84.2 to 87.8. Demonstrates evenhandedness and modest nature of our intervention policy.

4. Overvaluation of sterling caused more than half rise in unemployment since 1979?

[TCSC 2nd report on international monetary arrangements: 'Chairman's draft' says only half rise in unemployment due to world recession but 'overvaluation of sterling was a major element'.]

No. Unemployment has risen more in UK than other countries over whole period since 1979 because our problems have been more deepseated than theirs. If UK wage bargainers had reacted quicker to outside events in 1979-81 - as wage bargainers in some other countries did - then certainly rise in unemployment would have been less.

5. Why not a joint real - or nominal - exchange rate and monetary target for future?

[Proposals appended to TCSC 2nd report on international monetary arrangements.]

The two would be bound to conflict. Which should take priority? Sensible policy is one Government has adopted. Performance of monetary aggregates is interpreted taking account of movement of exchange rate. This policy very similar to that operated in West Germany - and quoted with approval in report. Would be wrong to try to turn this into some mechanistic rule.

6. Williamsburg Summit 28-30 May

[See also T1 -2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets.

7. Improve UK competitiveness directly by engineering further fall in exchange rate?

[Article discussing competitiveness will be published in June EPR on 13 July.]

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset effects. Confidence would collapse and jobs be destroyed. CBI at June Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

8. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Thus for example between 1970 and 1980 West Germany's cost competitiveness deteriorated 20 per cent but she maintained her 20 per cent of main manufacturing countries' exports; Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars: their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

9. Situation has been made less stable by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in face of strong market movements. They did not control leads and lags in trade payments, nor movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations.)

10. Join EMS exchange rate mechanism (ERM)?

Difficulties over membership remain. In particular, sterling as major internationally traded currency is still being affected by oil and other factors in different way from D mark. Membership of ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

11. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

1. May trade figures and current account

[Current account deficit just over £300 million in May, compared just over £100 million in April; cumulative current account surplus in first five months of 1983 £33 million, but £717 million surplus in last six months.]

Trade figures erratic month to month. Picture in May further confused because main reason for deterioration in current account was large increase (some £190 million) in imports of identifiable erratic items - precious stones, ships, aircraft and North Sea installations.

2. Trade in manufactures in deficit?

[Trade in manufactures was in deficit some £660 million in first quarter - on balance of payments basis. (NOT FOR USE Deficit on bop basis for year to May was roughly £1½ billion.) In 1982 trade in manufactures was £2½ billion in surplus.]

Deterioration in balance on manufactured trade not in itself cause for concern: a natural counterpart of improved oil balance we have enjoyed in recent years. Oil has enabled us to import more: if we had not done so it is true that we would have had even larger current account surpluses, but there would also have been larger offsetting capital outflows - is that what Opposition want? With low level of domestic inflation and prospects of reviving markets overseas, industry now has opportunity to increase level of exports and to improve market shares at home and abroad - provided costs kept under firm control. Important to remember level of manufactured exports: every day about £120 million worth of British manufactured goods leave for markets all over world.

3. Deteriorating oil balance?

Balance on trade in oil has fallen back to last autumn's levels following unusually high surpluses over the winter. Several reasons for high surpluses last winter; one was high level of domestic oil production, which has fallen back a bit since the spring; others were milder than usual winter weather and heavy drawing on stocks by UK companies, both of which tended to reduce imports and divert domestic production into exports.

4. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI Industrial Trends reports show encouraging improvement in order books and expectations of rise in deliveries over next few months.

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Recent rise in imports and form it has taken is consistent with other indications of economic revival. Increases seem to be concentrated in goods for use by industry (materials, fuels, capital equipment) rather than for consumption. May figures are in line with this overall view.

6. Import prices

Welcome news on inflation front is that non-oil import prices fell in May after increasing in recent months. Improvement probably reflects sterling's recovery since March.

7. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which had been in particularly large surplus (£1.1 billion) in 1981.

8. Abolition of exchange controls has led to huge capital outflows?

The net capital outflows in recent years simply reflect - as a matter of arithmetic - the large current account surplus. Just as a country in deficit has to borrow abroad, a country in surplus improves its international balance sheet. Our balance between overseas assets and liabilities is in a better state than it has been for years - and this will provide a useful source of overseas revenue for the future. [Our net overseas assets were £37.7 bn at the end of 1982 compared with £12.7 bn at the end of 1979.]

9. Portfolio investment overseas continuing at a high level?

Most overseas portfolio investment is made by the institutions who invest money on behalf of people who contribute to pension funds and life insurance. It is their duty to seek to earn the best possible return on the sums with which they are entrusted. They will be prepared to invest more in the UK if the profitability of doing so improves. And that means continuing to increase productivity and control costs.

10. Overseas direct investment replaces UK investment?

Overseas direct investment does not involve funds being drained from the country. If investors choose to invest abroad, that is, as the Wilson Committee found, because of a lack of profitable opportunity at home. Nothing, including exchange controls, will force people to invest in Britain if they are going to lose their money.

11. Current account 1983 forecasts

[FSBR forecast £1½ billion current account surplus in 1983 (down from £4 billion in 1982.]

Net forecast to be published will be in Autumn, as usual. Will incorporate Treasury's latest assessment of prospects for current account at time when outlook will have become clearer. [NOT FOR USE: Treasury are updating Budget forecast but not for publication.]

12. If current account surplus slumps this year, how will the flow of overseas investment be financed?

[Current account surplus of only £33 million in first 5 months of 1983.]

Investment overseas can be financed in a variety of ways. Some is financed in foreign currency borrowed overseas and out of the earnings of overseas subsidiaries. To the extent that it is financed by capital flows from the UK these will need to be offset by capital inflows and the current account.

TRADE POLICY

13. Protectionism

[Foreign Secretary pressing US on attitude to steel.]

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P5.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers'. They emphasised importance of working through GATT.

14. Expectations from Trade Ministers meeting in Leeds Castle?

Meeting is an informal conference arranged by Trade Policy Research Centre which is not an officially sponsored body. But UK Trade Minister is expected to be attending and so will CST in personal capacity as a former Trade Minister.

15. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

16. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

J TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also M7). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes. Objectives will be pursued within framework of responsible fiscal and monetary policies; without firm control of public expenditure there will be no room for significant tax cuts.

2. Summer Finance Bill: in view of action on public expenditure, why not drop Bill to save money?

See A4.

3. What happens to proposals announced in Budget but not in summer Finance Bill?

As Chancellor indicated in Debate on Address, Government urgently reviewing these proposals so that can announce as soon as possible and in as much detail as possible what action intend to take on each of them. Question of commencement dates is being considered as part of this review.

4. What will happen on freeports?

Government remains committed to establishment of freeports in UK on experimental basis. An announcement inviting applications from potential operators will be made before the Recess and all bids will be fully and carefully considered. Legislation will be included in a future Finance Bill, and there will be no delay in the eventual establishment of freeports.

5. All benefits of new Bill go to the well-off?

Need to be seen in context of Budget proposals as a whole. Bill does no more than apply same percentage increase (14 per cent) to higher rate bands and investment income surcharge threshold as to personal allowances. No bias in favour of higher paid - tax cut at all income levels.

6. Increase in mortgage interest relief limit unnecessary?

£25,000 limit was set in 1974 by Labour Government. Increasing evidence that old limit was beginning to hinder growing number of families who want to buy their first home or move. (In London about a quarter of first-time buyers with new building society mortgages have mortgages of over £25,000 - Q4 1982 figures.) Increase will also help construction industry.

7. Increase in mortgage interest relief limit increases competition for funds and pushes up interest rates?

[Points made by Mr Richard Wainwright during short debate on 30 June on Resolutions for Finance Bill.]

First increase since £25,000 limit introduced in 1974. Had that figure been increased in line with RPI it would now stand at around £80,000. If parties opposite don't want to help house buyers, they should say so openly.

8. Increasing subsidies to home owners while reducing them to council tenants?

True that subsidies to local authorities have dropped. But direct help to tenants (ie including Housing Benefit) has more than doubled since 1979 - increase of over £1 billion.

9. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in income tax allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

10. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession and need for responsible fiscal and monetary policies. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

11. Government's own figures prove average family now pays more tax than in 1978-79?

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax net of child benefit in 1983-84 than they did in 1978-79.

12. Budget benefits for lower paid

Budget provided help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

13. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rose in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out. Following is based on 1983-84 earnings levels taking, for illustrative purposes, the 6½ per cent earnings increase for 1983-84 used by Government Actuary.]

Tax reductions will be greater than effect of increase in NICs for all but a small minority. [IF PRESSED: Those who will lose out are married contracted out at about 1½ times average earnings and single contracted out at between ¾ and 1½ times average earnings.]

14. RPDI figures belie Government claim that after-tax incomes rising?

[RPDI in 1983 Q1 published 29 June]

Important distinguish between take-home pay of those in work from RPDI which includes income from other sources. Moreover, latest RPDI figures relate to period before effects of last Budget had been felt.

15. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut (see J15). Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

16. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Prime Minister said (23 June) during Debate on Queen's Speech that Government hoped to abolish NIS (cost £1.2 billion in full year) during present Parliament.

17. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

Committee has produced long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to UK and are not amenable to easy solutions. Manifesto (see J1) accorded high priority to the traps, and Government will be examining draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings.

18. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

19. Unitary taxation developments in US?

Government totally opposed to this method of taxation, which is contrary to international practice, and are taking immediate steps at highest level to press US Government for legislation to prevent its application by individual States to British companies operating in US.

20. Rossminster

Attorney General in Written PQ on 30 June said that no criminal proceedings were to be brought following the raids on Rossminster by Inland Revenue officials four years ago. Inland Revenue will deal with liabilities for tax, interest and penalties that have come to light in course of the investigation.

21. Treasury VAT deal to buy heritage bodies' silence?

[Guardian and D Telegraph stories 5 and 6 July.]

Government made it clear to heritage 'lobby' from outset that this relief not precursor of any wider relief for heritage items. This was fully appreciated by the bodies most directly concerned.

H FISCAL POLICY AND THE PSBR

[See also Section A]

1. Does Government plan to tighten/weaken fiscal policy?

[Chancellor's speech in Debate on Address reaffirmed need to reduce monetary growth and keep PSBR low.]

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal policy?

[Aim is to achieve trend reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. PSBR has been reduced. Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - lower PSBR over run of years implies lower interest rates - still holds true.

5. Why did 1982-83 PSBR overshoot?

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

6. PSBR out of control? New measures reflect Treasury panic?

[Press reports of internal forecast pointing to £3 billion PSBR overshoot this year. LBS forecast £1.9 billion spending overrun this year (before 7 July statement).]

See A.

7. What is new PSBR forecast?

See A.

8. £600 million spending package too small relative to PSBR forecasting errors and likely size of overshoot?

[FSBR quotes £4 billion margin of error on Budget forecasts for PSBR. Guardian 8 July talks of £3 billion overshoot in internal Treasury forecast.]

See A.

9. What do latest CGBR figures mean forPSBR?

[CGBR in April to June £5.5 billion compared with £3.1 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion. Next published forecast in the autumn.

10. Do PSBR overshoots mean higher interest rates?

Yes, lower PSBRs do lead to lower interest rates. But effect of overshoots limited because they do not signal change of strategy. PSBR over a run of years is what really counts.

11. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

12. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Chancellor's announcement 7 July - what caused the problem?

[Announcement 7 July of measures to counter possible overspending in 1983-84.]

A number of factors. Net provision for shortfall in the Budget now looks excessive. In part, may be caused by corrective action last October, to increase capital expenditure. But that was only part of the story. Cumulative effects of three years of squeezes in a cash planning system may have something to do with it.

2. Why pick on cash-limited programmes, when the trouble seems elsewhere?

Because it is the best way of achieving results. Do not mean to exclude action on the demand-determined programmes. Where Ministers can take action should do so. But the biggest problems are on agricultural support, Family Practitioner services and on social security benefits. Even if we decided to do something in these areas, they take time to respond.

3. Does this mean laying off staff?

Will be for each department to decide how to implement cuts. But large-scale redundancies unlikely. Laying off staff takes time (6 months notice) and actually adds to first year costs (redundancy etc). Should be possible to do by reduced recruitment, and reduction in casual staff.

4. Given margins of error on PSBR, put at £4 billion either way in FSBR, isn't the £600 million too small - and could easily be in wrong direction?

Have to take best judgements in uncertain world; indications not confined to expenditure, but also from borrowing and money supply. Dangers in waiting too long.

5. Capital/current split. Will this make the situation worse?

It may do. But we are exempting local authority capital and 2 per cent elsewhere is not a great deal. Every area has to make a contribution.

6. End-year flexibility: why capital only not current?

Make haste slowly. Most of the pressure arises on capital, because it is more difficult to predict exact timing of expenditure.

7. Special problems of defence?

With a budget of £16,000 million this year MOD has far more room for manoeuvre than others, it has grown by over 20 per cent real terms since 1979 and cannot be absolved from wider economic considerations. Even after a cash limit cut of this order, defence expenditure (Falklands exclusive) should increase this year by more than 3 per cent in real terms. Our defence effort is surpassed by none of our European allies. In absolute terms our annual spend is second only to the US; as a proportion of GDP and per capita, UK defence expenditure is higher than any other major European ally.

8. What are implications for spending plans of ½ per cent growth assumption just circulated to NHS?

Health authorities have been told to draw up their 10 year strategic plans on assumption that resources for hospital and community health services will grow at rate of around ½ per cent a year in real terms. Has been made clear that this is not a commitment and that their plans must be flexible enough to cope with more or fewer resources. Government will be reviewing all plans for next 3 years, including those for health, in the public expenditure survey.

9. Implications of Chancellor's statement for later years? More cuts on way?

Government has taken action to bring expenditure in 1983-84 closer to course laid down in White Paper. Measures to improve financial control have also been taken. Decisions in survey will also take account of latest developments. Wrong to draw conclusions that corrective action this year means expenditure out of control.

10. Effects of end year flexibility on 1984-85?

Will be bigger than this year because Departments will carry forward unspent balances. Will be taken into account during this year's Public Expenditure Survey.

11. Effect of Summer Supplementary Estimates on total public expenditure in 1983-84?

[Supplementaries presented 8 July: article in The Times 9 July.]

Summer Supplementary Estimates totalling just over £1 billion increase public expenditure by only £335 million. Balance met within existing planning totals (as in PEWP 1983) or charged to Contingency Reserve. Not all expenditure on Votes for demand-determined programmes adds to planning total. Payment to European Community Budget only an advance payment which will be completely offset by lower payments direct from Consolidated Fund. Social Security Votes (see also M) only partly add to planning total, while part charged to Contingency Reserve following Budget measures - eg child benefit uprating - or contained within existing provision.

12. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments and health authorities to reclaim VAT on contracted out services thus removing a disincentive to contracting out.

LOCAL GOVERNMENT

13. Local Authority overspending, and grant penalties

Local authorities were warned last year that 1983-84 rate support grants would be held back from overspenders. Action now being taken by respective Secretaries of State: in England budgets exceeded guidance figures by £¾ billion and Supplementary RSG Report has been laid proposing holdback of £280 million of RSG: in Wales budgets exceed guidance by £21 million and Supplementary Report proposes holdback of £12.6 million; in Scotland under selective action four authorities have been directed to reduce their rates because of excessive and unreasonable budgets and general grant abatement may also be prposed. Note GLC is not included in English holdback - GLC budget is so high in relation to assessed need to spend that it loses all grant under normal distribution arrangements before holdback calculation.

14. Grant penalties reaction to money supply/public expenditure overshoot?

Government has intended all along to take holdback action as appropriate on basis of budgets before Summer Recess. Holdback arrangements were integral to RSG settlements and action now being taken holds no surprises for local authorities. The significance in coincidence of timing with money supply figures/chancellor's public expenditure statement.

15. End-year flexibility: why exclude local authorities?

Because the case for including them is much less strong. Individually they already have more flexibility than we are now proposing to give to central government departments. and inclusion would mean a higher cost.

16. RSG settlements 1984-85?

Government recognises that authorities need long notice of broad features of settlement; accordingly early announcements of grant quanta and planning totals are intended.

17. Why not cut back local authority capital spending?

Because we do not want to hurt the construction industry, particularly in the housing sector. Allocations were increased accordingly.

18. LA capital underspending

Latest estimates suggest local authorities capital cash limits underspent by a little under £1 billion in 1982-83. Disappointing because it follows underspending of £¾ billion in 1981-82, but represents significant improvement on £1½ billion underspending forecast last autumn. Steps then taken to reduce underspend: PM wrote to local authority associations; local authorities invited to apply for extra allocations (about £½ billion issued), and allowed to spend without limit on improvement grants. These measures seem to have been very successful. Steps taken to reduce risk of underspending in 1983-84: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems, LAs can spend above allocations on improvement grants, and eligible expenditure limits raised in Budget by 20 per cent, also new 'enveloping' provisions announced in Budget.

19. Control of local authority rates

Bill will be introduced early in 1984 giving power to curb rate increases of selected overspending authorities in England and Wales from 1985-86. Selection will be on basis of past performance. Powers already exist in Scotland. Bill will also provide fall-back powers to be used if it proves necessary for general limit on rate increases. Wide consultation will precede legislation. Will publish White Paper shortly.

20. Business Rates

Rates now biggest single tax paid by industry. Excessive increases damage jobs. Bill (see K 19) will also require authorities to consult representatives of non-domestic ratepayers before setting rates, and will derate empty industrial property. In meantime, considering reducing statutory maximum non-domestic empty premises rate. Also, rate level below which business ratepayer may pay by instalments will be raised.

21. Other rates reforms

Propose to make each main rating and precepting authority provide annual statement to each ratepayer. Council tenants paying inclusive rents will receive separate advice of rates level.

22. Reform of Local Government Structure

Propose to simplify structure by abolishing upper tier in London and areas of metropolitan counties. Functions to be transferred to lower tier or assumed by new joint boards comprised of nominated elected members of lower tier. ILEA also to be replaced by joint board. Special arrangements for London Transport. White Paper with details this autumn. Wide consultation, including staff, before legislation. Bill to be introduced early next Session; aim for changeover on 1 April 1986.

FALKLANDS EXPENDITURE

23. What has defending Falklands cost so far and foreseeable future cost?

[£215 million to be spent on new airfield - announcement on 27 June]

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion). Cost of new airfield will be contained within this provision.

24. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10½ million spent in 1982-83; further £5 million expected to be spent in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

25. Cost of paying compensation for war damage

No final figure as claims still being processed. But bulk of claims for civilian compensation settled in 1982-83 at £2.3 million. Remainder expected to be settled in 1983-84. Total expected to be in region of £3½ million.

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1979, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K14.)

3. Civil service efficiency?

Civil Service unions say drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments have explored option cuts of 5 per cent and 10 per cent and stated needs for extra staff. No decisions have been taken.

5. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative. With General Election intervening now uncertain whether original target of July 1983 for publication can be met.

6. 1983 Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] A meeting of the Joint Co-ordinating Committee has been arranged for 14 July, at which it is expected that an offer will be made which the trade unions will be prepared to recommend to their members.

7. Civil Service pay in 1984-85?

[Press speculation about possible civil service pay cash limit.]

A. No decision has been taken on provision for pay in central government cash limits for 1984-85.

8. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

9. Top Salaries Review Body and the higher civil service

See D10.

M SOCIAL SECURITY

1. Next November's uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, Government has reverted to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May. Social Services Secretary put detailed proposals to Parliament on 23 June.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May - which was 3.7 per cent. Supplementary benefit will be uprated in line with increase in RPI less housing ie 4.3 per cent. Social Services Secretary gave detailed proposals to Parliament on 23 June for individual benefits. (Public Service pensions, under current legislation, will be uprated in line with State retirement pension.) Certain benefits - like Child Benefit, to be increased by substantially more.

2. 3.7 per cent uprating fails to price-protect pensions?

[Opposition will argue that inflation in year to November was forecast at 6 per cent at Budget time (although signs we are doing slightly better than this).]

No. Pensioners and other beneficiaries retain 2.7 per cent real increase in pensions given at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6 minus 2.7 = 3.3 per cent uprating. So beneficiaries better off under new system. In addition, under historic method, inflation in year from May 1983 automatically taken into account in 1984 uprating.

3. Cost of upratings?

Improvements Government has announced will add about £1½ billion to social security budget in full year but are within Government's expenditure plans as announced in last Budget.

4. Summer Supplementary Estimates totalling over £500 million?

[Following Budget announcement of reversion to historic basis for upratings then CSD promised Parliament that revised social security Estimates would be presented. Four Supplementaries now presented totalling £507.6 million (including £202 million on supplementary benefit and £215.6 million on housing benefit).]

In light of decision to revert to historic basis for uprating benefits, whereas main Estimates had been based on conventional Public Expenditure White Paper assumptions about upratings and prices, we promised to issue amended Estimates. This now done. We have taken opportunity to incorporate Budget and other changes.

5. Future price protection and uprating of benefits for the unemployed?

[Manifesto renewed undertaking given for period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit. Speculation in Observer and Sunday Times 3 July about de-indexing unemployment benefit; Chancellor pressed on 'Face the Press' programme; issue raised again with PM at Question Time 5 July.]

Manifesto renewed pledge, which was more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. Imprudent in present circumstances to promise more eg by extending pledge. But in November 1983 uprating both 'pledged' and 'unpledged' benefits will be price-protected. And in last Parliament most 'unpledged' benefits increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, substantially so. Unemployment benefit will be increased by 8.2 per cent, and worth more than at General Election 1979. Question of what November 1984 rates will be does not arise till next year.

6. Future of Child Benefit?

There are, as Social Services Secretary said on 27 June, no plans to change child benefit. However, as with all benefits, it must remain subject to examination for efficiency and effectiveness.

7. Present level of unemployment benefit disincentive to work?

[Question put to Chancellor on 'Face the Press' 3 July. Further discussions in Sunday Press 10 July.]

In certain circumstances benefits paid to unemployed can exceed net earnings they can expect to receive when in work. This must be matter for concern. Situation not solely caused by level of unemployment benefit, but must be borne in mind when considering future increases in that benefit.

8. Pensions to cost more than expected?

[Government Actuary's Report on cost of 1983 uprating, issued 5 July, says pensions living longer than expected. No details about numbers, but could be additional half million pensioners by end decade.]

1981 Census data shows that pensioners are living longer than actuaries expected. This affects benefit expenditure; nevertheless in 1983-84 National Insurance Fund deficit now expected to be £49 million less than calculated in November 1983. Implications for future years will be examined in course of this year's Public Expenditure Survey.

9. <u>Improvements in 1983 besides uprating?</u>

Substantial and wide-ranging improvements, including restoration of UB abatement, removal of 'invalidity trap' and increase in Child Benefit to highest ever real level, designed to aid most groups of beneficiaries.

N EUROPEAN COMMUNITY

[NB Finance Council meeting Monday 11 July.]

1. UK refunds for 1983

Stuttgart European Council agreed to net refunds of some £440 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly two-thirds. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. No risk-sharing arrangements for 1983?

No. The arrangement provides for a fixed net refund.

4. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

5. UK objectives on EC budget for longer-term?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a modest scale.

6. Will UK agree to new 'own resources'?

HMG remains unconvinced of case for increasing the Community's 'own resources'.

7. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guidelines on its rate of growth. Key measures remain price restraint and curbs on surplus production.

8. UK Government response to Commission request for advance to meet cash crisis?

Commission has right to invite these advances. We agreed, in view of current cash position, that an advance of £113 million should be made on 20 June. This decision and the necessary arrangements were announced in Parliament on 23 June (Hansard WA 3 and 4).

9. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

10. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of growth of guarantee expenditure.

11. Costs of CAP to UK consumers

Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to reduction in the cost of food to consumers could well involve increased costs to taxpayers.

12. European Monetary System exchange rate mechanism

See F1/10

P INDUSTRY

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £2 billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[In 1983 Q1 gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, were nearly 20 per cent above their average 1980 and 1981 levels; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

3. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

6. Loan Guarantee Scheme?

[Nearly 10,400 guarantees already issued - about half to new businesses. Total lending under scheme over £340 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

7. New Enterprise Zones

Eleven zones have now been in existence since 1981. Thirteen second-round zones, now agreed for UK and Northern Ireland, are going through necessary pre-designation stages. These zones will come into operation during summer (Wellingborough on 25 July being one of first). Research so far on first round of enterprise zones has shown that in general they appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. Approach to improving nationalised industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. EFLs for 1983-84 currently total £2.5 billion. (but see 3 below)

3. 2 per cent cut in EFLs

[Chancellor's statement on 7 July included reduction of 2 per cent (£57 million) in total provision for EFLs of nationalised industries in 1983-84, allocated in proportion to their turnover.]

Nationalised industries must make their contribution to keeping public expenditure within planning total. This reduction will encourage the industries to increase efficiency and make further improvements in control of current costs. Effect of reduction for individual industries will be announced as soon as possible.

INVESTMENT

4. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

5. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

6. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to May 1983 5.9 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

7. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

8. Prospects for gas and electricity prices in 1983?
Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

9. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight

Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

10. Future privatisation?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

11. Special asset sales in 1982-83?

Receipts totalling nearly £½ billion (£488 million). Major sales included Britoil (£334 million receipts in 1982-83 and £293 million in 1983-84) and Associated British Ports (£46 million).

12. What measures included in increase in asset sales programme in 1983-84?

[On 7 July Chancellor announced increase of £500 million in Special Sales of Assets target for 1983-84. New target is thus £1250 million.]

Not practice to disclose details of composition of targets for special sales of assets, because price information is commercially sensitive and timing of sales dependent on market conditions. Government's privatisation plans are outlined in the Manifesto [see also 10 Future Privatisations].

13. What plans included in special asset sale targets for future years?

[PEWP 1983 has targets of £1500 million in 1984-85 and £500 million in 1985-86.]

See 12 above.

14. Action in this Session of Parliament?

Queen's Speech specifically refers to re-introduction of British Telecom legislation and proposals to transform Royal Ordnance Factories into Companies Act companies as precursor to introducing private capital. British Telecom largest privatisation ever. Legislation to permit other privatisations will be introduced as and when needed.

15. Employee share-ownership?

Many shares in previous privatisations have been bought by companies' own employees and managers which is truest public ownership of all. Around 100,000 employees have taken up shares in privatised companies. Employees, for example, given free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil, ABP); preference in allocation of shares (BAe, C&W, Amersham, Britoil, BP, ABP); provision for matching shares - one for each share subscribed for - (BAe, Amersham, Britoil, BP, ABP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company (NFC). Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. North Sea oil prices?

[BNOC have proposed no change in N. Sea prices in Q3.]

BNOC proposal of unchanged prices in third quarter reflects stability restored to oil market since OPEC March agreement. Whether this stability continues will depend on OPEC. North Sea prices a matter for BNOC who will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985? Effect on revenues?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about impact decline might have on economy. Effect on revenues will be muted because of tendency of revenues to lag behind output.

5. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields has been reintroduced. Bill containing provisions for PRT expenditure relief on shared assets will be introduced in autumn.

6. Benefits of North Sea should be used to strengthen economy?

Without North Sea revenue taxes would be higher or public expenditure lower. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

7. Are we really any better off for North Sea oil?

We are clearly better off for North Sea oil than we would have been without it. At today's prices, the cost of extracting it is far below the cost of buying oil on the world market. But this was not always true. At pre-1974 prices, it would have been cheaper to import oil and devote resources used in developing the North Sea to produce exports.

8. Revenues from oil being frittered away on consumption/unemployment benefits?

[Opposition spokesman on trade, Mr John Smith MP, has repeatedly accused Government of 'frittering away' on unemployment benefit the £20½ billion on North Sea revenues received since May 1979.]

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

[OECD Economic Outlook July 1983 being published <u>11pm</u> Tuesday 12 July]

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. New 'Bretton Woods'?

[Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.]

UK will play full part in considering with our partners conditions for improving international monetary system. UK view is that prudent policies among major countries offer best prospects for stable and durable system. Premature conference which ended in disagreement would be damaging.

3. World recovery under way?

[Encouraging signs of recovery particularly in US (see T~~6~~5) and Canada; also in Europe, where industrial production rose slightly in first quarter, and business confidence has improved. Expect IMF about 2 per cent growth in major industrialised countries this year.]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). Most forecasters expect recovery to accelerate during course of this year (with output rising by perhaps 2 per cent) and to continue into next year.

4. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on <u>latest available</u> figures: US (from 6.7 to 3.5 per cent), UK (9.5 to 3.7 per cent), Japan (2.8 to 2.0 per cent), Canada (11.8 to 5.4 per cent) France (13.8 to 9.0 per cent), Germany (5.3 to 3.0 per cent), Italy risen slightly (from 15.2 to 16.4 per cent).]

UK performance in bringing down inflation in past year one of the best among our major trading partners. Lower inflation has helped lay basis for signs of recovery being seen both in UK and rest of world this year.

5. Prospects for US economy?

[Administration have revised upward (for second time) their short term forecasts. Now expect growth of 5½ per cent in year to 1983 Q4 compared 4.7 per cent expected previously. Preliminary estimates suggest that GNP rose strongly by about 1½ per cent in second quarter after rising ½ per cent in first quarter and by fall at end of 1982.]

Welcome further signs of strengthening activity in US. Essential for world recovery that this trend continue. But uncertain outlook concerning budget deficit continues to threaten recovery in medium run.

6. US budget

[First budget resolution for FY 84 has now been passed by both Houses of Congress. This provides for 5 per cent growth in defence spending and additional taxes of $12 billion contributing to budget deficit of $170-179 billion compared with Administration's initial proposals of $190 billion, though this does not take account of faster growth than expected. Proposals by House of Representatives to limit benefit from 10 per cent cut in income tax scheduled for July (last of three) has been rejected by Senate, so alternative way will have to be found to finance expenditure increased in the budget resolution.]

Share widely expressed concern over size of potential budget deficit. Disappointed that so far Administration and Congress failed to agree exactly how budget deficit should be reduced. Essential that prospective fiscal deficits put on convincing downward path over medium term otherwise emerging recovery may be jeopardised by higher interest rates.

7. US has relaxed monetary policy?

[Level of M1 fell in most recent week by about $3 billion but nonetheless has risen at annual rate of over 12 per cent since 1982 Q4 - well above 4-7 per cent target range. M2 and M3 remain at the top or just above their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates; Fed is keen to sustain recovery, has successfully reduced inflation to only 3½ per cent and remains solidly committed to preventing any resurgence.

8. US interest rates

[Although the growth of M1 has slowed recently it is still well above target having grown at an annual rate of about 12 per cent since its Q4 b[illegible] compared with its 4-7 per cent target. Consequently widespread concern been expressed that Federal Open Market Committee at its meeting this week will have to tighten policy possibly leading to higher interest rates in order to slow the growth of M1. Despite policy stance remaining broadly unchanged 3 month interest rates have risen by about 1 per cent over the last 2 months.]

Difficult to foresee future level of interest rates which are largely determined by developments in markets. Have to await outcome of FOMC meeting. Fed following firm but flexible policies in face of continuing distortions (especially affecting M1). However, M2 and M3 now within, or just above, their target ranges. Lack of agreement over ways to reduce budget deficit is continuing cause for concern over future interest rate trends.

9. International debt

[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil) falls in interest rates since last summer, recent rises in commodity prices and expected growth in world trade during this year will help to improve underlying conditions.

10. Brazil about to default?

[IMF programme for Brazil suspended. As result some commercial bank facilities have been suspended and repayments to BIS postponed.]

We have always recognised that adjustment would be difficult for many debtors. Even although Brazil has not met IMF's performance criteria. Many improvements have already been made. Negotiations between Brazil and IMF are in progress. No reason to believe that satisfactory agreement will not be reached.

11. Why is legislation on quotas/GAB needed?

[On 23 June the International Monetary Arrangements Bill was introduced in UK Parliament and draft IMF (Increase in Subscription) Order laid.]

IMF Interim Committee agreed in February that quotas should be increased by 47.5 per cent. Earlier, Ministers of Group of Ten had decided that commitments under IMF General Arrangements to Borrow should be increased. The draft legislation presented to Parliament implements our share of these decisions.

12. What is timetable?

Interim Committee urged implementation of decisions increasing IMF resources by end of 1983.

13. Fund running out of money?

[The Times 27 June suggested Fund would need to raise additional resources to meet commitments over next few years.]

Fund still has undisbursed resources. New resources from Eighth Quota Review, brought forward under chairmanship of previous Chancellor, should be available early next year, together with enlarged GAB if conditions warrant.

2.37

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 11 JULY 1983

Financial Conditions

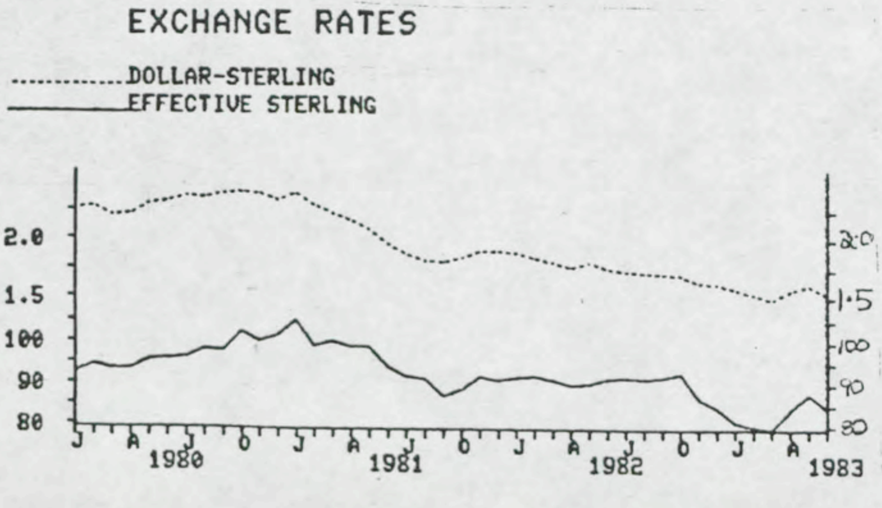
1. In the four months to June the monetary target aggregates have grown at a rate well above the 7-11 per cent range, partly reflecting high public borrowing.

Banking Months			% changes, seasonally adjusted
	M1	£M3	PSL2
March	1.2	1.0	1.7
April	1.1	1.7	2.1
May	1.5	0.6	0.6
June	1¾	1¾	1
<u>Annual % change (to June)</u>			
Target period	17½	15¾	17¾
Last 12 months	14½	11¾	12

On 7 July the Chancellor announced a set of public expenditure measures which would reduce this year's likely public expenditure outturn by over £1 billion. These measures do not imply any reduction in the PEWP planning total of £119.6 billion but rather an adjustment to bring actual spending closer to the planned path. The provisional estimate of the CGBR in June is £2.5 billion bringing the cumulative total since April 1st to £5.5 billion.

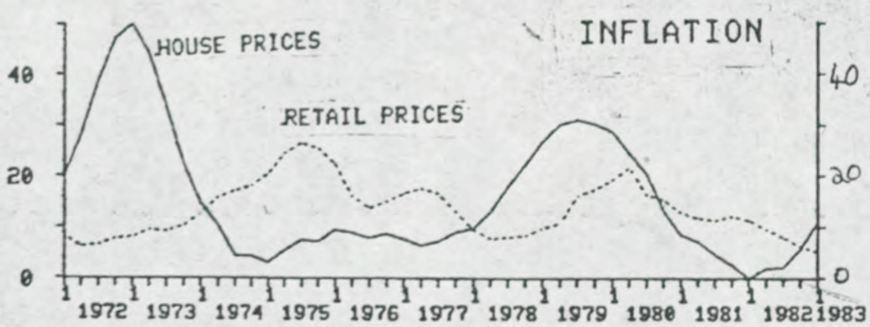
2. Bank base rates were reduced to 9½ per cent on 15 June. They are now at their lowest level for five years, apart from the period last autumn when they briefly fell to 9 per cent. The Building Societies announced on 22 June a 1¼ per cent increase in the mortgage rate, to 11¼ per cent, effective from 1 July. Apart from the last six months, mortgage rates are still at their lowest level since the summer of 1978.

3. The <u>effective exchange rate</u> is now around 85 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.



Inflation and Costs

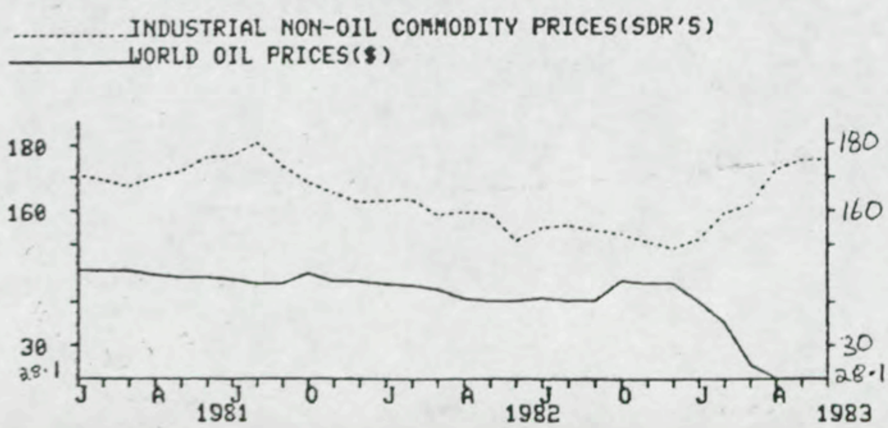
4. RPI inflation was 3.7 per cent in May, its lowest level for over fifteen years. UK inflation is also lower than the 'Major 6' average although remains higher than in West Germany (3 per cent) and Japan (2 per cent). As some of last year's favourable influences are removed from the 12-monthly comparison inflation is expected to rise to 5-6 per cent towards the end of the year. The mortgage rate increase will add about 0.4 per cent to the July RPI (published in August). Although some companies announced petrol price rises of 8p there are indications that less than half of this will stick which would add only 0.1 per cent to the RPI. In the year to June wholesale output prices (excluding petroleum products) rose by 5.7 per cent. Materials and fuel prices rose by 4.4 per cent. The prices of assets such as houses have shown more rapid increases but these are not high by historical standards.



5. Average settlements in manufacturing are currently running at about 5-6 per cent some 1½ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was 7¼ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round. Wage moderation, coupled with productivity gains (in the three months ending April manufacturing output per head was 4½ per cent higher than a year earlier) have brought down the increase in manufacturers' unit wage and salary costs to around 3½ per cent in the year to the three months ending April. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge.

6. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index though the increases in May and June were relatively modest. World oil prices appear to have stabilised in the last few months.

COMMODITY PRICES(LEVELS)



Company Finances

7. Nominal profits (for both oil and non-oil firms) of industrial and commercial companies were little changed in the first quarter and are well up on their 1980 and 1981 levels though the improvement is from an historically low level and following real declines because of inflation. This improvement is reflected in small increases in pre-tax real rates of return and in a strengthening of the company sector's financial position.

REAL NET PRE-TAX RATES OF RETURN

	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

Competitiveness and Trade

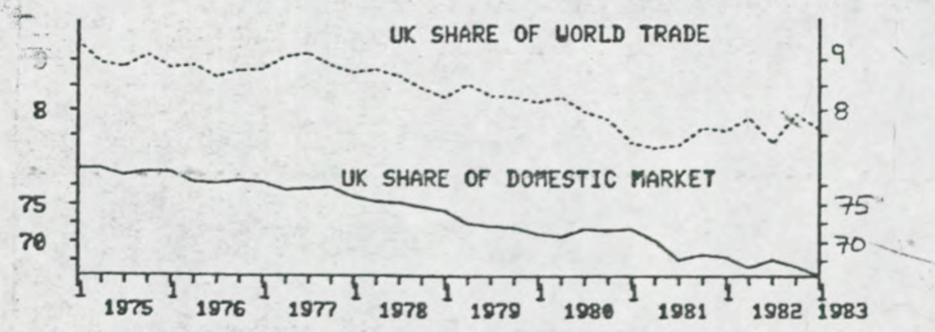
8. Manufacturing trade competitiveness can be measured in a number of ways although the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (largely reflecting the lower exchange rate) though remaining substantially worse than in the mid-1970s.

MEASURES OF MANUFACTURING TRADE COMPETITIVENESS

NB. Upward movements in the indices represent lower competitiveness.

9. The deficit on the current account increased from a revised £110 million in April to £302 million in May. However, the figures remain very erratic and it is hard to discern any clear trends. The main reason for the deterioration was the large increase in imports of erratic items (precious stones, ships, aircraft and North Sea installations) and of oil. Though this was partly offset by a marked reduction in imports of finished manufactures - particularly consumer goods other than cars. The underlying volume of non-oil exports has remained broadly flat in the last six months. Recent rises in import volumes are consistent with the turnround in stockbuilding and the underlying increase in output. Trade performance in manufactures in overseas and domestic markets is illustrated in the chart below.

TRADE SHARES IN MANUFACTURES



Domestic Demand

10. In 1982 real domestic demand - using the expenditure components of GDP - was almost 3 per cent higher than a year earlier. In the first quarter of this year there was growth of almost 2½ per cent largely resulting from the turnround in stockbuilding.

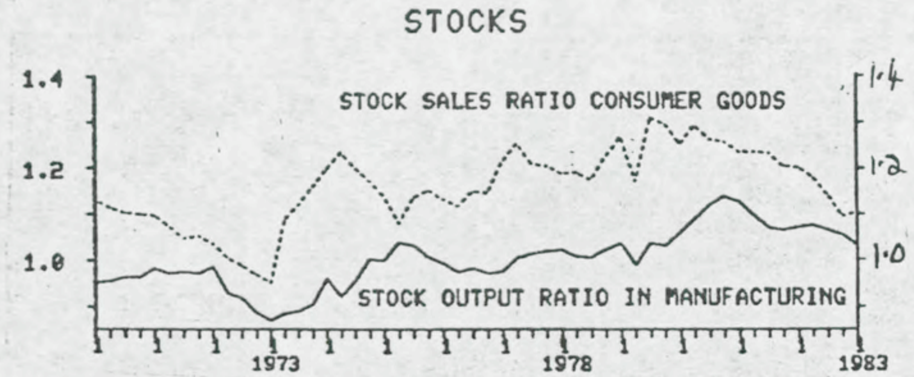
11. Much of the recovery in total domestic demand during 1982 reflected the growth consumer spending, partly reflecting lower inflation and the summer 1982 abolition of HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Consumers' expenditure fell back slightly in 1983 Q1 but is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

Year-on-year % changes

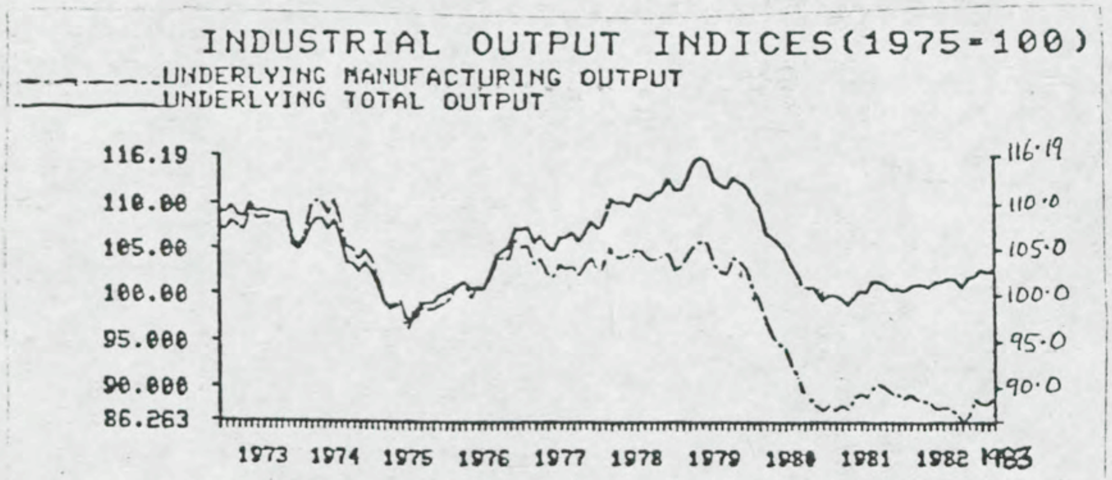
		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.0	4.3
3 months to May		na	5.8

12. Total fixed investment rose sharply in the first quarter of 1983. Upward trends in distribution and services have offset the continued fall in manufacturing. After substantial destocking (over £700 million at 1975 prices) in the second half of 1982 modest restocking (of £95 million) resumed in the first quarter of this year. Manufacturers reduced stocks further in 1983 Q1, but at a much slower rate than in 1982 H2.



Output and Unemployment

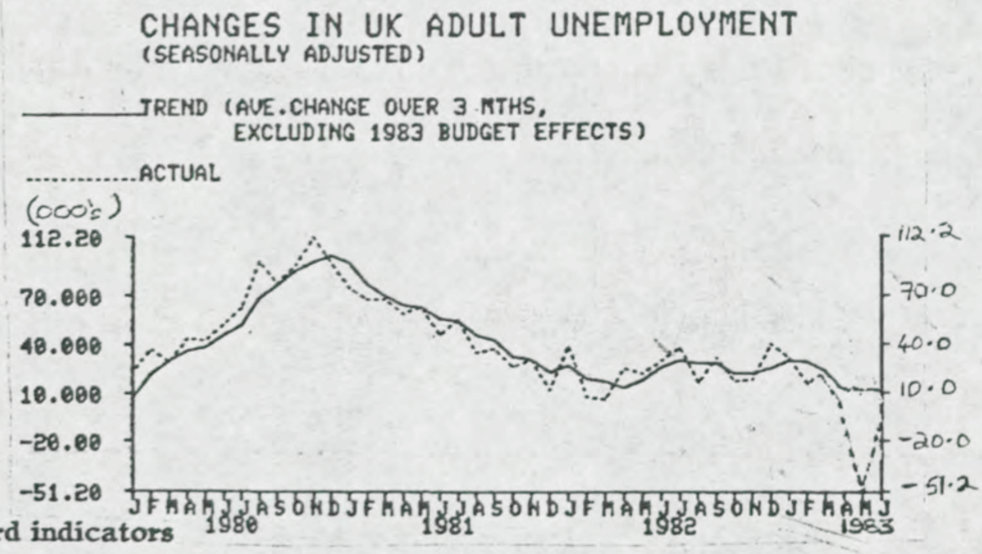
13. Total output (GDP(O)) rose by ½ per cent between 1982 Q4 and 1983 Q1; GDP(A) is now 3½ per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.



Housebuilding has been particularly buoyant although, as expected starts have fallen back in April and May from their high first quarter level. This followed a change in the unusually favaourable weather conditions at the beginning of the year. An additional factor may be the tightness of building societies' funds and much reduced bank lending.

14. However, the underlying level of unemployment is still rising - though the upward trend may have eased slightly. In June, the UK total (not seasonally adjusted) was

2.98 million (12.5 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). However, the figures are distorted by the effects of the measures announced at Budget-time (automatic credits and long-term supplementary benefit for men over 60). Allowing for these measures, the adult total rose by 19,000. Notified vacancies rose by 8,000 in June to 139,000 and remain on a slowly rising trend. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.

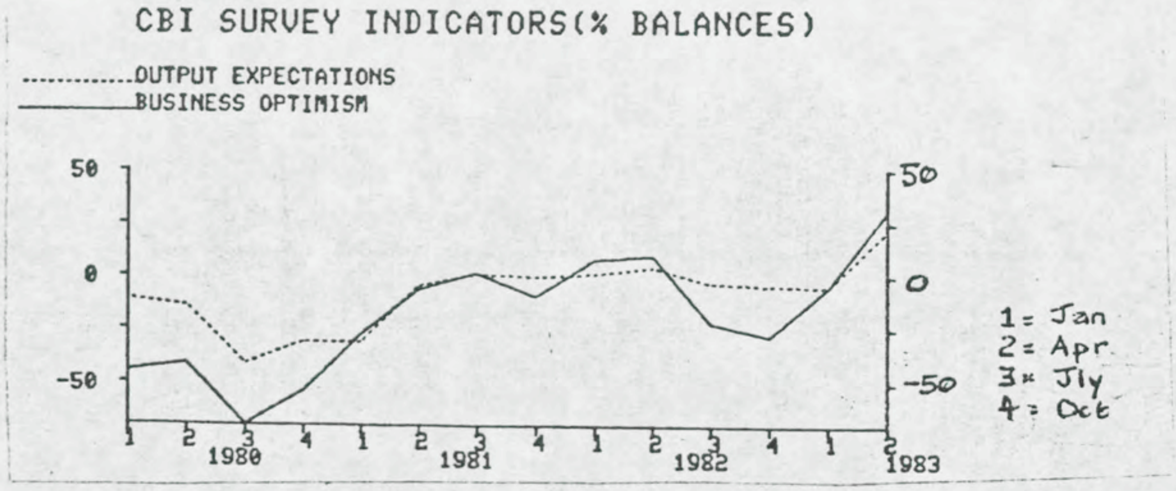


Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. Total engineering orders fell 1 per cent in 1983 Q1 compared with the previous quarter, but export orders rose by over 26 per cent the same comparison and latest forecast published by the Engineering Employers Federation expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984. The volume of new construction orders fell back 3 per cent in the three months ending April.

16. The CBI's April Industrial Trends Survey contained encouraging signs with improved business optimism (the highest net balance since 1976), order books and output expectations, and investment intentions. The results also pointed to a slowdown in destocking and job shedding. This message was further confirmed in their May and June Enquiries which showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output has been positive for five successive months and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The June Enquiry contained encouraging

results for consumer goods industries whose recent production had not matched the buoyancy of consumer spending.



The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

17. The Government forecast published with the Budget expected inflation to stabilise around the 6 per cent level by the end of 1983 and GDP growth of 2 per cent between 1982 and 1983. Since Budget-time prospects for this year have improved (Chancellor, 29 June, put GDP growth at "up to 2½ per cent" for this year and RPI inflation at "5 to 6 per cent by the end of the year". Recent outside forecasts are in broad agreement expecting GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6 per cent by the end of the year. Consumers' spending and stockbuilding are the main expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth.

Key indicators to be published in week ending 15 July

Mon	11	:	Wholesale Prices (June)
		:	CGBR (June)
Tues	12	:	Car production (June provisional)
		:	Building Societies figures (June)
Wed	13	:	Industrial production (May)
Thurs	14	:	Monetary aggregates (June final)
Fri	15	:	Retail Price Index (June)
		:	Tax and Price Index (June)

1/1

PA

PPS/CHANCELLOR

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copied to:

Mr Salveson (for transmission to No.10)
PS/CST
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PS/Lord President of the Council
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PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Trade and Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Parliamentary Secretary to the Treasury
Other Ministers with an interest and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 27 June, are sidelined.

M M Deyes

M M DEYES

12/7

R I G ALLEN
4 July 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Chancellor's speech in Debate on Address 29 June - his first major statement on economic policy as Chancellor.]

Intend to consolidate and build on progress already made in creating conditions for sustainable recovery. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. Stance of policy will shift towards reducing unemployment?

No trade off exists between inflation and unemployment. Government has important role in easing transition to low inflation-high employment economy. But to reduce unemployment on a lasting basis we need to continue fight against inflation, keep costs under control and improve productivity.

3. Future of MTFS?

Government will continue to set a framework of sound money, with an appropriate balance between fiscal and monetary policies. Heart of approach will remain the medium-term financial strategy.

4. Approach to monetary policy?

Monetary policy will continue to be operated flexibly and sensibly in light of circumstances, consistently with reducing inflation.

5. CBI critical of high interest rates/exchange rate?

[CBI saw Chancellor Wednesday 22 June and PM Monday 27 June.]

CBI not critical: like Government, would like to see lower interest rates. Also stress need not for lower exchange rate *per se* but less volatility. In line with Williamsburg consensus (see F5).

6. Borrowing out of control?

No evidence of this. But shall be watching course of Government borrowing closely over coming months; stand ready to take action if our objectives are endangered. [See also Section H]

7. Cuts in public spending on their way? Cut in real value of benefits to unemployed?

[Chancellor questioned in 'Face the Press' 3 July.]

Of course Government cannot rule out changes to public spending plans if need arises - as Prime Minister made clear during election campaign. Government 'have to look at public spending every year and afresh' (Weekend World 5 June). (See also K1 and M5.)

8. Government's 'secret Manifesto'

There is no secret Manifesto. The published Manifesto sets out Government's intentions fully and frankly. Their actions will be consistent with these.

9. Summer Finance Bill 'bonanza for the rich'?

Summer Bill result of choices made by Opposition about first Finance Bill. Measures need to be seen in context of whole Budget. Child Benefit is being increased to record levels and personal allowances raised by 14 per cent. Bill extends this 14 per cent increase to higher rate bands and investment income surcharge threshold. (See also Section J.)

10. Current economic situation

Modest recovery is under way. GDP up 3½ per cent since mid-1981. Restocking now taking place. Private investment recovering and retail sales remain buoyant. Other indicators - including recent CBI reports (latest Trends Inquiry 27 June - see B5), and CSO cyclical indicators - point in direction of continued gradual recovery. With inflation lower and evidence (eg from US and Germany) that world economy is picking up, good prospects that recovery will be sustained. (See also Section B.)

11. 'New Treasury forecast' shows GDP 2½ per cent growth in 1983?

[Press reports of Chancellor's 29 June speech.]

No new forecast will be published until autumn. Chancellor simply said during 29 June Debate that prospects - both for output and inflation - were a little brighter than expected at time of Budget, with GDP growing 'up to 2½ per cent' this year and inflation rising temporarily to '5 or 6 per cent' by the end of year. No more than slight amplification of earlier comments by previous Chancellor.

12. Bank of England Quarterly Bulletin take gloomier view than Government?

[Bank's June Bulletin published 30 June, widely reported as 'gloomy'.]

For Bank to comment on their view of economy. But Bulletin recognises 'signs of recovery' in world and UK economies and comments that modest expansion - and lower inflation - is likely to continue.

13. Outlook for unemployment?

[Guardian 31 May: Mr Lawson reported as saying '... in my judgment all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment'.]

Employment always responds to changes in output with some delay. Good progress on inflation and output has been made over past year. Much will now depend upon factors outside Government's control, including developments in world economy and our ability to hold down domestic costs. But room for some optimism about prospects. (See also Section C.)

14. New Chancellor's view of pay? Concordat with CBI?

See D9.

15. New Chancellor's view of international consensus on economic policy?

As Chancellor made clear in 29 June speech, Government continues to attach importance to working together with our partners and IMF to ensure convergence on non-inflationary growth and maintenance of a stable monetary system for world as a whole. [See also Section T.]

16. Is deficit running out of control - world interest rates heading up?

[Article by Tim Congdon in Times of 22.6.83 presented projections of exploding US fiscal deficit and predicted financial breakdown unless action taken. Key problem was that US deficit exceeded net debt interest payments so that debt accumulated rapidly.]

The US deficit is a major problem. It contributed to current high level of interest rates throughout the world. Demonstrates need to control public borrowing. Important therefore that US administration and Congress should agree on measures to put deficit on continuing declining path in medium term. (See also T7.)

17. Chancellor's meetings with Messrs Volcker/Larosiere?

See T9

18. Select Committee on Procedure (Finance) Report: Government response?

[Report published 16 June makes number of major recommendations relating to Parliamentary control of borrowing, of non-'supply' expenditure and public expenditure as a whole, and of long term expenditure projects. Also major proposals for budgetary reform, and proposals relating to contingencies fund and to provision of financial information. Report would, if fully implemented, lead to major shift of power in financial area from Executive to Legislature.]

Committee have produced substantial piece of work with large number of recommendations across whole range of financial procedure affecting expenditure, taxation and borrowing.

Government will want to consider them carefully. Detailed comment inappropriate at this stage.

BULL POINTS

Output and Demand

- Total output (GDP) up 3½ per cent on mid-1981.

- Industrial output in three months to April up 3-3½ per cent on spring 1981 trough.

- Manufacturing production recovered 1 per cent in three months to April on previous three (chemical and allied industries and electrical engineering showing strongest improvement).

- Consumers' expenditure in 1983 Q1 3 per cent up on a year earlier.

- Retail sales in three months to May almost 6 per cent up on year earlier.

- £700 million destocking in 1982H2; turn round to £100 million restocking in 1983Q1.

Prospects

- CBI (June) Enquiry balances showed (i) total order books strongest since November 1979; (ii) positive output expectations for fifth successive month; (iii) excessive finished goods stocks lowest since November 1979; (iv) expectations for increase in domestic prices still historically low.

- Fixed investment (private sector) set to rise 3-4 per cent in both 1983 and 1984.

- CSO's cyclical indicators point to continuing upswing in the business cycle.

- Outside forecasts recently suggest higher GDP growth this year than Budget estimate [NB Chancellor said 29 June that he expected an increase of "up to 2½ per cent".]

Financial Strategy

- Government borrowing amongst lowest in industrialised world.

- Public expenditure planning total in FSBR for 1983-84 (£119.3 billion) below total published in 1983 White Paper and £¾ billion below planning total in Autumn Statement. First time since 1977 that Government not increased spending plans in course of Survey.

- Short-term interest rates down about 7 points since autumn 1981.

- Official external foreign currency debt down from $22 billion in May 1979 to less than $12 billion at end-May 1983. Remaining debt now smaller in relation to imports than at any time since Second World War.

Inflation, Costs and Profits

- RPI inflation 3.7 per cent (May) - lowest since March 1968. [NB Chancellor said 29 June some temporary rise to 5-6 per cent by end-1983.]

- Output per head (manufacturing) risen 16½ per cent since end-1980 and at record levels. Output per head and output per hour now 9 and 12 per cent above previous cyclical peak in H1 1979. Manufacturers' unit wage and salary costs up 3½ per cent in 3 months to April on year earlier. (Would be lower still with NIS cut).

- Cost competitiveness (manufacturing) improved around 20 per cent since early 1981 (assuming £ effective of 84).

- Non-oil ICC's profits nearly 20 per cent above level in 1980 and 1981. (50 per cent up for oil ICC's.) Real profitability also improving slightly.

- Company liquidity at best level since mid-1979.

Labour Market

- Working days lost in May (110,000), well below average in first four months of 1983 (476,000). 5.3 million days lost last year was well below 12 million average of preceding 10 years.

Freedom, Enterprise and Initiative

- Many controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls.

- Further 13 enterprise zones announced in 1982 (total now 24).

- Civil Service now under 650,000 (1 April 1983) - cut of 11½ per cent since Government took office. On target to achieve smallest Civil Service since war by 1984

(630,000). LA manpower (GE) cut by 106,000 (4½ per cent) between June 1979 and December 1982.

- Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost ½ million public sector tenants bought their houses since May 1979; further ¼ million in process of buying.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Evidence for recovery?

[GDP (0) - the best short-term indicator of the three GDP measures - rose ½ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; GDP(O) now 3½ per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production in three months ending April was 1½ per cent up on previous three; underlying industrial output now around 3-3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1 per cent higher in three months to April than in previous three.]

Total output has recovered 3½ per cent since spring of 1981, and industrial output has recovered around 3-3½ per cent. Manufacturing production three months to April increased 1 per cent on previous three and expectations (eg recent CBI reports, CSO leading indicators) are for further increases. Consumers' expenditure in 1983 Q1 up 3 per cent on year earlier. Retail sales at record level - almost 6 per cent higher in three months to May compared with year earlier. De-stocking in second half 1983 (£730 million at 1975 prices) has been turned round into modest restocking (£100 million) in first quarter this year.

2. UK suffered worse recession than major competitors?

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (average measure) fall of over 3½ per cent - though not strictly comparable measure.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most against difficult international trade background. Growing signs of world recovery - particularly in US - should make going easier.

3. Prospects for UK economy good?

Total output growth of up to 2½ per cent in prospect for this year, and, with world background slowly improving, should be a little easier from now on. Inflation to remain moderate at 5-6 per cent by end of year. [IF PRESSED on publication of revised forecast, see A11.]

4. Latest (June) CBI Industrial Trends Inquiry

[See Commentary for details.]

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, Sir James Cleminson has pointed out that, while Inquiry results are encouraging, not all manufacturing industry has benefited yet from this steady but modest increase in business activity.

5. Is recovery sustainable?

[Mr Shore in Debate 29 June claimed sustained 2½ per cent growth 'wildly improbable'.]

Recovery has been modest but against very difficult world background; many indicators point to continuing growth. Longer term prospects look good so long as we stick to sound financial policies and work for greater competitiveness, efficiency and enterprise. Containment of costs also of crucial importance if lower inflation to be translated into lasting growth and jobs. Much progress already made (lower inflation and interest rates, improvements in productivity and competitiveness and encouragement of competitive market forces); need to consolidate further.

6. Recovery over with stockbuilding and consumption petering out?

[June BEQB 'stimulus from stockbuilding is unlikely to be repeated, nor may there be any immediate resumption of the earlier fast growth of consumer spending. May NIESR Review 'Consumer demand .... now likely to weaken'.]

Retail sales are still at record level and CBI's June Inquiry showed consumer goods firms not pessimistic about output prospects. Inquiry also showed balance of firms with excessive finished goods stocks at lowest level since November 1979. Fixed investment also growing and world recovery should make it easier for exports. Nearly all major outside forecasters see prospects of continuing modest recovery in 1983 (GDP up around 2-½ per cent), modest price inflation (around 6 per cent by end 1983) and further growth in 1984.

7. Domestic industry missing out on the consumer spending spree?

[For details of consumer spending see Commentary. Buoyancy, particularly of retail sales contrasts sharply with movements in consumer goods production. In three months to April latter was only ½ per cent up on preceding three months and was little changed from its level a year earlier.]

Consumer goods production figures disappointing. However, CBI's June Trends I shows that output expectations are particularly strong for consumer goods sector and May trade figures showed fall in value of consumer goods imports from April level. But scope remains for further improving competitiveness by moderating wage settlements and improving product design, etc.

8. Latest construction and engineering industry indicators suggest recovery over?

[Construction output and orders have fallen in recent months. Housing starts have fallen in last three months but still well up on year ago. Total engineering orders fell 1 per cent in 1983 Q1 compared with previous quarter, reflecting continuing weakness of domestic orders.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4. Some pause not surprising though latest figures are disappointing. But not too much weight should be placed on one quarter's figures, particularly when set against background of general recovery. Engineering export orders have rose in 1983 Q1 and latest forecast by EEF expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984.

9. Hasn't recent investment performance been weak?

[Total fixed investment in 1983 Q1 3 per cent up on 1982 H2 level. Manufacturing investment (including leasing) in 1983 Q1 over 4 per cent down on 1982 Q4 and over 5 per cent down in latest six months compared previous six. But total capital expenditure by manufacturing, distribution and service industries up 1 per cent latest six months compared previous six.]

Manufacturing investment has been disappointing (over 4 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment, likely to recover later this year. Fixed investment in other sectors has been stronger: total fixed investment rose almost 4 per cent in 1983 Q1 on previous quarter, and investment in distributive and service industries (excluding shipping and leased assets) almost 2 per cent on same comparison. And investment in all sectors should respond to significant improvements in company profitability and liquidity (see Section P) and growing signs of sustained recovery.

10. Investment intentions?

Latest DOI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. Outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984. First time since July 1979 that majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

11. Trade figures suggest that recovery will hit balance of payments 'stop' just as in the old days?

May figures affected by 'erratic' items and oil. Recent rise in imports and form it has taken are consistent with other indicators of industrial recovery (see also Section G).

12. High real interest rates choking off recovery?

Real interest rates are high whilst economy adjusts to low levels of inflation - just as real interest rates were negative when inflation was accelerating in 1970s. Real interest rates in UK not particularly high by international standards. Expect some fall in real interest rates in developed countries as inflation brought firmly under control.

13. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 5½ per cent in year to 1983 Q1; and overall improvement of around 17 per cent since end 1980. Some slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Also, manufacturing output now rising. Overall performance since 1981 better than could have been expected on past experience.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[June fall in 'headline' total largely reflects favourable seasonal factors and distortions due to administrative changes announced in Budget. Vacancies are on a slowly rising trend. Overtime worked remains broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	1982			1983		
	June	Sep	Dec	Apr*	May*	June*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.05	2.98
Adult sa unemployment (millions)	2.77	2.87	2.95	3.02	2.97	2.97
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+13 [+23]	-10 [+24]	-18 [+22]
Vacancies (000s)**	105	107	118	135	131	139

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

Fall in 'headline' total is welcome but mainly reflects special factors. Over next few months these factors will tend to go into reverse and 'headline' total will probably rise. However there are signs that upward trend has eased slightly. Vacancies have been rising and other indicators of economic recovery given grounds for cautious optimism about unemployment prospects.

2. True level of UK unemployment really much higher than published figure?

Gross exaggerations are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed.

3. Official figures take no account of unregistered unemployment/non-claimants?

Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Estimates in June Department of Employment Gazette show that, in 1981, these groups broadly offset each other.

4. Why has Government decided to write-off nearly ½ million unemployed as scroungers? [Reference to June Employment Gazette article].

Estimate of 400,000 on unemployment count not actively seeking work nothing new. Many independent studies have come to broadly same conclusions. These people certainly not all scroungers. Include occupational pensioners and other registered only to obtain national insurance credits (before administrative change announced in Budget), some who would welcome a job if the Jobcentre were able to offer one but are not so concerned as to consider themselves as actively jobseeking (perhaps for age or family reasons), and some who are 'unemployable' or do not believe any jobs are available for them.

5. Budget measures just Government attempts to 'fiddle' the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First two of these removed around 122,000 from June unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

6. Do revised employment estimates represent further fiddling?

[Employment Gazette article on over-estimation of fall in employment since 1981.]

No. Aim is to give best guidance we can to users on what we believe to be position. Article explains why it seems that estimates are too low, and says estimates incorporating an allowance - assuming unchanged rate of under-estimation - will be published alongside basic figures.

7. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.' 1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84.]

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies. As 1983 PEWP made clear: 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

8. Chancellor's forecast a fall in unemployment next year?

See A~~5~~7 13.

9. Unemployment in UK worse compared with other countries?

[On standardised definitions in April 1983 UK unemployment on new basis was 13.7 per cent (compared with 5.5per cent in 1979), Canada 12.4 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.0 per cent (compared 5.9 per cent), Germany 7.6 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was greater in Netherlands (over 26 per cent - rise of 3½ points in unemployment rate in May), Germany (nearly 40 per cent - 2 points in May), and Canada (21½ per cent - 2 points in May) than in UK (11½ per cent - 1.3 points in June (allowing for Budget changes)).

10. Cost of unemployment £17 billion?

Government always willing to answer questions about direct cost to Exchequer of benefits paid to unemployed. But larger figures sometimes quoted, purporting to take account of income tax and national insurance contributions foregone, unhelpful because fail to address central issue of how to reduce unemployment. Government itself cannot determine level of unemployment. Its role is to set appropriate framework in which opportunities for new jobs emerge.

11. Exchequer cost of unemployment ?

Unemployment and supplementary to people counted as unemployed currently expected to total about £5-7 billion in 1983-84 (provisional DHSS estimate in 1983 PEWP).

12. Government don't care about unemployment? Should do something about it?

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Cuts in NIS have reduced tax on jobs. Also Government creating sound foundations for sustainable growth in employment by (i) maintaining firm financial policies designed to reduce inflation and interest rates further (ii) encouraging competition, enterprise and initiative by number of 'supply side' measures. But Governments cannot do everything. Much depends on world developments and private sector's ability to hold down costs and improve competitiveness.

13. Unemployment benefits to be cut in real terms?

See M5.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in May, compared 4.0 per cent in April].

12 monthly rate of inflation again fell sharply in May to 3.7 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year

RPI scarcely rose at all between June and September last year. As a matter of simple arithmetic there is likely to be an increase in the 12 month change over corresponding period in 1983. It was made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year perhaps to about 6 per cent; if anything progress since then has been better than expected. As Chancellor said on 29 June, there is and will be no sudden resurgence of inflation of the sort we have seen in the past.

3. Effect of higher mortgage rates/petrol price rises on RPI?

[1¼ percentage points increase in mortgage interest rate (to 11¼ per cent) announced by Building Societies' Association on 22 June will add around 0.4 per cent to RPI, mainly coming through in July. Petrol price rise announced 1 July will add up to ½ per cent to RPI depending on extent to which price increase holds.]

Mortgage rate/petrol price rise only two factors amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS), likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies. Taking all factors into account, outcome could still be better than Budget forecast, with retail price inflation of 5-6 per cent by 1983 Q4.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2 (6 per cent). Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. Comparison with competitors

[May figures UK inflation 3.7 per cent compared 3.0 per cent in West Germany, 3.5 per cent in US, 9.0 per cent in France, 16.4 per cent in Italy, 5.4 per cent in Canada, and 2.0 per cent (April figure) in Japan]

UK inflation now lower than average of major OECD 6 and well below France and Italy but still some way to go to match West Germany and Japan.

6. TPI increase

12 monthly increase in TPI (3.2 per cent) over year to May 1983, now ½ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

PAY

7. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.7 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase 7¾ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings 8.2 per cent in April, compared 4.0 per cent growth in RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. 2-3 per cent settlements in next pay round?

[Report in The Times 28 June following PM's meeting with CBI previous day.]

Not yet been decided whether Government's plans for next financial year will be calculated on basis of explicit 'pay factor'. However there will be continuing need in next pay round for still lower pay settlements consistent with improved job prospects industry concerned. The lower pay settlements are, the better.

10. Recommendations of Review Bodies

[Press speculation on 1 and 2 July about proposals to be made by Government on MPs pay.]

Government published on 12 May its decisions on Reports from the Armed Forces Pay Review Body and from the Doctors' and Dentists Review Body. The recommendations have been accepted. Two reports from the Top Salaries Review Body on the salaries of the higher civil service, senior officers in the Armed Forces and the judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, are still under consideration.

E MONETARY AND FINANCIAL POLICY

[Monetary aggregates for June (provisional) to be published Tuesday 5 July]

1. What is Government's monetary policy in its second term?

Government continues to adhere to 1983 MTFS. Growth of M1, £M3 and PSL2 within last year's target range of 8-12 per cent. Target is 7-11 per cent for 1983-84.

2. What further changes in MTFS was Chancellor referring to in speech 29 June?

Chancellor made clear in his speech that substance of policy remains unchanged; 'to maintain the general thrust of a monetary policy to reduce inflation'. But also making general point that form of MTFS has evolved over past few years and may be expected to continue to evolve. (Hansard col 590).

3. Is the money supply out of control?

[M1, £M3 and PSL2 grew by 1.5 per cent, 0.8 per cent, and 0.8 per cent respectively in banking May (seasonally adjusted). Annualised growth rates of first 3 months of current target period produces rates of growth well above target range.]

Early days yet for new target range. First two months of target period affected by surge of public sector borrowing. Annualising rates of growth highly misleading when using only a few months figures. Target range is for a year as a whole, not particular months.

4. Is there a change in emphasis away from the money supply towards the exchange rate?

No. Government looks at whole range of factors in assessing financial conditions. This includes the exchange rate.

5. Does recent fall in base rates despite high monetary growth indicate a change in policy?

No. We look at a variety of indications of financial conditions. The evidence from real interest rates, inflation and the exchange rate is that monetary conditions remain sound.

6. Any prospect of a further fall in interest rates?

Sound monetary conditions and low inflation offer best basis for sustainable reductions in interest rates. Interest rate reductions are desirable, but only if not jeopardising this strategy.

7. Bank lending

[Rise of £0.9 billion in banking May after £0.2 billion in April and £0.6 billion in March banking months.]

Continues at levels well below levels reached last summer. Recent slackening continues.

8. Government view of mortgage rate increase?

[Building Societies Association announced 22 June changes in recommended interest rates, to take effect from 1 July. Mortgage rate will rise from 10 per cent to 11¼ per cent and ordinary share rate from 6¼ per cent to 7¼ per cent (basic rate tax paid).]

Sorry that mortgage rate has gone up but level of building society interest rates a matter for them, not Government. Societies have to decide their own rates in relation to demand for mortgages, which has been very strong in recent months, and level of other rates. (For effect on RPI see D3).

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 9 per cent in effective terms, 10 per cent against the dollar, 9 per cent against the D-Mark, 20 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms; on 28 March reached record low against dollar of $1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets. In run up to General Election £ strengthened, but has now fallen back to its effective levels in early May.

	October average	1 July noon	% change Oct - 1 July
$/£	1.6977	1.5336	-9.7
DM/£	4.2932	3.8906	-9.4
Y/£	460.12	366.22	-20.4
£ effective	92.5	84.2	-9.0

2. Exchange rate policy/Government wants lower exchange rate?

Government has no target for exchange rate although it is taken into account in interpreting domestic monetary conditions in Government's attitude to interest rate movements. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible, whether pound is rising or falling - though intervention cannot hope to prevent movement in face of strong market pressures or, by itself, influence rate in other than short term.

3. Overvaluation of sterling cause more than half rise in unemployment since 1979?

[TCSC 2nd report on international monetary arrangements: 'Chairman's draft' says only half rise in unemployment due to world recession but 'overvaluation of sterling was a major element'.]

No. Unemployment has risen more in UK than other countries over whole period since 1979 because our problems have been more deepseated than theirs. If UK wage bargainers had reacted quicker to outside events in 1979-81 - as wage bargainers in some other countries did - then certainly rise in unemployment would have been less.

4. Why not a joint real - or nominal - exchange rate and monetary target for future?

[Proposals appended to TCSC 2nd report on international monetary arrangements.]

The two would be bound to conflict. Which should take priority? Sensible policy is one Government has adopted. Performance of monetary aggregates is interpreted taking account of movement of exchange rate. This policy very similar to that operated in West Germany -

and quoted with approval in report. Would be wrong to try to turn this into some mechanistic rule.

5. Williamsburg Summit 28-30 May

[See also T1-2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets, bearing in mind their conclusions on the Jurgensen report (see F7).

6. Jurgensen Report - significance?

[Jurgensen report on exchange market intervention, commissioned at Versailles Summit, published 29 April.]

Report covered only narrow topic of intervention. It aimed at giving better understanding of the methods, motives and effects of past intervention. Therefore did not make any policy recommendations. Does not herald an early return to fixed exchange rates. Although it noted importance of broader economic policies in determining the exchange rate it did not consider wider issues of greater policy convergence or IMF surveillance. These questions considered at Williamsburg; will be taken further in IMF.

7. Jurgensen Report - verdict on UK policy?

Report's findings confirmed approach taken by UK Government. Government have always felt that intervention could be useful at times to help steady and calm disturbed market conditions. But always considered that consistent pursuit of sound, counter-inflationary monetary and fiscal policies is only long-term solution to problem of exchange rate instability, and that trying to solve problem through intervention alone would be misguided and ineffective.

8. Improve UK competitiveness directly by engineering further fall in exchange rate?

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset effects. Confidence would collapse and jobs be destroyed. CBI at June Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

9. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Thus for example between 1970 and 1980 West Germany's cost competitiveness deteriorated 20 per cent but she maintained her 20 per cent of main manufacturing countries' exports; Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars: their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

10. Situation has been made less stable by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in face of strong market movements. They did not control leads and lags in trade payments, nor movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations.)

11. Join EMS exchange rate mechanism (ERM)?

Difficulties over membership remain. In particular, sterling as major internationally traded currency is still being affected by oil and other factors in different way from D mark. Membership of ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

~~12. Impact on inflation of movements in sterling?~~

~~See D3.~~

12. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

1. May trade figures and current account

[Current account deficit just over £300 million in May, compared just over £100 million in April; cumulative current account surplus in first five months of 1983 £33 million, but £717 million surplus in last six months.]

Trade figures erratic month to month. Picture in May further confused because main reason for deterioration in current account was large increase (some £190 million) in imports of identifiable erratic items - precious stones, ships, aircraft and North Sea installations.

2. Trade in manufactures in deficit?

[Trade in manufactures was in deficit some £660 million in first quarter - on balance of payments basis. (NOT FOR USE Deficit on bop basis for year to May was roughly £1½ billion.) In 1982 trade in manufactures was £2½ billion in surplus.]

Deterioration in balance on manufactured trade not in itself cause for concern: a natural counterpart of improved oil balance we have enjoyed in recent years. Oil has enabled us to import more: if we had not done so it is true that we would have had even larger current account surpluses, but there would also have been larger offsetting capital outflows - is that what Opposition want? With low level of domestic inflation and prospects of reviving markets overseas, industry now has opportunity to increase level of exports and to improve market shares at home and abroad - provided costs kept under firm control.

3. Deteriorating oil balance?

Balance on trade in oil has fallen back to last autumn's levels following unusually high surpluses over the winter. Several reasons for high surpluses last winter; one was high level of domestic oil production, which has fallen back a bit since the spring; others were milder than usual winter weather and heavy drawing on stocks by UK companies, both of which tended to reduce imports and divert domestic production into exports.

4. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI Industrial Trends reports show encouraging improvement in order books and expectations of rise in deliveries over next few months.

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Recent rise in imports and form it has taken is consistent with other indications of economic revival. Increases seem to be concentrated in goods for use by industry (materials, fuels, capital equipment) rather than for consumption. May figures are in line with this overall view.

6. Import prices

Welcome news on inflation front is that non-oil import prices fell in May after increasing in recent months. Improvement probably reflects sterling's recovery since March.

7. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which - at a surplus of £1.1 billion - were down £0.6 billion on 1981.

8. Abolition of exchange controls has led to huge capital outflows?

The net capital outflows in recent years simply reflect - as a matter of arithmetic - the large current account surplus. Just as a country in deficit has to borrow abroad, a country in surplus improves its international balance sheet. Our balance between overseas assets and liabilities is in a better state than it has been for years - and this will provide a useful source of overseas revenue for the future. [Our net overseas assets were £37.7 bn at the end of 1982 compared with £12.7 bn at the end of 1979.]

9. Portfolio investment overseas continuing at a high level?

Most overseas portfolio investment is made by the institutions who invest money on behalf of people who contribute to pension funds and life insurance. It is their duty to seek to earn the best possible return on the sums with which they are entrusted. They will be prepared to invest more in the UK if the profitability of doing so improves. And that means continuing to increase productivity and control costs.

10. Overseas direct invetment replaces UK investment?

Overseas direct investment does not involve funds being drained from the country. Those who wish to sell sterling for foreign currency to invest abroad have to find someone else who wishes to invest in Britain to purchase sterling in return. If investors choose to invest abroad, that is because there is, as the Wilson Committee found, a lack of profitable opportunity at home. Nothing, including exchange controls, will force people to invest in Britain if they are going to lose their money.

11. Current account 1983 forecasts

[FSBR forecast £1½ billion current account surplus in 1983 (down from £4 billion in 1982.]

Net forecast to be published will be in Autumn, as usual. Will incorporate Treasury's latest assessment of prospects for current account at time when outlook will have become clearer. [NOT FOR USE: Treasury are updating Budget forecast but not for publication.]

12. If current account surplus slumps this year, how will the flow of overseas investment be financed?

[Current account surplus of only £33 million in first 5 months of 1983.]

Investment overseas can be financed in a variety of ways. Some is financed in foreign currency borrowed overseas and out of the earnings of overseas subsidiaries. To the extent that it is financed by capital flows from the UK these will be offset by capital inflows and the current account.

TRADE POLICY

13. Protectionism

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P~~6~~7.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers'. They emphasised importance of working through GATT.

14. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

15. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

H FISCAL POLICY AND THE PSBR

1. Does Government plan to tighten/weaken fiscal policy?

[Chancellor's speech in Debate on Address reaffirmed need to reduce monetary growth and keep PSBR low.]

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal policy?

[Aim is to achieve trend reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. PSBR has been reduced (but see H5 and 7-8). Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - lower PSBR over run of years implies lower interest rates - still holds true.

5. Why did 1982-83 PSBR overshoot?

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

6. Public expenditure out of control?

No. Simply less underspending on plans than was assumed at Budget time. No question of any failure of public expenditure control system. Only two extremely minor breaches of cash limits and year ended with large part of the Contingency Reserve unspent.

7. PSBR overshooting this year - tax increases or expenditure cuts in the offing?

[Budget forecast £8.2 billion, 2¾ per cent. As result of last year's overshoot and high figures for CGBR recently, many - but not all - outside forecasters now predict an overshoot. In 29 June Debate Chancellor said: '... we shall be watching the course of borrowing closely in the coming months, and I stand ready to take action if our objectives are endangered.]

Too early to form new view about prospect for this year. Next official forecast will be published with Autumn Statement. Government intend to continue firm control of public spending and borrowing.

8. But high CGBR in April and May surely means PSBR overshooting?

[CGBR in April to May £2.9 billion compared with £1.9 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion - next forecast at time of Autumn Statement.

9. Do PSBR overshoots mean higher interest rates?

Yes, lower PSBRs do lead to lower interest rates. But effect of overshoots limited because they do not signal change of strategy. PSBR over a run of years is what really counts.

10. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

11. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

12. UK fiscal policy tightest in world?

[IMF report said UK fiscal contraction over last 3 years was largest of any major country; OECD calls for prudent fiscal relaxation.]

Agree we have had more success in controlling borrowing than many other countries. They are now trying to emulate us. IMF and OECD support our commitment to cutting inflation and interest rates.

J TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also J15). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes. Objectives will be pursued within framework of responsible fiscal and monetary policies; without firm control of public expenditure there will be no room for significant tax cuts.

2. Summer Finance Bill

New Finance Bill published 1 July. Since it is hoped that House will complete consideration of the Bill before Summer Recess, Bill does not contain all those proposals contained in original Finance Bill that were not enacted before General Election. Bill restores original Budget proposals on higher rate tax thresholds and investment income surcharge threshold (both increased by 14 per cent), increase in limit for mortgage interest relief (to £30,000), increase in CTT threshold and rate bands, and increase in profits limits for 'small companies' rate of corporation tax. Bill also contains small number of essential provisions. Budget proposals on oil taxation that were not enacted in Finance Bill 1983 will be contained in an Oil Taxation Bill to be introduced in the autumn.

3. What happens to proposals announced in Budget but not in summer Finance Bill?

New Finance Bill deals with some important matters which need to be settled before Recess. Would have been unreasonable to ask House to consider remaining proposals - given their length and complexity - in same timescale. But new Treasury Ministers will be urgently considering these. Will examine detailed issues that have arisen on various proposals since Budget and consider representations received on measures in original Finance Bill. Where appropriate will publish draft clauses -or revised draft clauses - so that 1984 Finance Bill can be prepared with benefit of fullest possible consultation.

4. All benefits of new Bill go to the well-off?

Need to be seen in context of Budget proposals as a whole. Bill does no more than apply same percentage increase (14 per cent) to higher rate bands and investment income surcharge threshold as to personal allowances. No bias in favour of higher paid tax - cut at all income levels.

5. Increase in mortgage interest relief limit unnecessary?

£25,000 limit was set in 1974 by Labour Government. Increasing evidence that old limit was beginning to hinder growing number of families who want to buy their first home or move. (In London about a quarter of first-time buyers with new building society mortgages have mortgages of over £25,000 - Q4 1982 figures.) Increase will also help construction industry.

6. Increase in mortgage interest relief limit increases competition for funds and pushes up interest rates?

[Points made by Mr Richard Wainwright during short debate on 30 June on Resolutions for Finance Bill.]

First increase since £25,000 limit introduced in 1974. Had that figure been increased in line with RPI it would now stand at around £80,000. If parties opposite don't want to help house buyers, they should say so openly.

13. Increasing subsidies to home owners while reducing them to council tenants?

True that subsidies to local authorities have dropped. But direct help to tenants (ie including Housing Benefit) has more than doubled since 1979 - increase of over £1 billion.

8. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in income tax allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

9. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession and need for responsible fiscal and monetary policies. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

10. Government's own figures prove average family now pays more tax than in 1978-79?

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax net of child benefit in 1983-84 than they did in 1978-79.

11. Budget benefits for lower paid

Budget provided help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

12. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rose in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out. Following is based on 1983-84 earnings levels taking, for illustrative purposes, the 6½ per cent earnings increase for 1983-84 used by Government Actuary.]

Tax reductions will be greater than effect of increase in NICs for all but a small minority. [IF PRESSED: Those who will lose out are married contracted out at about 1½ times average earnings and single contracted out at between ¾ and 1½ times average earnings.]

13. RPDI figures belie Government claim that after-tax incomes rising?

[RPDI in 1983 Q1 published 29 June]

Important distinguish between take-home pay of those in work from RPDI which includes income from other sources. Moreover, latest RPDI figures relate to period before effects of last Budget had been felt.

14. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut (see J15). Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

15. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Prime Minister said (23 June) during Debate on Queen's Speech that Government hoped to abolish NIS (cost £1.2 billion in full year) during present Parliament.

16. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

Committee has produced long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to UK and are not amenable to easy solutions. Manifesto (see J1) accorded high priority to the traps, and Government will be examining draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings.

17. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

18. Unitary taxation developments in US?

Recent Supreme Court judgement that unitary taxation is legitimate applies only to US domestic companies: position of foreign multinationals has not yet been considered by Supreme Court. Government remains opposed to unitary taxation of British companies and will study Supreme Court judgement to consider what action is appropriate.

19. Rossminster

Attorney General in Written PQ on 30 June said that no criminal proceedings were to be brought following the raids on Rossminster by Inland Revenue officials four years ago. Inland Revenue will deal with liabilities for tax, interest and penalties that have come to light in course of the investigation.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Further cuts in public expenditure?

[Press speculation 1 July about tough public expenditure survey. Chancellor pressed in interview 3 July. See also M5.]

Present expenditure plans cover next 3 years only. These plans as revised by Budget show steady decline in ratio of public spending to GDP. They are starting point for current public expenditure survey. Proposals for increases or reductions to plans being looked at during survey.

2. What are implications for spending plans of ½ per cent growth assumption just circulated to NHS?

Health authorities have been told to draw up their 10 year strategic plans on assumption that resources for hospital and community health services will grow at rate of around ½ per cent a year in real terms. Has been made clear that this is not a commitment and that their plans must be flexible enough to cope with more or fewer resources. Government will be reviewing all plans for next 3 years, including those for health, in the public expenditure survey.

3. Capital spending plans lower in 1983-84 than 1982-83?

Immediate problem not making more funds available but getting local authorities and nationalised industries to spend capital provision available to them. Reduction in planned expenditure compared with last year's plans reflects fact that those plans were not realised.

4. Over-run on spending plans for 1982-83 suggests failure of public spending control?

No. (See H6).

5. Implications for 1983-84 and later years?

[1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. Total shortfall for 1982-83 compared plans announced in 1982 Budget thought at Budget time likely to be £2.2 billion but now likely to be much smaller.]

Not clear that expenditure was accelerating in any underlying sense in last weeks of 1982-83. There are one or two items of expenditure that could have fallen either side of 31 March, but in the event fell inside 1982-83. Wrong therefore to draw conclusions either about likelihood of expenditure overshooting in 1983-84 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

6. Spending running above intentions in current year?

Spending in first couple of months only slightly above profile. Too early draw conclusions. Updated expenditure analysis will be published with Autumn Statement.

7. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments and health authorities to reclaim VAT on contracted out services thus removing a disincentive to contracting out.

8. IMF conjuring trick?

Hamish McRae's column in Guardian 24.6.83 criticised present classification of UK's increased contribution to the IMF]

No conjuring trick - classification follows agreed national accounts conventions. But Guardian got it wrong in saying that if IMF lent our money to eg National Enterprise Board (NEB) there would also be no public expenditure effects:- public expenditure would be increased (planned total includes market and overseas borrowing of NEB).

LOCAL GOVERNMENT

9. Local authority overspending?

Local authority current expenditure in England some £¾ billion in excess of guidance issued by the Environment Secretary. (About half of overspending due to GLC and ILEA. All of the eighteen highest overspenders in Labour control). Overspending approximately £1 billion in GB overall. Local authorities were warned at the time of the last Rate Support Grant (RSG) settlement that such overspending would lead to holdback of grant. Details will be announced shortly.

10. RSG settlements 1984-85?

Government recognises that authorities need long notice of broad features of settlement; accordingly early announcements of grant quanta and planning totals are intended.

11. LA capital underspending

[Report by Alan Budd published 27 June offered suggestions for boosting capital spending]

Latest estimates suggest local authorities capital cash limits underspent by a little under £1 billion in 1982-83. Disappointing because it follows underspending of £¾ billion in 1981-82, but represents significant improvement on £1½ billion underspending forecast last autumn. Steps then taken to reduce underspend: PM wrote to local authority associations;

local authorities invited to apply for extra allocations (about £½ billion issued), and allowed to spend without limit on improvement grants. These measures seem to have been very successful. Steps taken to reduce risk of underspending in 1983-84: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems, LAs can spend above allocations on improvement grants, and eligible expenditure limits raised in Budget by 20 per cent, also new 'enveloping' provisions announced in Budget.

12. Revenue implications of capital projects

Concern about revenue implications should not inhibit full use of allocations: plans for relevant LA current expenditure allow for financing costs of full planned capital programmes; many capital projects have no immediate running costs eg roads, reclamation of derelict land; others will reduce running costs by rationalisation. Government cannot guarantee there will be no underspending - LAs take the decisions. But Government will be monitoring closely, and will take further action, if needed, to encourage full use of provision.

13. Control of local authority rates

Bill will be introduced early in 1984 giving power to curb rate increases of selected overspending authorities in England and Wales from 1985-86. Selection will be on basis of past performance. Powers already exist in Scotland. Bill will also provide fall-back powers to be used if it proves necessary for general limit on rate increases. Wide consultation will precede legislation. Will publish White Paper shortly.

14. Business Rates

Rates now biggest single tax paid by industry. Excessive increases damage jobs. Bill (see K 13) will also require authorities to consult representatives of non-domestic ratepayers before setting rates, and will derate empty industrial property. In meantime, considering reducing statutory maximum non-domestic empty premises rate. Also, rate level below which business ratepayer may pay by instalments will be raised.

15. Other rates reforms

Propose to make each main rating and precepting authority provide annual statement to each ratepayer. Council tenants paying inclusive rents will receive separate advice of rates level.

16. Reform of Local Government Structure

Propose to simplify structure by abolishing upper tier in London and areas of metropolitan counties. Functions to be transferred to lower tier or assumed by new joint boards comprised of nominated elected members of lower tier. ILEA also to be replaced by joint board. Special arrangements for London Transport. White Paper with details this autumn. Wide consultation, including staff, before legislation. Bill to be introduced early next Session; aim for changeover on 1 April 1986.

FALKLANDS EXPENDITURE

17. What has defending Falklands cost so far and foreseeable future cost?

[£215 million to be spent on new airport - announcement on 27 June]

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion). Cost of new airport will be contained within this provision.

18. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10½ million spent in 1982-83; further £5 million expected to be spent in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

19. Cost of paying compensation for war damage

No final figure as claims still being processed. But bulk of claims for civilian compensation settled in 1982-83 at £2.3 million. Remainder expected to be settled in 1983-84. Total expected to be in region of £3½ million.

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1929, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K7.)

3. Civil service efficiency?

Civil Service unions say drive for efficiency, motivated largely by Government's determination to reduce size of civil service, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments have explored option cuts of 5 per cent and 10 per cent and stated needs for extra staff. No decisions have been taken.

5. Management and Personnel Office

MPO now part of Cabinet Office. Lord Gowrie, Privy Council Minister of State and Arts Minister responsible for day to day issues, Mr Barney Hayhoe, Treasury Minister of State, answers in the Commons. Prime Minister, as before, in charge.

6. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of

their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative by July 1983.

7. Civil service pay negotiations for 1983 - non-industrials

Council of Civil Service Unions representing the non-industrial civil service have signified their acceptance of the agreement reached with Treasury. Agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. Cost is to be met from within provision already made for Civil Service administrative expenditure.

8. Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] An opening offer will be made at a meeting with the unions arranged for 8 July.

9. Civil Service pay in 1984-85?

[Press speculation about possible civil service pay cash limit.]

No decision has been taken on provision for pay in central government cash limits for 1984-85.

10. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

11. Top Salaries Review Body and the higher civil service

See D~~9~~.
10

M SOCIAL SECURITY

1. Next November's uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, Government has reverted to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May. Social Services Secretary put detailed proposals to Parliament on 23 June.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May - which was 3.7 per cent. Social Services Secretary gave detailed proposals to Parliament on 23 June for individual benefits. (Public Service pensions, under current legislation, will be uprated in line with State retirement pension.) Certain benefits - like Child Benefit, to be increased by substantially more.

2. 3.7 per cent uprating fails to price-protect pensions?

[Opposition will argue that inflation in year to November was forecast at 6 per cent at Budget time (although signs we are doing slightly better than this).]

No. Pensioners and other beneficiaries retain 2.7 per cent real increase in pensions given at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6 minus 2.7 = 3.3 per cent uprating. So beneficiaries better off under new system. In addition, under historic method, inflation in year from May 1983 automatically taken into account in 1984 uprating.

3. Supplementary benefit uprating?

[Last November supplementary benefit uprated for first time in line with RPI broadly adjusted for housing costs, yielding increases ½ per cent lower than for other benefits. This year supplementary benefit uprated similarly by increase in RPI less housing in year to May.]

As in last uprating, supplementary benefit will be uprated in line with increase in RPI less housing in year to May. This means an uprating of 4.3 per cent, ie 0.6 percentage points higher than for most other benefits.

4. Cost of upratings?

Improvements Government has announced will add about £1½ billion to social security budget in full year but are within Government's expenditure plans as announced in last Budget.

5. Future price protection?

[Manifesto renewed undertaking given for period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit. Speculation in Observer and Sunday Times 3 July about de-indexing unemployment benefit and Chancellor pressed on 'Face the Press' programme].

Manifesto renewed pledge, which was more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. Imprudent in present circumstances to promise more. But in November 1983 uprating both 'pledged' and 'unpledged' benefits will be price-protected. And in last Parliament most 'unpledged' benefits increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, substantially so.

6. Future of Child Benefit?

There are, as Social Services Secretary said on 27 June, no plans to change child benefit. However, as with all benefits, it must remain subject to examination for efficiency and effectiveness.

7. Improvements in 1983 besides uprating?

[These include:

Families

(i) 11 per cent increase in child benefit to £6.50 a week, highest ever real level, similar increase for one parent benefit;

(ii) £1 increase in children's needs allowance in housing benefit from April 1984, on top of 50p in November: helps 700,000 low paid families with children;

Unemployed

(iii) restoration of 5 per cent abatement of unemployed benefit;

(iv) higher long term rate of supplementary benefit to be available to unemployed men over 60 from June;

(v) men between 60 and 65 no longer need to 'sign on' to safeguard pension entitlement;

(vi) main supplementary benefit disregard up from £2,500 to £3,000; single payments disregard up from £300 to £500; new separate £1,500 disregard for life assurance policies;

Sick and disabled

(vii) abolition of 'invalidity trap' (ie inability of invalidity pensioners to qualify for long term supplementary benefit rate): pensioners over 60 get long term rate immediately, ofter after 1 year. Helps 55,000 sick and disabled;

(viii) therapeutic earnings limit - amount disabled and chronic sick can earn with doctors' approval before benefit withdrawn - up from £20 to £22.50 per week;

(ix) new mobility supplement for war pensioners;

Pensioners

(x) 14 per cent increase in pensioners' earnings limit - up from £57 to £65 per week.]

Substantial and wide-ranging improvements designed to aid most groups of beneficiaries.

N EUROPEAN COMMUNITY

1. UK refunds for 1983

Stuttgart European Council agreed to net refunds of some £440 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly two-thirds. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. No risk-sharing arrangements for 1983?

No. The arrangement provides for a fixed net refund.

4. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

5. UK objectives on EC budget for longer-term?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a modest scale.

6. Will UK agree to new 'own resources'?

HMG remains unconvinced of case for increasing the Community's 'own resources'.

7. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guidelines on its rate of growth. Key measures remain price restraint and curbs on surplus production.

8. UK Government response to Commission request for advance to meet cash crisis?

Commission has right to invite these advances. We agreed, in view of current cash position, that an advance of £113 million should be made on 20 June. This decision and the necessary arrangements were announced in Parliament on 23 June (Hansard WA 3 and 4).

9. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

10. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of growth of guarantee expenditure.

11. Costs of CAP to UK consumers

Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to reduction in the cost of food to consumers could well involve increased costs to taxpayers.

12. European Monetary System exchange rate mechanism

See F11.

P INDUSTRY

1. What is Government's view of future role of National Economic Development Council?

As PM said in her written answer to Mr Craigen on 29 June, the National Economic Development Council will continue to be a forum where the Government, the CBI, the TUC and certain others can meet on a regular basis to discuss economic and industrial issues of mutual interest.

2. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

3. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £2 billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[In 1983 Q1 gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, were nearly 20 per cent above their average 1980 and 1981 levels; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

4. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

5. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

6. 'Battle looming between Treasury and DTI over cost of export credits?

[Observer 19 June speculation.]

There is no dispute: but of course the whole range of Government payments to industry is always subject to continuous assessment.

7. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

8. Loan Guarantee Scheme?

[Nearly 10,400 guarantees already issued - about half to new businesses. Total lending under scheme over £340 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

9. <u>New Enterprise Zones</u>

Proposed sites for nine new zones in England were announced by Environment Secretary 15 November though one of these (NE Derbyshire) is not now going ahead; sites for two new zones for Scotland, one for Northern Ireland and two for Wales have also been announced. Meanwhile, the report from consultants published 26 April shows that the zones in general appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. Approach to improving nationalised industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. EFLs for 1983-84 currently total £2.5 billion.

INVESTMENT

3. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

4. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

5. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to May 1983 5.9 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

6. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

7. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

8. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

9. Future privatisation?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will

become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

10. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £500 million. Full details of receipts will be published shortly.

11. What sales included in special asset sale targets for future years?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive.

12. Action in this Session of Parliament?

Queen's Speech specifically refers to re-introduction of British Telecom legislation and proposals to transform Royal Ordnance Factories into Companies Act companies as precursor to introducing private capital. British Telecom largest privatisation ever. Legislation to permit other privatisations will be introduced as and when needed.

13. Employee share-ownership?

Many shares in previous privatisations have been bought by companies' own employees and managers which is truest public ownership of all. Around 100,000 employees have taken up shares in privatised companies. Employees, for example, given free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil, ABP); preference in allocation of shares (BAe, C&W, Amersham, Britoil, BP, ABP); provision for matching shares - one for each share subscribed for - (BAe, Amersham, Britoil, BP, ABP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company (NFC). Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. North Sea oil prices?

[BNOC reported to have agreed with companies on no change in N. Sea prices in Q3.]

Unchanged BNOC prices in third quarter reflects stability restored to oil market since OPEC March agreement. Whether this stability continues will depend on OPEC. North Sea prices a matter for BNOC who will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985? Effect on revenues?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about impact on economy of falling North Sea output. Effect of falling output on revenues will be muted because of tendency of revenues to lag behind output.

5. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields has been reintroduced. Provisions for PRT expenditure relief on shared assets will be reintroduced in autumn.

6. Benefits of North Sea should be used to strengthen economy?

Without North Sea revenue taxes would be higher or public expenditure lower. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

7. Are we really any better off for North Sea oil?

We are clearly better off for North Sea oil than we would have been without it. At today's prices, the cost of extracting it is far below the cost of buying oil on the world market. But this was not always true. At pre-1974 prices, it would have been cheaper to import oil and devote resources used in developing the North Sea to produce exports.

8. Revenues from oil being frittered away on consumption/unemployment benefits?

[Opposition spokesman on trade, Mr John Smith MP, has repeatedly accused Government of 'frittering away' on unemployment benefit the £20½ billion on North Sea revenues received since May 1979.]

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. IMF's World Economic Outlook

[IMF's World Economic Outlook published 16 June; concerning IMF's forecasts see T4.]

IMF give further support to the consensus reached at successive international meetings and most recently at Williamsburg upon need to pursue prudent monetary and fiscal policies to consolidate progress made in reducing inflation and to help reduce interest rates. The IMF also stress that any change to more expansionary policies would risk kindling inflationary expectations.

3. New 'Bretton Woods'?

[Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.]

UK will play full part in considering with our partners conditions for improving international monetary system. UK view is that prudent policies among major countries offer best prospects for stable and durable system. Premature conference which ended in disagreement would be damaging.

4. World recovery under way?

[Encouraging signs of recovery particularly in US and Canada where industrial production rose sharply in first quarter and housing starts have risen. In Europe, industrial production also rose slightly in first quarter, and business confidence has improved. IMF now expect about 2 per cent growth in seven major economies and 1 per cent rise in world trade this year, broadly comparable with FSBR forecast.]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). Most forecasters expect recovery to accelerate during course of this year (with output rising by perhaps 1½-2 per cent) and to continue into next year.

5. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.7 to 3.5 per cent), UK (9.5 to 3.7 per cent), Japan (2.8 to 2.0 per cent), Canada (11.8 to 5.4 per cent) France (13.8 to 9.0 per cent), Germany (5.3 to 3.0 per cent), Italy risen slightly (from 15.2 to 16.4 per cent).]

UK performance in bringing down inflation in past year one of the best among our major trading partners. Lower inflation has helped lay basis for signs of recovery being seen both in UK and rest of world this year.

6. Prospects for US economy?

[Administration have revised upward (for second time) their short term forecasts. Now expect growth of 5½ per cent in year to 1983 Q4 compared 4.7 per cent expected previously. Preliminary estimates suggest that GNP rose strongly by about 1½ per cent in second quarter after rising ½ per cent in first quarter and by fall at end of 1982.]

Welcome further signs of strengthening activity in US. Essential for world recovery that this trend continue. But uncertain outlook deficit continues to threaten recovery in medium run.

7. US Budget

[First budget resolution for FY 84 has now been passed by both Houses of Congress. This provides for 5 per cent growth in defence spending and additional taxes of $12 billion contributing to budget deficit of $170-179 billion compared with Administration's initial proposals of $190 billion, though this does not take account of faster growth than expected. Proposals by House of Representatives to limit benefit from 10 per cent cut in income tax scheduled for July (last of three) has been rejected by Senate, so alternative way will have to be found to finance expenditure increased in the budget resolution.]

Share widely expressed concern over size of potential budget deficit. Disappointed that so far Administration and Congress failed to agree exactly how budget deficit should be reduced. Essential that prospective fiscal deficits put on convincing downward path over medium term otherwise emerging recovery may be jeopardised by higher interest rates.

8. US has relaxed monetary policy?

[M1 has grown very rapidly in recent weeks following slight fall in April and is well above its 4-7 per cent target range set out in February. M2 and M3 are within their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates, Fed is keen to sustain recovery but remains solidly committed to preventing any resurgence of inflation.

9. Chancellor's meetings with Messrs Volcker and Larosiere?

Discussed matters of mutual interest and outlook for world economy.

10. International Debt

[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil) falls in interest rates since last summer, recent rises in commodity prices and expected growth in world trade during this year will help to improve underlying conditions.

11. Why is legislation on quotas/GAB needed?

[On 23 June the International Monetary Arrangements Bill was introduced in UK Parliament and draft IMF (Increase in Subscription) Order laid.]

IMF Interim Committee agreed in February that quotas should be increased by 47.5 per cent. Earlier, Ministers of Group of Ten had decided that commitments under IMF General Arrangements to Borrow should be increased. The draft legislation presented to Parliament implements our share of these decisions.

12. What is timetable?

Interim Committee urged implementation of decisions increasing IMF resources by end of 1983.

13. Fund running out of money?

[The Times 27 June suggested Fund would need to raise additional resources to meet commitments over next few years.]

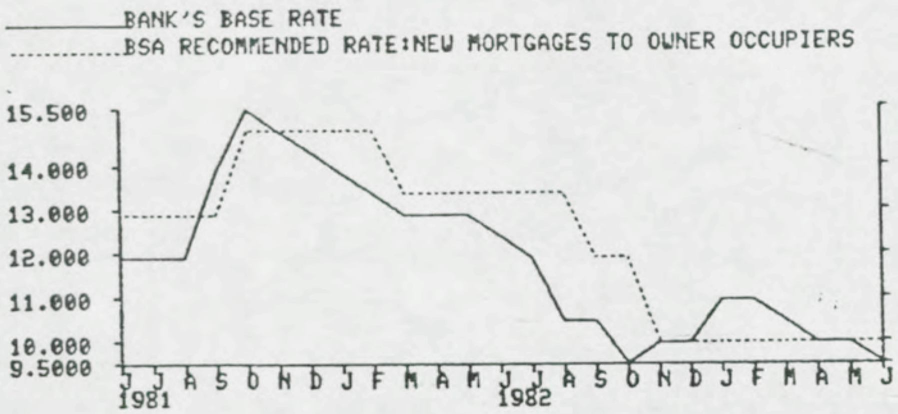
Fund still has undisbursed resources. New resources from Eighth Quota Review, brought forward under chairmanship of previous Chancellor, should be available early next year, together with enlarged GAB if conditions warrant.

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 4 JULY 1983

Financial Conditions

1. Bank base rates were reduced to 9½ per cent on 15 June. They are now at their lowest level for five years, apart from the period last autumn when they briefly fell to 9 per cent. Long-term rates have also registered slight falls. The Building Societies announced on 22 June a 1¼ per cent increase in the mortgage rate, to 11¼ per cent, effective from 1 July. This reflected a realignment of their competitive position rather than a new trend in interest rates . . Building Societies were facing shortages of funds with their inflows insufficient to meet heavy mortgage demand. Apart from the last six months, mortgage rates are still at their lowest level since the summer of 1978.

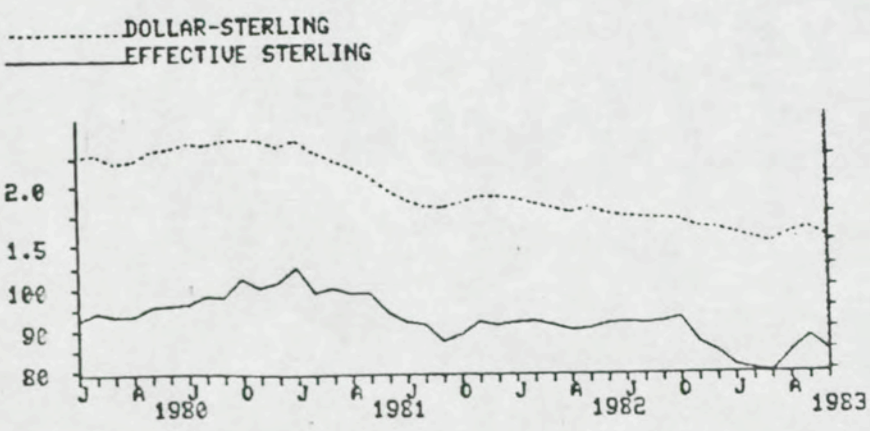
INTEREST RATES (AT END OF MONTH)



2. Although the target monetary aggregates rose more slowly in banking May, there have been large increases in the first three months of the new target period, reflecting the high level of government borrowing. Other indicators such as real interest rates, the exchange rate and inflation suggest that overall financial conditions remain sound.

3. The effective exchange rate is now around 84 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.

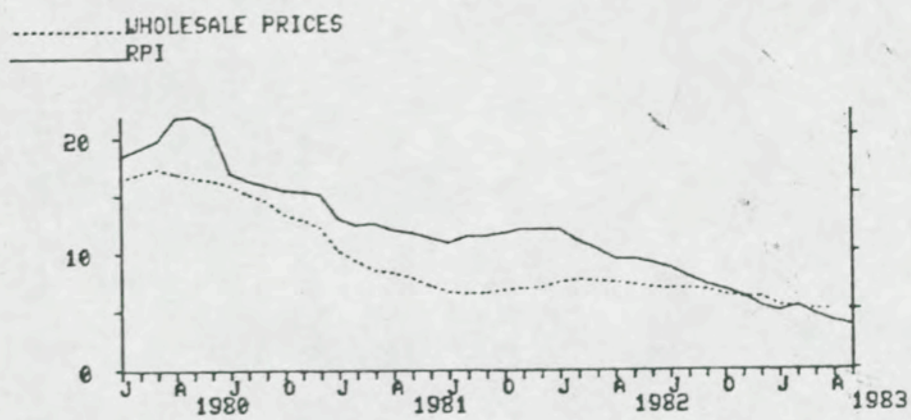
EXCHANGE RATES



Inflation, real incomes and consumer spending

4. Inflation continues to fall. The 12-monthly increase in retail prices was 3.7 per cent in May, its lowest level for over fifteen years. Other measures of inflation tend to show somewhat larger increases (the RPI has been benefitting from exceptionally low increases in food prices and previous cuts in mortgage interest rates), though still a declining trend. RPI inflation will tend to rise slightly through the second half of the year as some of the favourable influences are removed from the 12-monthly comparison. The mortgage rate increase will add about 0.4 per cent to the July RPI (published in August).

INFLATION(12 MONTHLY % CHANGES)



5. Average settlements in manufacturing are currently running at about 5-6 per cent some $1\frac{1}{2}$ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was $7\frac{1}{4}$ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round.

6. In the first four months of 1983 average earnings grew around 3 per cent faster than both the RPI and the TPI suggesting large improvements in both gross and net real earnings. On a longer term comparison the growth in real take-home pay has been more modest as has the movement in per capita real personal disposable income (which includes the net income of those out of work as well as those in work).

7. Much of the recovery in total domestic demand during 1982 reflected the growth i consumer spending, partly reflecting lower inflation and the summer 1982 abolition o HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Consumers' expenditure fell back slightly in 1983 Q1 but is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

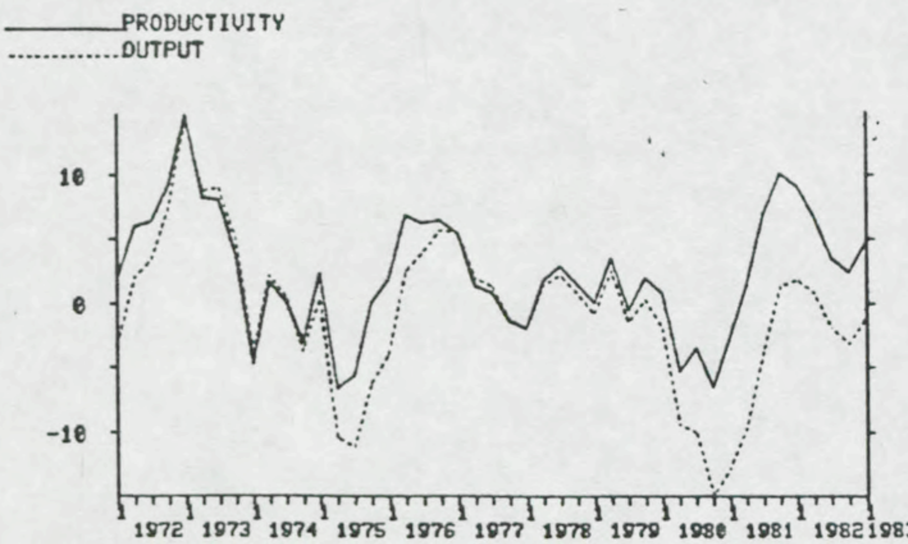
Year-on-year % changes

		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.0	4.3
3 months to May		na	5.8

Costs, Company Finances and Investment

8. In the three months ending April manufacturing output per head was up by 4½ per cent on a year earlier, and some 6½ per cent above its trough level at the end of 1980 - an impressive improvement for this stage of the economic cycle. Continued productivity gains, coupled with further wage moderation, have brought down the increase in manufacturers' unit wage and salary costs to around 3½ per cent in the year to 1983 Q1. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index, but world oil prices have weakened and, after allowing for the lower exchange rate, prices of materials and fuels purchased by manufacturers are only some 3 per cent higher than in the autumn.

MANUFACTURING PRODUCTIVITY(4 QTR % CHANGES)



Housebuilding has been particularly buoyant although, as expected starts have fallen back in April and May from their high first quarter level. This followed a change in the unusually favourable weather conditions at the beginning of the year. An additional factor may be the tightness of building societies' funds and much reduced bank lending.

9. Nominal profits (for both oil and non-oil firms) of industrial and commercial companies were little changed in the first quarter and are well up on their 1980 and 1981 levels though the improvement is from a historically low level and following real declines because of inflation. This improvement is reflected in small increases in pre-tax real rates of return and in a strengthening of the company sector's financial position.

REAL NET PRE-TAX RATES OF RETURN

	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

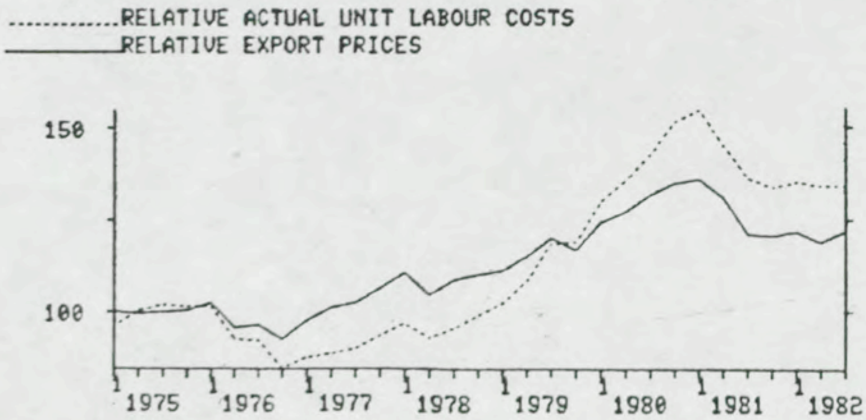
The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

10. Total fixed investment rose sharply in the first quarter of 1983. Upward trend in distribution and services have offset the continued fall in manufacturing. After substantial destocking (over £700 million at 1975 prices) in the second half of 1982 modest restocking (of £95 million) resumed in the first quarter of this year. Manufacturers reduced stocks further in 1983 Q1, but at a much slower rate than in 1982 H2.

Competitiveness and Trade

11. Manufacturing trade competitiveness can be measured in a number of ways althoug the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (largely reflecting the lower exchange rate) though remaining substantially worse than in the mid-1970s.

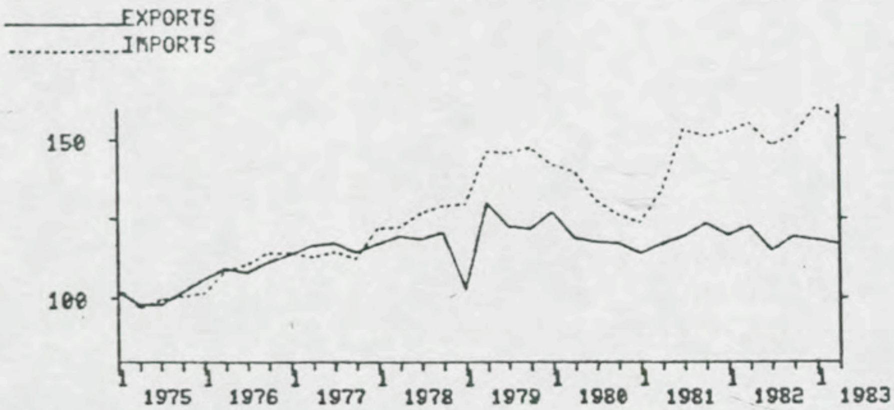
MEASURES OF MANUFACTURING TRADE COMPETITIVENESS



NB. Upward movements in the indices represent lower competitiveness.

12. The deficit on the current account increased from a revised £110 million in April to £302 million in May. However, the figures remain very erratic and it is hard to discern any clear trends. The main reason for the deterioration was the large increase in imports of erratic items (precious stones, ships, aircraft and North Sea installations) and of oil. Though this was partly offset by a marked reduction in imports of finished manufactures - particularly consumer goods other than cars. The underlying volume of non-oil exports has remained broadly flat in the last six months. Recent rises in import volumes are consistent with the turnround in stockbuilding and the underlying increase in output.

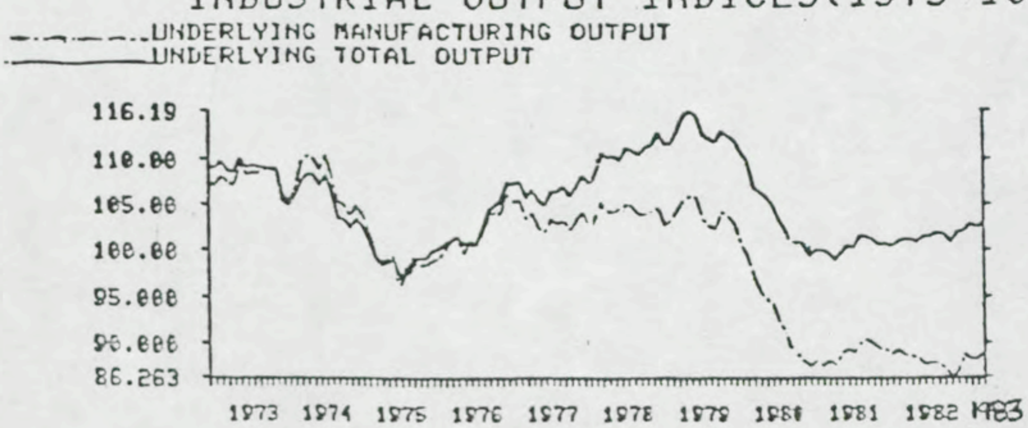
TRADE VOLUMES(EXCL. OIL & ERRATICS)



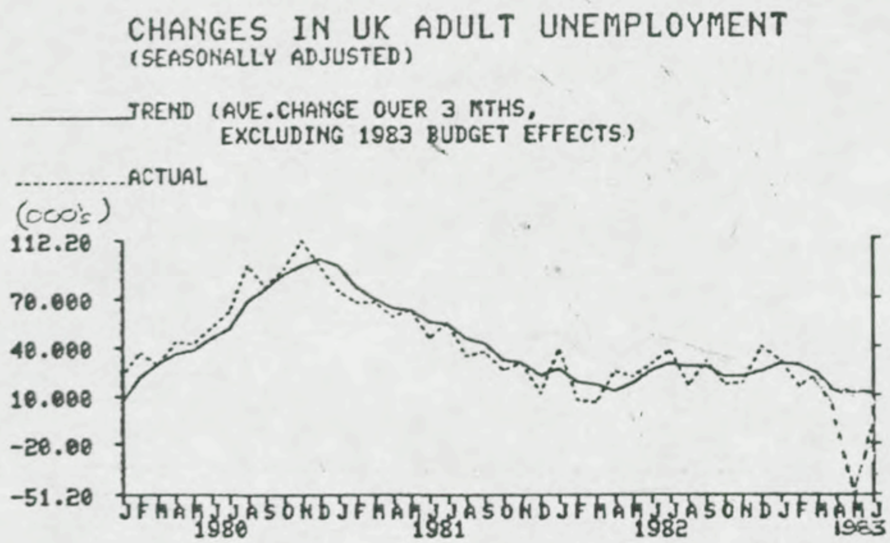
Demand, Output and Unemployment

13. In 1982 real domestic demand - using the expenditure components of GDP - was almost 3 per cent higher than a year earlier. In the first quarter of this year there was growth of almost 2½ per cent largely resulting from the turnround in stockbuilding. There is also growing evidence that a modest recovery in domestic supply is underway. Total output (GDP(O)) rose by ½ per cent between 1982 Q4 and 1983 Q1; GDP(A) is now 3½ per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.

INDUSTRIAL OUTPUT INDICES(1975=100)



14. However, the underlying level of unemployment is still rising - though the upward trend may have eased slightly. In June, the UK total (not seasonally adjusted) was 2.98 million (12.5 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). However, the figures are distorted by the effects of the measures announced at Budget-time (automatic credits and long-term supplementary benefit for men over 60). Allowing for these measures, the adult total rose by 19,000. Notified vacancies rose by 8,000 in June to 139,000 and remain on a slowly rising trend. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.

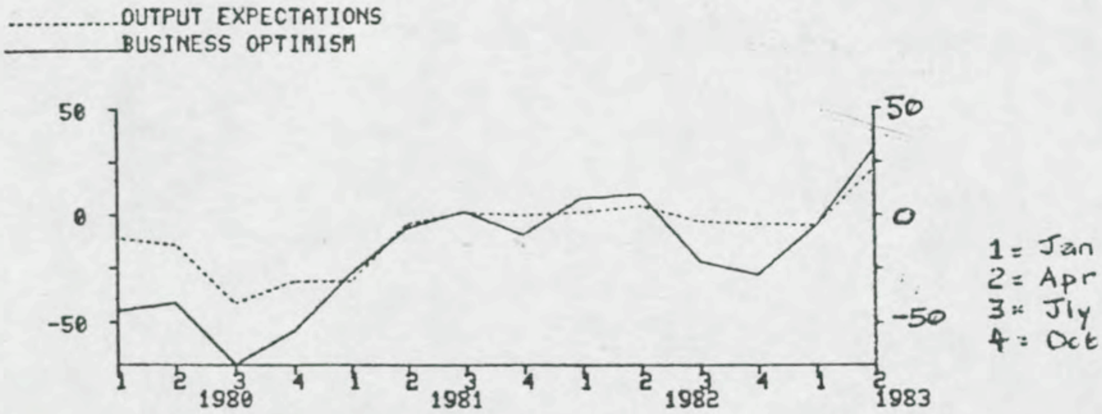


Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. However, specific indicators confirm the patchiness of the recovery. In the three months to May car production increased by 18 per cent compared to the previous three months. On the same comparison steel production was 20 per cent higher but remained 4½ per cent below the rate of production achieved in the same period a year earlier. Total engineering orders fell 1 per cent in 1983 Q1 compared with the previous quarter, but export orders rose by over 26 per cent on the same comparison and latest forecast published by the Engineering Employers Federation expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984. The volume of new construction orders fell back 3 per cent in the three months ending April. Total housing starts have fallen since February but in the three months to May were 8 per cent higher than a year earlier.

16. The CBI's April Industrial Trends Survey contained encouraging signs with improved business optimism (the highest net balance since 1976), order books and output expectations, and investment intentions. The results also pointed to a slowdown in destocking and job shedding. This message was further confirmed in their May and June Enquiries which showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output has been positive for five successive months and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The June Enquiry contained encouraging results for consumer goods industries whose recent production had not matched the buoyancy of consumer spending.

CBI SURVEY INDICATORS(% BALANCES)



The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

17. The Government forecast published with the Budget expected inflation to stabilise around the 6 per cent level by the end of 1983 and GDP growth of 2 per cent between 1982 and 1983. Since Budget-time prospects for this year have improved (Chancellor, 29 June, put GDP growth at "up to 2½ per cent" for this year and RPI inflation at "5 to 6 per cent by the end of the year." Recent outside forecasts are in broad agreement expecting GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6 per cent by the end of the year. Consumers' spending and stockbuilding are the main

expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth, though possibly at a slower rate than in 1983.

Key indicators to be published in week ending 8 July

Mon	4:	Retail Sales (May final)
	:	Credit Business (May)
	:	Housing Starts and Completions (May)
Tues	5:	Monetary Aggregates (June provisional)

Strategy

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ECONOMIC PROSPECTS

JUNE 1983 REPORT

The report on the June 1983 exercise is attached.

H P EVANS

30 June 1983

H M Treasury
Parliament Street
SW1

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ECONOMIC PROSPECTS: JUNE 1983 EXERCISE

Contents of Report

Introduction and summary

1. This internal forecast updates the Budget exercise; it is prepared on broadly similar assumptions about Government policy. The next forecast to be published will be in the Autumn Statement. A separate report on world economic prospects was circulated on 27 June; and a report on the forecasts of North Sea oil and gas is being circulated shortly. Recent developments and their relationship with the budget forecast were reviewed in the Monitoring Note of 14 June.

2. The main news in this forecast is in the higher outlook for the PSBR in the current financial year, and in the change in the scope for tax reductions in later years given the MTFS path for borrowing. Higher spending accounts for most of the upward revision. A detailed breakdown of the revisions is given on page 26. The comparison between the budget and latest forecasts is given in the following table. It should be noted that the figures below are central projections: major uncertainties still surround the total forecast for the current year.

		1983 Budget		June forecast	
1982-83	PSBR, £billion	7½		9	
	% of GDP		2¾		3¼
1983-84	PSBR, £billion	8		11½	
	% of GDP		2¾		4
1984-85	PSBR, £billion	8		8	
	(of which fiscal adjustment)	(½)		(-2)	
	% of GDP		2½		2½

3. This forecast is constructed on the basis of an unconstrained PSBR for 1983-84: we assume the maintenance of budget tax proposals and expenditure controls. For 1984-85 the assumption that the PSBR is constrained to the MTFS path by means of a change in tax rates appears to require a sizeable rise in taxation in the 1984 Budget.

4. Over the last 15 years, PSBR errors at budget time have averaged the equivalent of £4 billion; over the last five years, some £2½ billion. The flows on either side of the account approach £200 billion a year and a 1 per cent error on one side alone accounts for nearly £2 billion. Inevitably, from time to time, changes in the forecast will be large relative to policy changes and to the absolute level of the PSBR. Some further material on PSBR forecasts can be found in a paper "Forecasting the PSBR" circulated on 24 June.

5. Higher borrowing this year probably means that the rates of growth of the broad monetary aggregates, £M3 and PSL2, (as well as M1) will exceed the target ceiling. We have nevertheless assumed that interest rates stay at their present level for the rest of the financial year. Next year, the PSBR is cut - by assumption - back to the £8 billion MTFS level. This lower level of the PSBR helps to bring growth of £M3 back within the MTFS range.

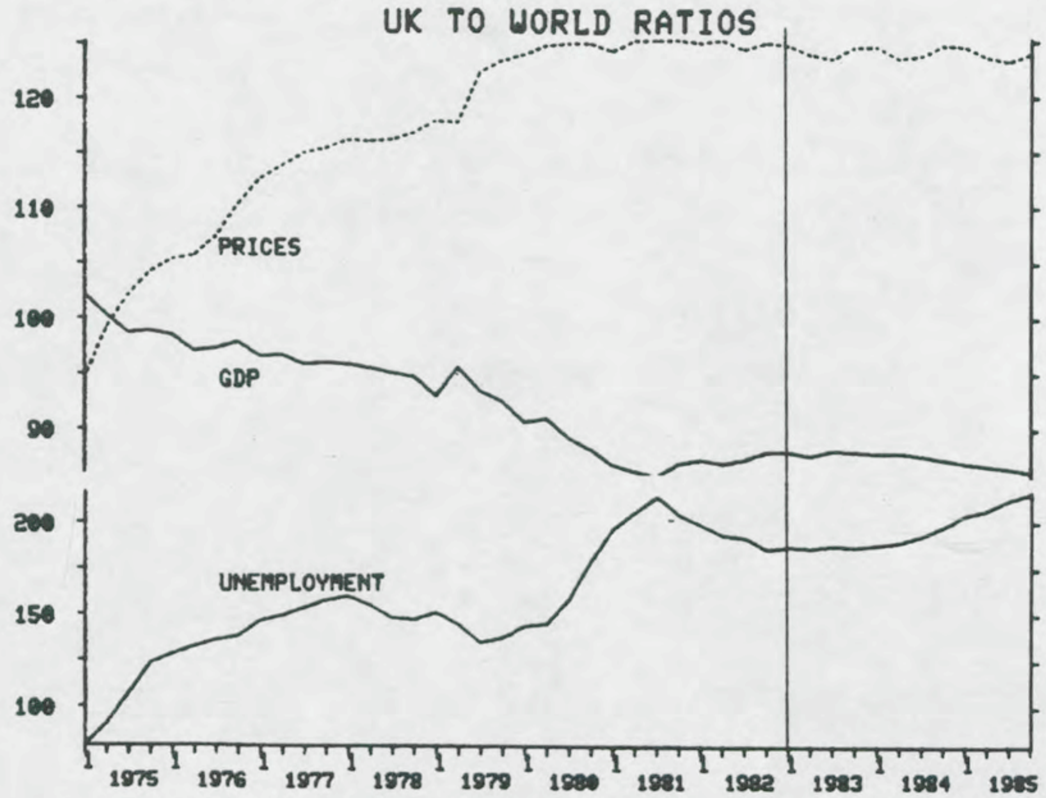
6. The more expansionary fiscal and monetary conditions emerging for 1983-84, but not by assumption beyond then, could lead to a lower exchange rate for a time, the extent depending on expectations about future policies; as well as to higher domestic demand and a worse balance of payments.

7. Inflation has come down a little faster this year than envisaged at budget time. Some further moderate decline in the exchange rate, together with rises in some commodity prices, and a little widening of profit margins, may keep the inflation trend around 5 per cent for the next year or two.

8. Output growth, forecast at 2½ per cent this year, is a little higher than the budget forecast despite slower growth in world trade. In 1984, the slower growth of domestic demand may be broadly offset by a faster rise in world demand, producing another year of 2-2½ per cent growth.

9. For the rest of the world we project a recovery which is slow by past standards and which has only a muted impact on inflation. It may be well into 1984 before substantial growth resumes in our markets in Europe and many developing countries. We now expect lower growth in our export markets than in the budget forecast.

10. A useful perspective on the UK forecast is a comparison with that of the major 6 economies (US, Japan, Germany, France, Italy, Canada) in the chart below:



11. Over the period 1981 to 1985 the forecast shows the UK's inflation and output growth close to that of our major competitors, with no major change in unemployment forecast for most countries. This is a much better performance on inflation and output than in the 1970s. Nevertheless, in absolute terms, the performance of both world and UK economies forecast for the next few years is not encouraging: despite starting from a position of low inflation and high unemployment, there is little or no improvement in either over the forecast period. Moreover there are real risks to the forecast of the world economy from the possibility of higher US interest rates.

12. With the long-term growth rate in the UK probably still below that of most of our major competitors, the tendency for demand to grow faster in the UK, already evident in 1982 and 1983, is making for faster growth in imports than in exports - with relatively slow growth of world trade, there is likely to be some further deterioration in the balance of payments. We think that the current account could be in deficit this year and next, perhaps to the extent of £1-2 billion, compared to the £1½ billion surplus forecast at budget time. Most of the difference reflects a forecast of higher import prices: higher import volumes do not contribute much. In spite of the major uncertainties, this outlook suggests that some further improvement in competitiveness is likely.

Indeed the combination of a further move into deficit on current account with a continuing desire to build up overseas portfolios could produce a sharper fall in the exchange rate than we have allowed for.

13. The 1983 MTFS made assumptions on growth and inflation over the period 1982-83 to 1985-86. These compare closely with this forecast:

	per cent growth per annum	
	Output	Inflation (GDP deflator)
1983 MTFS	$2\frac{1}{2}$	$5\frac{1}{2}$
June forecast	2	5

On these prospects, there may be little change in unemployment over the period.

14. As the FSBR said, no forecast is complete without some indicator of error margins. The average errors from past forecasts provide some guidance. Thus we could well still be £3-4 billion out on the PSBR this year; 1-2 per cent on the inflation rate at the end of 1983; 1 per cent on output; and £2 billion on the current account.

15. The uncertainties in economic forecasts can also be appreciated by examining forecasts compiled outside the Treasury, as in the Annex - though the extent of uncertainty is usually understated, since most forecasts tend to cluster together. By comparison with most outside forecasts, we are expecting a somewhat lower rate of inflation this year and later; and a larger borrowing requirement and more monetary growth in 1983-84.

16. The forecast is summarised in the table on pages 5 and 6. Detailed tables are at the back of the report. The precision of these tables is more apparent than real, and the presentation in terms of the central forecast should not obscure the extent of the uncertainties.

SUMMARY TABLE AND COMPARISON OF FORECASTS

	FSBR/MTFS MARCH 1983	INTERNAL FORECAST JUNE 1983
World Trade in Manufactures (% change on year earlier)		
1982	- 3½	- 3
1983	1	- ½
1984	6½	4
1985	6½	6
GDP Volume (% change on year earlier)		
1981	- 2½	- 2½
1982	½	1
1983	2	2½
1984	2½	2½
1985	2½	1½
Manufacturing Output (% change on year earlier)		
1981	- 6½	- 6½
1982	- ½	- ½
1983	2	2
1984	2½	2½
1985	2	1
Unemployment (UK sa excluding school leavers, millions, new definition)		
1981 Q4	2.6	2.6
1982 Q4	2.9	2.9
1983 Q4	3.0	2.9
1984 Q4	3.1	2.9
1985 Q4	3.1	3.0
RPI (% change on year earlier)		
1981 Q4	11.9	11.9
1982 Q4	6.2	6.2
1983 Q4	6	5½
1984 Q4	5½	5½
1985 Q4	5	5½
Effective Exchange Rate 1975 = 100		
1981	95	95
1982	91	91
1983	81	82
1984	82	81
1985	81	80

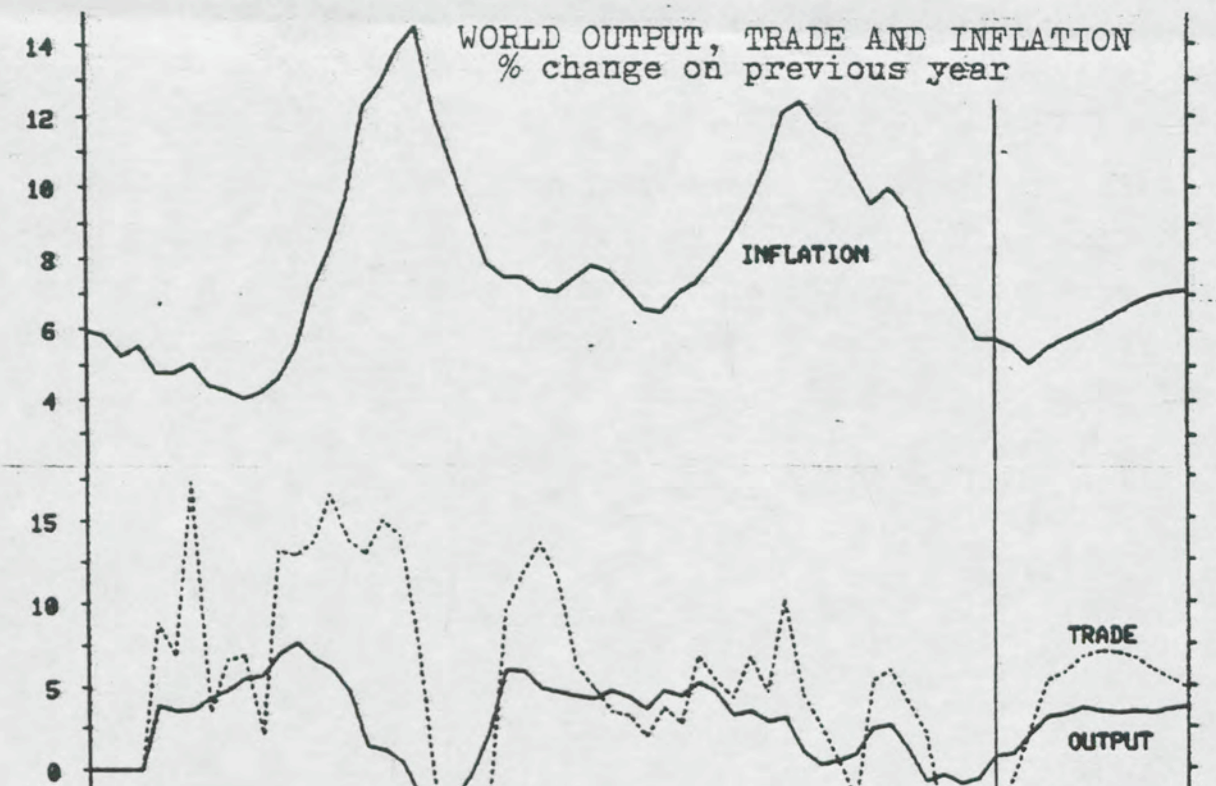
	PSBR/MTFS MARCH 1983		INTERNAL FORECAST JUNE 1983	
Current Balance (£ billion)				
1981	6		6	
1982	4		4	
1983	1½		- 1	
1984	1½		- 2½	
1985	- ½		- ½	
Nominal GDP (mp) (% change on year earlier)				
1981	9½		9½	
1982	9		9	
1983	7½		7½	
1984	8½		7½	
1985	8		7	
PSBR and fiscal adjustment (£ billion)				
1982-82	8½		8½	
1982-83	7½		9	
1983-84	8		11½	
1984-85	8	(½)	8	(-2)
1985-86	7	(4)	7	(-1½)
Interest Rates Short-term per cent				
1981-82	14		14	
1982-83	11½		11½	
1983-84	9½		10	
1984-85	8		8½	
1985-86	7½		8	
Money Supply £M3 (% change on year earlier)				
1982 Target period	13½		13½	
1983 " "	9½		11	
1984 " "	9		12½	
1985 " "	9		7½	
1986 " "	7½		7½	
M1 (% change on year earlier)				
1982 Target period	7		7	
1983 " "	12		11¾	
1984 " "	12		14	
1985 " "	12½		10½	
1986 " "	10		10	

World Economic Prospects

17. Output fell in many OECD countries in 1982, with much of the fall in demand a response to tight monetary policies and in some countries tight fiscal policies. In many developing countries imports had to be cut back sharply. All this helped bring inflation down, with some of the effects, such as lower oil prices, not being felt until 1983. The early months of 1983 provided clear evidence, above all in the United States, of recovery in demand and activity spurred on by rising real incomes and lower interest rates (at least in nominal terms). But trade and activity remained subdued in continental Europe, the developing countries and OPEC.

18. The forecast for the world economy is summarised in the following table and chart and reported in full in the June 24 report on world economic prospects.

	per cent changes			
	1982	1983	1984	1985
GNP (major 6)	-½	2	3	3
Consumer prices (major 6)	7	4½	4½	5
World trade in manufactures (UK weights)	-3	-½	4	6



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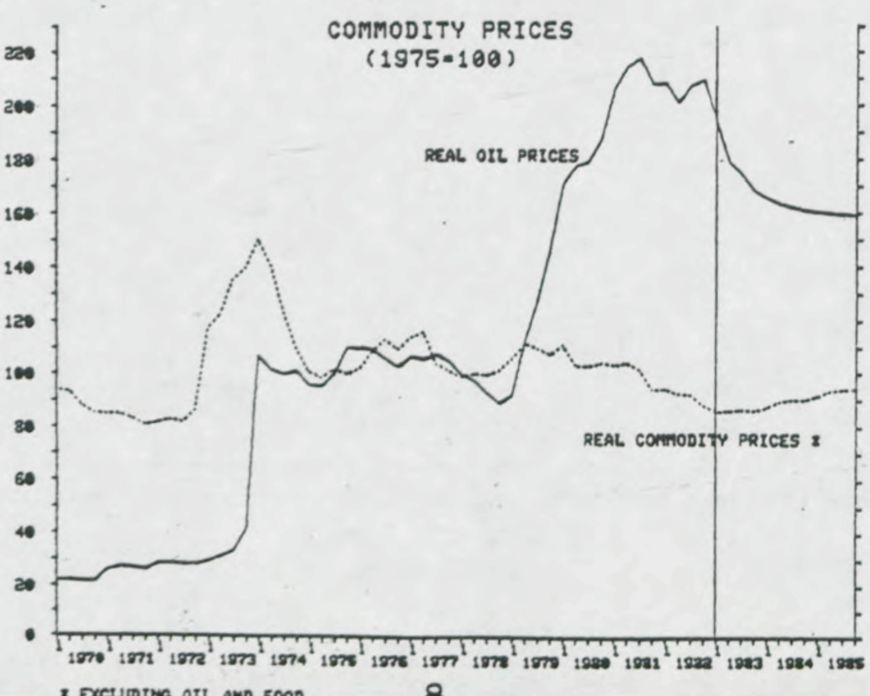
19. Policies generally seem likely to show some divergence between most European countries, attempting to reduce structural deficits, and the US where monetary policy has become more accommodating and fiscal deficits are expected to remain large. We expect a moderate growth in US demand and fast growth in US imports over the next two years, together with an increase in inflation; but continued slow growth in Europe with inflation tending to fall. There may be only a gradual recovery in the ability to import of many developing countries and none at all in OPEC. This points to very different rates of import growth:

per cent per annum	1982-84
US	11
Europe and Japan	2
Developing countries	2
OPEC	-3
(UK	7)

20. This is a slow recovery by past standards, and the pattern of import growth by markets looks unfavourable for the UK. Since the budget forecast we have revised down our expectations of world trade in manufactures, for both 1983 and 1984.

21. Even so, there are already upward pressures on some commodity prices (from exceptionally low levels, outside oil, in 1983) and we see some very limited inflationary pressures over the next three years coming from higher commodity prices. Current levels of unemployment suggest that wages should not be a source of higher inflation over the forecast period.



* EXCLUDING OIL AND FOOD

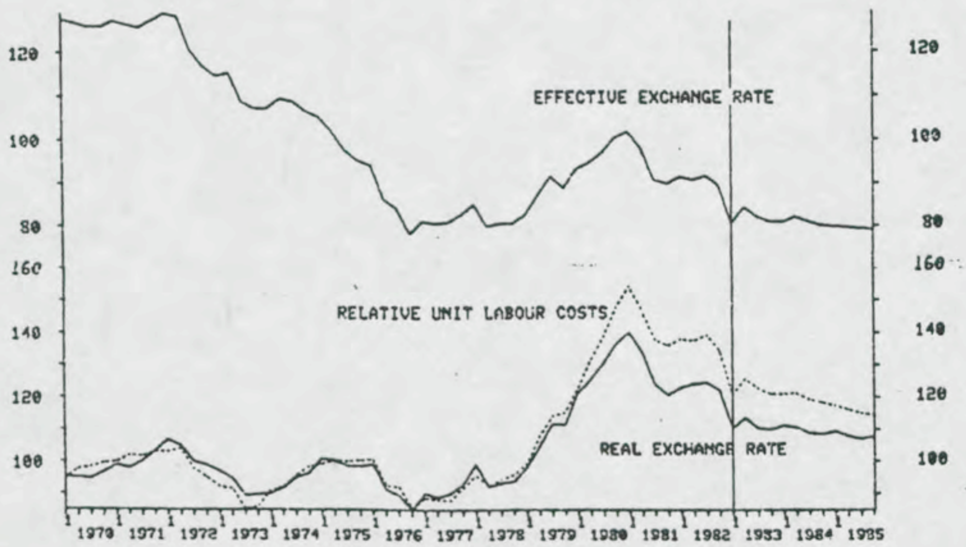
The exchange rate and competitiveness

22. There has already been a substantial fall in the real exchange rate over the past two years. Between the first halves of 1981 and 1983 the level of relative unit labour costs is estimated to have fallen 18 per cent. This was the same as the fall in the effective exchange rate: productivity increases, NIS reductions and falling pay settlements all contributed to keeping increases in domestic costs broadly in line with those of our competitors.

23. Over the next few years, the growth in prospect for the UK with present policies is close to that of other countries. At present exchange rates this is liable to involve the current account of the balance of payments moving into deficit. This could be reinforced by a continuing desire to build up foreign portfolios. In these circumstances - and aware of the great uncertainties surrounding these judgments - we think that some further fall in the real exchange rate is likely. The prospects for world and domestic inflation - and perhaps the experience of the last two years - suggests that the adjustment is more likely to come through a fall in the nominal exchange rate.

24. We therefore take the view that over the forecast period as a whole the exchange rate is a little more likely to fall than to rise. The fall could be sharper than we have allowed for if the deficit on current account - or other developments in the forecast - become a source of serious concern to the markets. The overall picture in 1983 and 1984 would not however look very different had we assumed an effective exchange rate constant in the 80-84 range. The chart below shows the paths of the effective exchange rate and of cost competitiveness.

EXCHANGE RATE AND COMPETITIVENESS



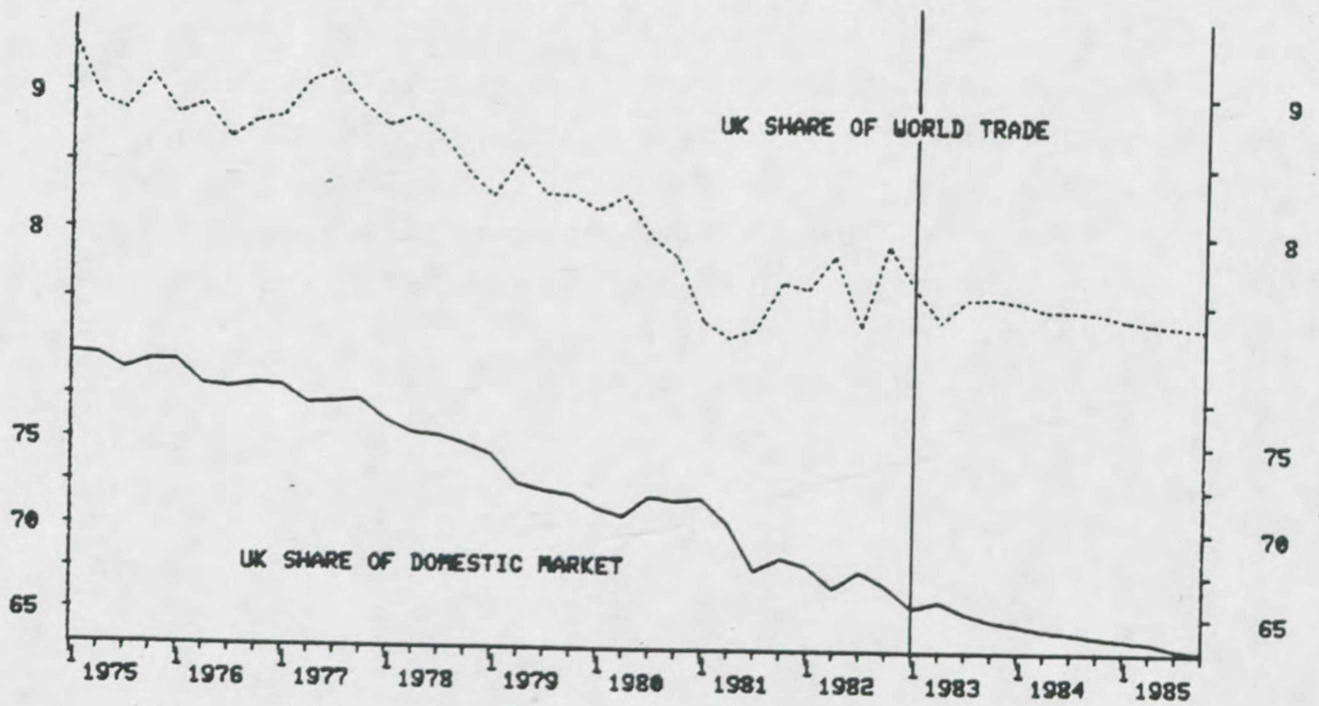
Trade

25. The underlying trend in export performance has been obscured by sharp month to month fluctuations in the statistics and by the usual uncertainty over developments in our markets overseas. The trend in export volume has been slowly downwards since the first half of 1982, but CBI survey evidence in April-June this year shows a sharp improvement in optimism about exports. With UK markets picking up (more slowly than expected at budget time) export volumes could be showing growth of perhaps 3-4 per cent by the first half of 1984.

26. As the chart suggests, export performance in 1982 was well above average, at a time of poor competitiveness. The forecast judgment is that the UK's gain in the share of world trade in 1982 will be maintained but not repeated.

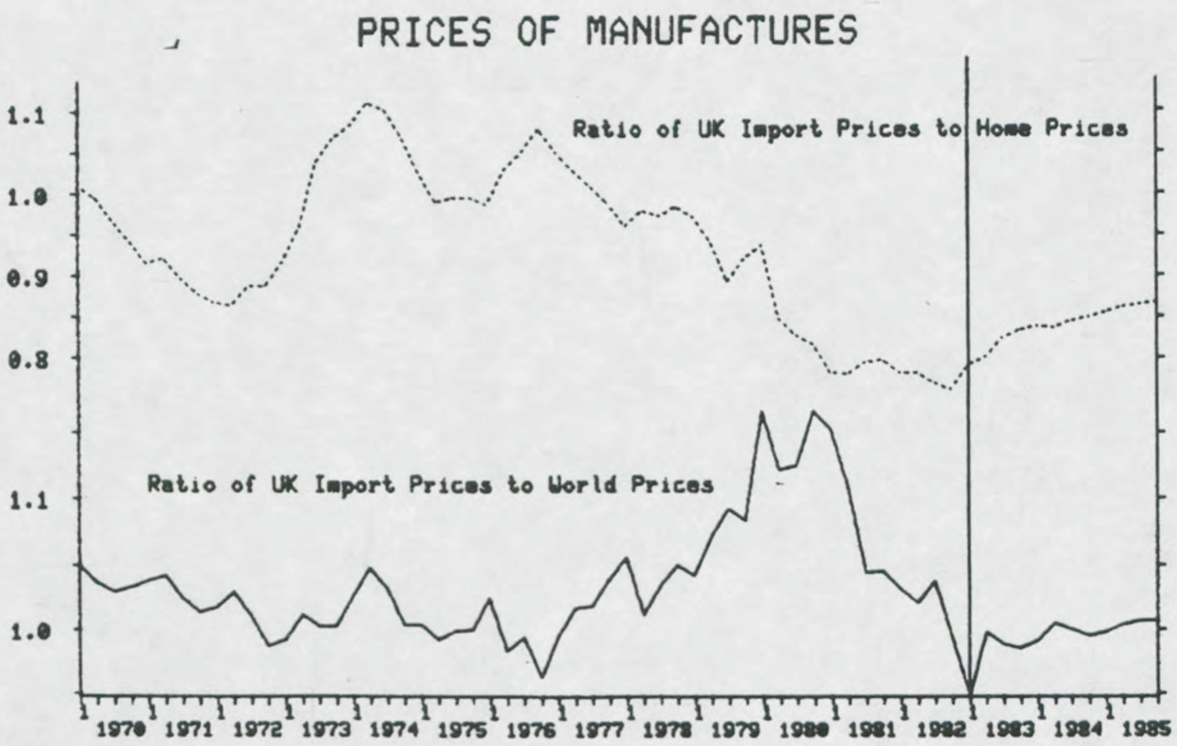
27. The chart below shows trade performance in manufactures in overseas and domestic markets. In non-manufactured goods and in services, we forecast no loss of share in these markets, in line with past trends.

TRADE SHARES IN MANUFACTURES



28. The fall in the share of the UK market for manufactures taken by domestic producers - that is, the rise in import penetration - has been going on for many years, though interrupted at times by bouts of destocking. We expect further rises in import penetration, though less rapid than in the period 1978-82, because of improving competitiveness.

29. Import prices are an important part of total costs and, particularly in the case of manufactures, an influence on the prices charged by UK producers. In turn, importers normally price their goods giving some weight to domestic prices. When the exchange rate was at its peak in early 1981, importers were able to charge lower prices, on average, than their UK competitors while charging more in the UK than in other countries. The present position - shown in the chart below - is that since the fall in the exchange rate over the past two years importers are now charging prices in the UK much more in line with those charged elsewhere. But the level of import prices still looks low in relation to domestic prices: a significant constraint on UK inflation.



30. At budget time we were looking for a surplus on current account in 1983 of £1½ billion. The deterioration since then reflects higher UK demand relative to world demand and a somewhat higher level of import prices, and hence worse terms of trade, already evident in recent trade figures. The surplus on invisibles should improve, particularly in later years as activity and profitability in the world economy pick up, and as US interest rates rise relative to UK rates. The table below summarises the prospect:

£ billion

	Visible balance Oil	non-oil	Invisibles	Current balance
1981	3	0	3	6
1982	4½	-2½	2	4
1983	6 (6½)	-9½(-9)	2½	-1
1984	5½	-11½	4	-2
1985	6	-12½	6	-½

Figures in brackets for 1983 show the first five months data at an annual rate.

Inflation

31. The rapid fall in the rate of inflation as measured by the Retail Prices Index exaggerates to only a modest extent the underlying fall in inflation. The rate of increase in the RPI is currently less than trend mainly because of the falls in the mortgage rate last year and the low level of seasonal food prices. The table below compares the RPI with a price index for the whole of private consumption.

	per cent increases on a year earlier	
	RPI	Consumers' expenditure deflator
1980 second quarter	21½	19
1981 second quarter	11½	10½
1982 second quarter	9½	8½
1983 second quarter	4	5½ (forecast)

32. Since 1980 the growth in unit labour costs has also come down, more rapidly than earnings growth over the last two years, because of increased productivity and reductions in the National Insurance Surcharge.

Whole economy

		per cent changes on a year earlier	
		Earnings	Labour costs per unit of output
1980 second quarter		21	23
1981 " "		12½	13
1982 " "		9½	5
1983 " "	(forecast)	7½	3

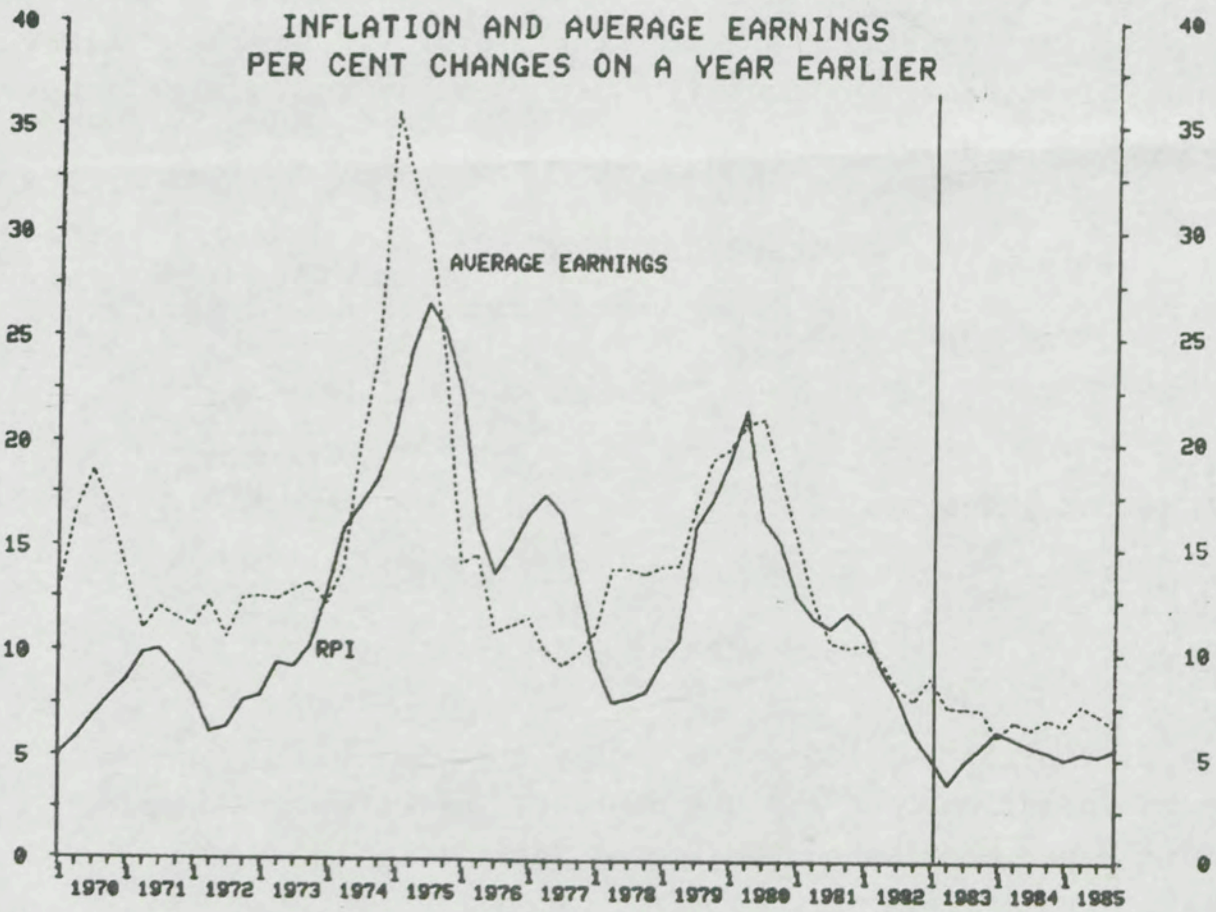
33. For the rest of 1983, the prospect is for little change in the rate of inflation. On the RPI measure, inflation is currently running ½ per cent below the budget forecast.

34. The forecast takes account of the rise in the mortgate rate (which will add 0.4 per cent to the total index, mainly in July) and continued slow rises in the private sector (and, this year, in nationalised industries as well). By the fourth quarter of 1983 the RPI may be 5½ per cent up on a year earlier.

35. <u>Pay settlements</u> have been running at about 5½ per cent since the autumn, consistent with a growth in earnings of 7 per cent or a little less. For the next pay round (ie from September/ October 1983 onwards) a further fall in the rate of settlements is probable, but may be very limited:

i) Inflation - looking backwards - will be several points lower than last autumn; but tending to rise rather than to fall.

ii) We are looking for recovery in output and the demand for labour (with unemployment flattening out), together with some continuing recovery in profitability, helped by a further reduction in NIS.



36. Inflationary expectations can be measured in a number of ways. Published inflation forecasts (now being revised downwards) average 6 per cent for end 1983 and 7 per cent for end 1984 (see Annex). The relationship between yields on indexed and conventional gilts suggests that longer-term inflationary expectations are now running 3 or 4 per cent lower than a year ago. Industrialists' expectations of inflation, measured qualitatively in the CBI Survey by the balance of firms expecting prices to rise, are running rather higher than in the second half of 1982, but still at a fairly low level.

37. Further ahead, the prospects for inflation (and unemployment) turn to an important extent on the role of demand and competitiveness in price and wage formation. On one view, the high level of unemployment and spare capacity will lead to a continuing trend towards lower inflation, given financial policies which inhibit large changes in the exchange rate or other asset prices. Another view gives greater emphasis in generating inflation to projected increases in capacity utilisation, to the expected levelling off in unemployment, to the rise in world demand generally - and in some versions to the prime role of costs (particularly wage costs). On this view there are now pressures for higher inflation.

38. Our own forecasting experience - cautiously giving weight to both views as much empirical work suggests we should - is that domestic inflationary pressures have continued to abate more than expected over the past two years. This is despite a little rise in capacity utilisation in manufacturing and some flattening in unemployment. We continue to give most weight to the dampening effect of slack in the economy.

39. Externally, however, commodity prices (except oil) have generally strengthened this year and we see a small continued rise in real terms, together with a slow fall in the exchange rate, as tending to offset the domestic pressures.

40. Over the next year, a further fall in real oil prices (helped by a fall in the dollar) is forecast to provide some downward pressure on inflation. By the end of 1984, most measures of inflation could be around 5 per cent or a little more; with the possibility of a higher rate of inflation in 1985.

41. Since 1981 the real cost of labour to employers has been declining: the increases in unit labour costs shown in the table in paragraph 32 have been clearly less than the rate of increase in prices charged. Part of this difference affected rising import prices; but part reflected a rise in profitability from the trough in 1981:

Rate of return
(pre-tax, industrial and commercial companies, outside the North Sea)

per cent

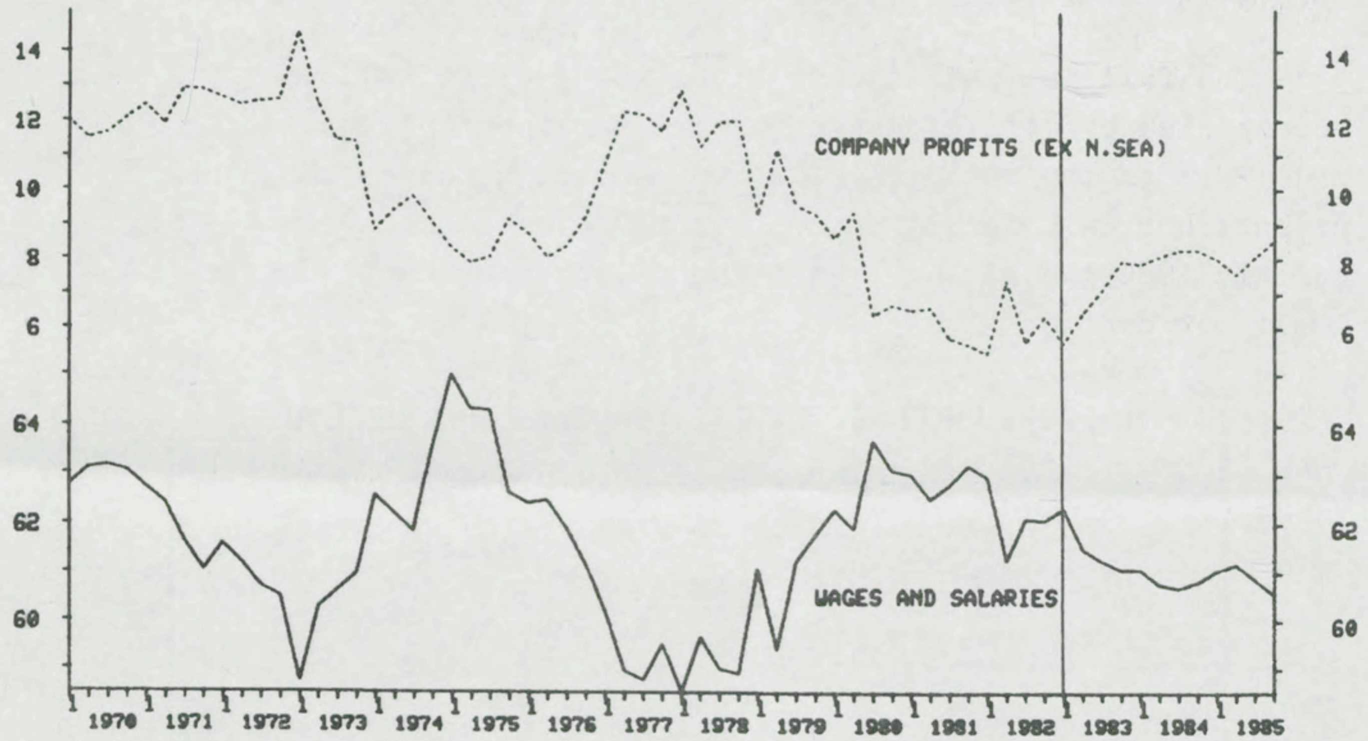
1973-79 average	6½
1980	4
1981	3½
1982	4
1983-85 (forecast)	5

(While real wages paid by employers have been declining, the real wage received by the average employee - which benefits from productivity improvements reflected in prices - has been rising since mid 1982).

42. The steep fall in profitability in 1979 and 1980 resulted from the rapid acceleration in costs, ahead of prices, and then from the slowdown in price rises ahead of cost rises. From 1981, as already documented, labour (and total) costs rose more slowly than prices. The fall in the real exchange rate and the recovery of output have also contributed to the recovery in profits. But this has been modest mainly because the extent of the recovery in output outside the North Sea sector has been limited, and because despite the fall in the real exchange rate competitive pressures in the UK and elsewhere have remained very strong.

43. The implications of these projections of domestic inflation, productivity and output for the distribution of income between wages and profits are set out in the chart below:

SHARES IN TOTAL NON-NORTH SEA INCOME, PERCENT

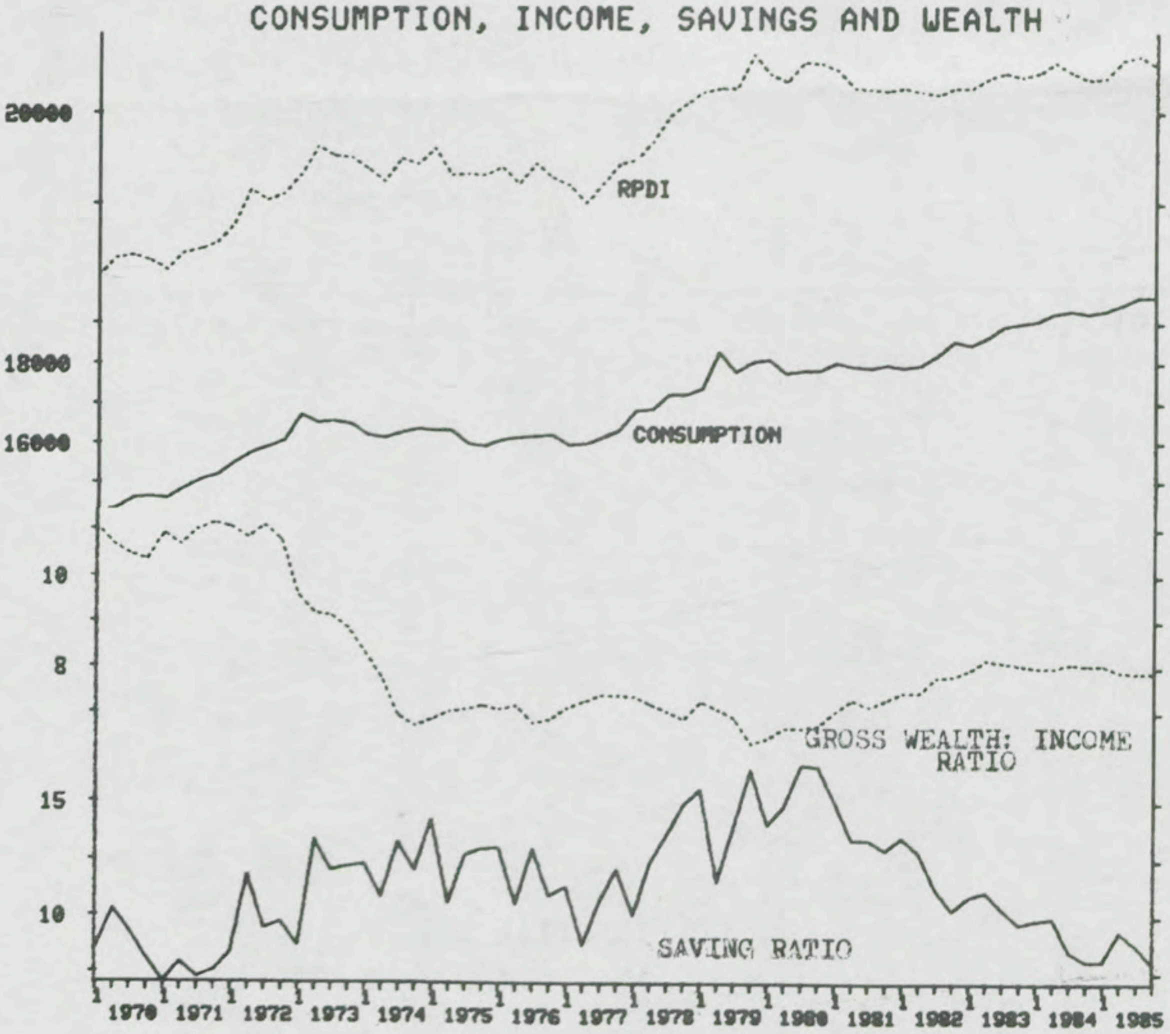


Domestic demand and output

44. Consumer demand has risen quite strongly with expenditure on durables running 20 per cent up on the first half of 1982. The increase reflects the fall in interest rates in the second half of 1982 and the abolition of HP controls last July, as well as the modest rise in real personal incomes since mid 1982. The high level of borrowing from banks and building societies also contributed to the rise in spending - though it is difficult to establish cause and effect.

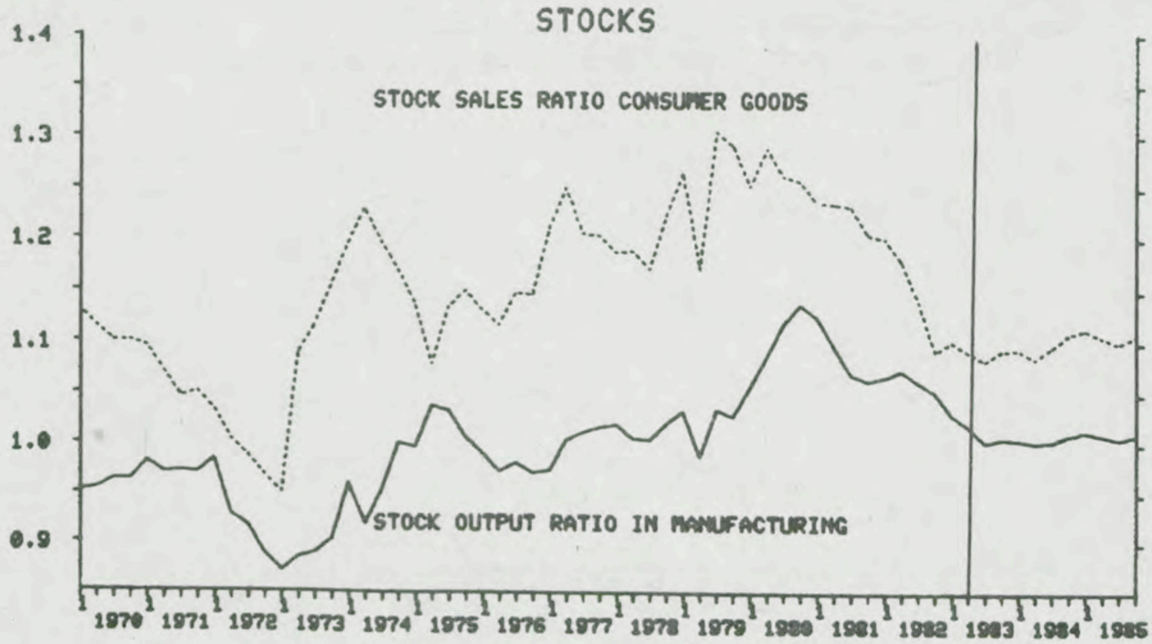
45. The fall in real incomes since the peak in 1980 was accompanied by little change in consumer spending until mid 1982: as the rate of inflation came down and as the stock of bank borrowing built up, consumers saved less. From 15½ per cent in 1980 the saving ratio has fallen in recent quarters to 10-11 per cent.

CONSUMPTION, INCOME, SAVINGS AND WEALTH



46. The chart shows how the personal sector has begun to rebuild its financial wealth*: the ratio of wealth to income has been rising over the last year or two, and is forecast to rise further over the next year, before levelling off. Lower interest rates (which increase the value of fixed-interest securities and equities) and high borrowing together with lower inflation more than offset the fall in the flow of savings. It is still very uncertain how far consumers wish to go in rebuilding their stocks of wealth: we have assumed that they are content with the position since 1974, and do not wish to go all the way back to the much higher stocks (in relation to income) of the late 1960s and early 1970s. If so then consumers will need to save a lower proportion of their income than in recent years: at about 9 per cent next year, the forecast savings ratio is close to the average for the period 1965-72, compared to 13 per cent in the period 1973-1981. Housing starts in the private sector have been running at a level 50 per cent up on 1981. Investment in dwellings is forecast to be up by a third by 1985 over the 1982 level, with only a moderate rise in the relative price of houses.

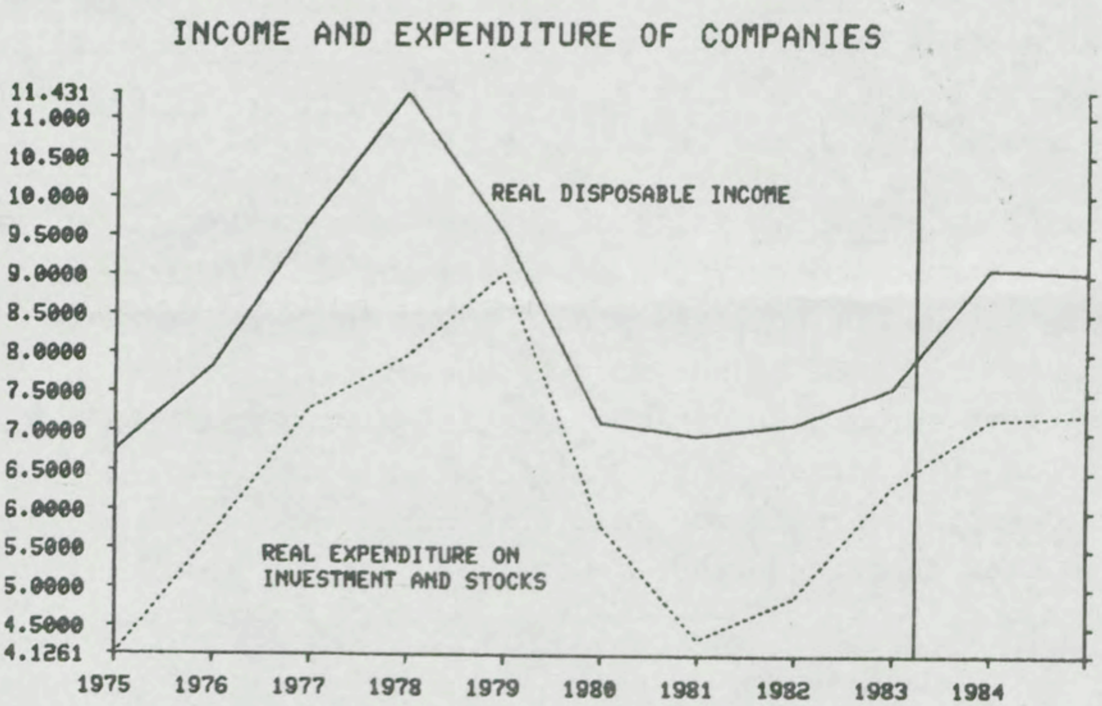
47. Spending by companies faltered in the second half of 1982 as the boom in consumption gave manufacturers and distributors an opportunity to run off unwanted stocks. The fall in stocks in the second half of 1982 helped to make the stock/output ratio look less above normal, though the apparent upward trend in the series in the 1970s makes that a difficult judgment. Early in 1983 firms' growing confidence in a continuing recovery in demand encouraged them to raise production rather than run down their stocks further.



*defined as the total of all financial assets owned by the personal sector.

48. Indications from the investment intentions survey suggest that industrial investment will rise again in 1983 and 1984, reflecting the expected growth in the economy and helped by the fall in nominal (though not real) interest rates in 1982. Within the total, manufacturing investment could level out in the course of 1983.

49. The relationship between company income and expenditure (for the industrial and commercial companies, excluding those operating in the North Sea) is shown in the following chart:



50. Since early 1980 companies have fully reversed the sharp reduction in their gross* liquidity ratio sustained in 1979-80 as inflation rose, and this suggests scope for the reduced borrowing and increased spending that is a feature of early 1983 and the forecast period.

ICCs GROSS LIQUIDITY: RATIO TO TOTAL FINAL EXPENDITURE

51. There has also been a contribution to higher demand from the public sector: not only did the large decline in public investment come to an end last year but the encouragement to spend up to cash ceilings helped to produce an end year spurt in spending by central government and local authorities. The higher spending forecast for 1983-84 also adds to demand, particularly in the construction and defence sectors.

per cent increases on a year earlier

	1981	1982	1983	1984	1985
Personal consumption	½	1	3	2½	1½
Change in Stockbuilding (as per cent of level of GDP)	0	1	1	½	0
Fixed investment (public and private)	-9	5½	3	4	2½
Public consumption	0	1	2½	½	½
Total domestic demand	-1½	3	4	2½	1½

*ie before deduction of bank borrowing.

52. With better competitiveness and profitability, there are reasonable prospects (and recent indications) that a substantial part of this demand will be met from higher production at home. The growth in demand in 1983 is entirely domestic; as this slows in 1984, we expect world demand for our exports to be picking up, producing another year of growth of about 2½ per cent in domestic output.

	1981	1982	1983	1984	1985
Exports of goods and services	-2½	½	½	3½	4½
Imports of goods and services	- ½	5	5½	5	2½
Gross Domestic Output	-2½	1	2½	2½	1½
Manufacturing Output	-6½	-½	2	2½	1

53. The prospects for manufacturing output are considerably more uncertain than for total output: although the CBI surveys suggest higher output this year, we have generally been too optimistic about manufacturing output.

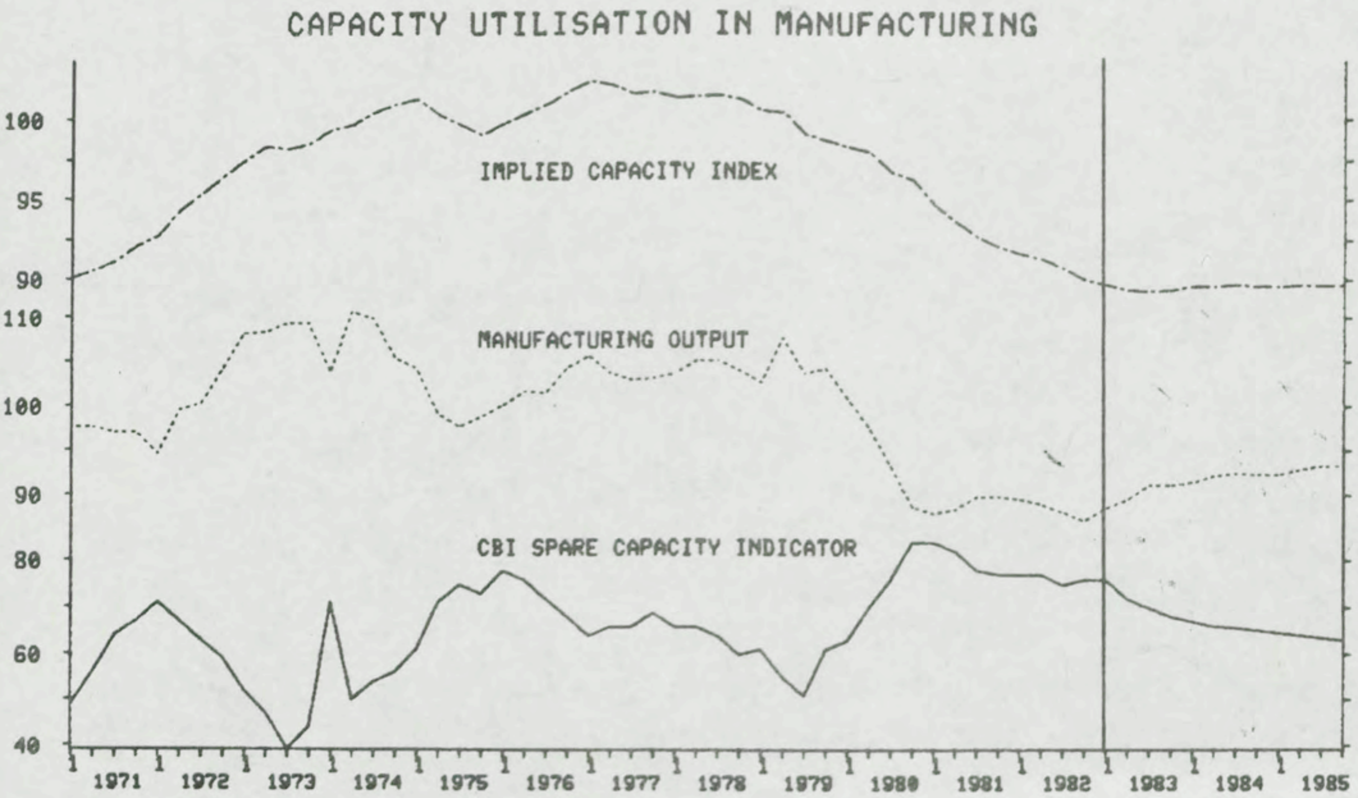
Unemployment and spare capacity

54. In the two years to early 1983, employment in the whole economy (taking account of DE's latest upward revisions) fell by about 1 million, or 4 per cent, three quarters of which was in manufacturing, the rest being in the nationalised industries.

55. Over the forecast period the recovery in demand and the continued fall in real labour costs should lead to a flattening out and perhaps some rise in employment in total. We assume that from now on the trend growth of productivity in manufacturing returns to a more normal rate (but since manufacturing output is rising ahead of employment, for a time, we can expect actual productivity rates of possibly 4-5 per cent to the first half of 1984 for cyclical reasons). In the private sector outside manufacturing (with employment about twice that in manufacturing) productivity growth may be in the 1-2 per cent range, with some prospect of employment increasing.

56. The population of working age is growing by ½-1 per cent each year. We and DE judge that the rise in the labour supply will be much the same and so the rise in employment in the forecast is about matched by the rise in labour supply, leaving unemployment close to its current level.

57. The chart below shows the proportion of firms (according to the CBI Survey) operating below normal capacity utilisation; together with the level of manufacturing output. We also show a line entitled "implied capacity index" derived from the two other lines. This estimate of capacity is extremely rough and ready, but probably gets the direction of movement right.



58. Between early 1981 and early 1983 CBI members reported a fall in the proportion working below normal capacity; yet over this same period output has been little changed. This implies that the level of capacity in manufacturing has continued to fall - reflecting the closure or part closure of firms and plants. In view of the better trend in manufacturing output and investment over the forecast period, and perhaps some reassessment of the concept of "normal" capacity, we have not allowed for any further fall in the level of capacity over the next few years. With output forecast to rise, the margin of spare capacity may fall to about the 1970s average.

Public Sector

59. The forecast of the public sector assumes that the 1983 Budget proposals are enacted in full; and that public expenditure cash controls are maintained. The unexpectedly high level of public spending and borrowing in the March-May period of 1983 has already led some commentators to expect an upward revision to the PSBR forecast for 1983-84. This forecast suggests an upward revision of some £3½ billion.

60. The major revisions to the budget forecast are set out in the table on page 26.

61. The reasons for the revisions fall into the following broad categories:

(i) Higher spending and borrowing in 1982-83 by central and local government, influencing judgments about 1983-84.

(ii) Specific factors increasing expenditure in 1983-84, the main ones detailed in the table on page 26.

(iii) Lower revenues in 1983-84, with projections of low rates, lower surpluses by nationalised industries and low income tax offsetting higher receipts from the North Sea.

Changes in the general economic outlook have not contributed a great deal.

62. There remain of course major uncertainties about the current year. We have examined the record of PSBR forecasts to gain some idea of the relability of the June forecast, relative to the FSBR. Over the period 1967 to 1982, the error on the budget forecast averaged (regardless of sign) nearly 1½ per cent of GDP, equivalent in 1983-84 to some £4 billion. Evidence suggests that the improvement between the budget and June forecasts is worth on average nearly ½ per cent of GDP, or around £1 billion.

63. Over the past five years the errors in the June forecast averaged the equivalent of £2½ billion.

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MAIN CHANGES TO THE BUDGET FORECAST OF THE PSBR IN 1983-84

	Changes to Expenditure (£ billion)	Changes to Receipts (£ billion)	Comments
Central Government Receipts			
1 Inland Revenue (non-North Sea)		-0.6	Mainly lower forecast of wage and salary bill; also more tax relief on mortgage interest.
2 Total North Sea Receipts		+0.8	Mostly higher production levels.
3 Customs & Excise		0	Forecast of poorer compliance than expected at budget time; offset by higher consumer spending.
Central Government Expenditure			
4 Cash-limited items	+0.6		Lower estimate of shortfall reflecting experience in 1982-83 (particularly on defence) and fresh look at historical experience by programme.
5 Non-cash-limited items of which:	+1.1		
Agricultural Support	(+0.3)		Higher beef production and lower beef prices; higher milk production.
Grants	(+0.3)		Higher estimates of take-up of housing benefits; higher estimate of number of social security recipients.
Family Practitioner Services	(+0.1)		Poor estimate at Budget time.
EC Contributions	(+0.3)		Mainly lower refund.
6 Debt Interest (net)	+0.5		Effects of higher borrowing and estimating revisions.
7 Central Government Financial Transactions		-0.3	Assumed delay in sale by BGC of North Sea oil interests.
8 Local Authorities Borrowing	+0.9		
of which: Rate Income		(-0.5)	Poor estimate of average rate increases this year.
Current Expenditure	(+0.3)		Implications of higher overspend than expected in 1982-83.
9 Public Corporations' Borrowing	+0.3		
of which: Nationalised Industries' Trading Surpluses		(-0.5)	Downward revision to industries' expected sales this year (reflecting new information from industries); some price increases reduced or delayed.
PSBR total change	+3.5		

64. Another approach is to consider the revisions between FSBR and June forecasts: in one year it went in the wrong direction; but in six cases the direction was right. Where the changes between the FSBR and June forecast were substantial (more than 1 per cent of GDP) the June forecast was invariably better than the FSBR. On the two previous occasions when (upward) revisions to the PSBR between the Budget and June forecast approached or exceeded 1 per cent of GDP, the final revision was larger.

65. Higher volume expenditure in 1984-85 is the main reason why the fiscal adjustment - shown as a £½ billion reduction in taxes in the FSBR - now emerges as an increase in taxation worth £2 billion in PSBR terms. Such estimates are liable to large margins of error. They depend crucially on the judgments about public expenditure (see paragraphs 68 to 69).

66. The stance of fiscal policy can be measured in a number of different ways:

	1980-81	1981-82	1982-83	1983-84	1984-85
PSBR as percentage of GDP	5½	3½	3¼	4	2½
Inflation tax, % of GDP	4¾	4¼	2½	2½	2¼
"Real" PSBR ie nominal PSBR less inflation tax as percentage of GDP	+¾	-¾	+¾	+1½	+¼

67. These measures point to fiscal policy becoming less tight in 1982-83, and again in 1983-84; but tightening up in 1984-85, given the assumption of a lower PSBR brought about by income tax increases. Since 1981-82, the changes in the PSBR would not be greatly different if output were growing at a trend rate of say 2 per cent per annum.

Public expenditure

The planning total in this forecast compares with the budget forecast as follows:

	1981-82	1982-83	1983-84	1984-85
£ billion cash				
Planning total - Budget/PEWP	104½	112½	119½	126½
Planning total - June forecast	104½	114	121½	126½
£ billion cost terms (cash deflated by the GDP deflator), 1981-82 prices				
Planning total - Budget/PEWP	104½	105	105½	106
Planning total - June forecast	104½	106½	108½	107½

68. There has been a rise in the forecast of cash expenditure in 1983-84 of about £2 billion. In 1984-85, partly because asset sales are now expected to be larger, partly by assumption, the forecast of the planning total is unchanged. With price rises now a little below those expected at budget time, the table shows a larger increase in cost terms in 1983-84. The forecast fall in the planning total in cost terms in 1984-85 mainly reflects larger sales of assets (including BT, which does not affect the PSBR at that stage, and BGC's "Holdings").

69. The relationship between the planning totals in the budget and in this forecast are set out in the following table. It should be noted that these forecasts of public expenditure are subject to a wide margin of error. The cash-limited part of public expenditure is only about one third of the total; and even in this area judgments have to be made about the extent of underspending.

	£ billion cash	
	1983-84	1984-85
Planning Total in Budget/PEWP	119½	126½
of which contingency reserve/ Provisional Reserve	1	3
___add___ back allowance for shortfall	1	(0)
Planning total before shortfall in Budget/PEWP	120½	(126½)
Differences in forecast from plans before shortfall:		
Local authority current and capital	+1	+2
Central government cash limits	-½	-½
Central government non-cash limits	1	1½
Nationalised industries (of which -½ in each year from contingency reserve)	-1	-1
Special asset sales	+½	-½
Offsets against provisional reserve	-	-1½
Planning Total in forecast	121½	126½

Points to note:

i) Nationalised industries forecast to underspend EFLs in both years; and also not to spend contingency reserve allocation.

ii) Rise in overspending by local authorities, mainly on current expenditure.

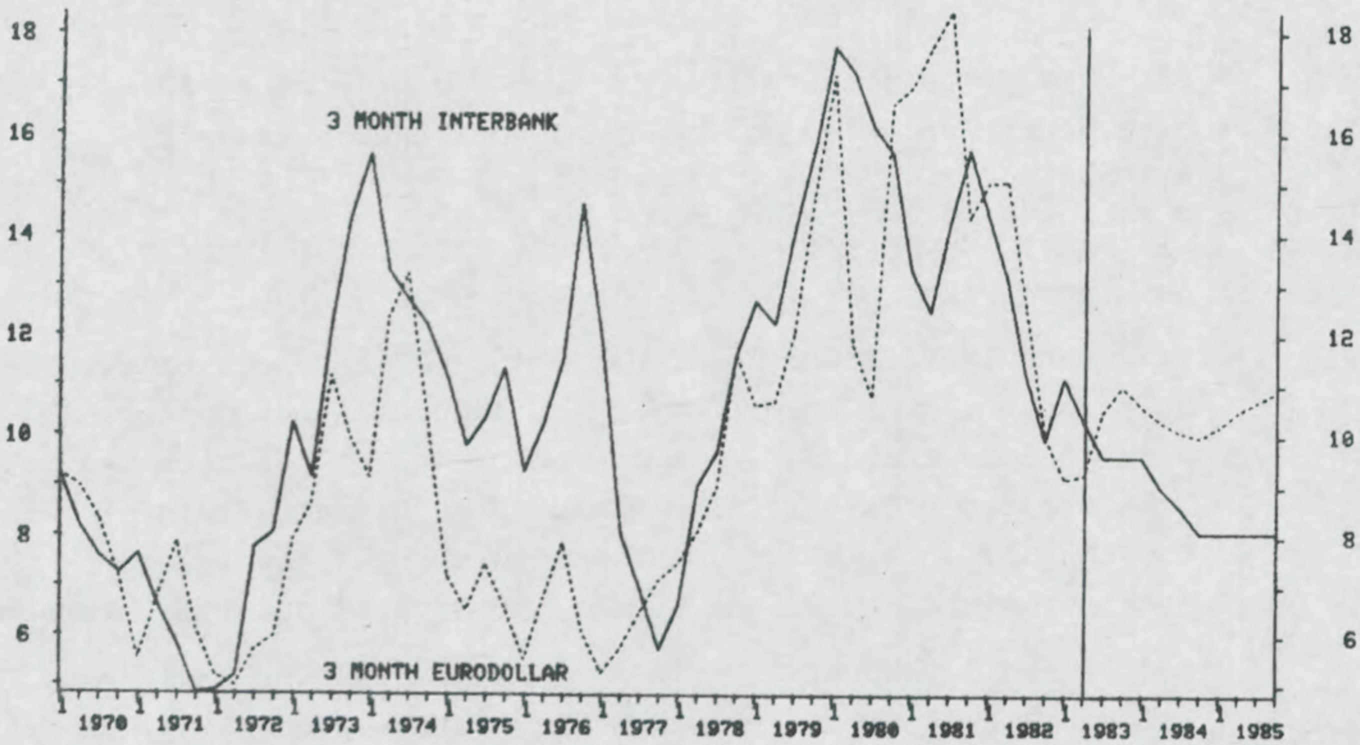
iii) The Provisional Reserve for 1984-85 has been treated as an operational reserve of £1½ billion (allocated to specific programmes); while the remaining £1½ billion has been treated as a partial offset to the higher levels of spending by local authorities and to some of the upward estimating changes in the higher spending by central government.

iv) Overall "shortfall" (in the PEWP sense) was earlier put at £1 billion in 1983-84. This forecast suggests longfall of £1 billion ie that outturn will exceed plans by £1 billion.

Interest rates

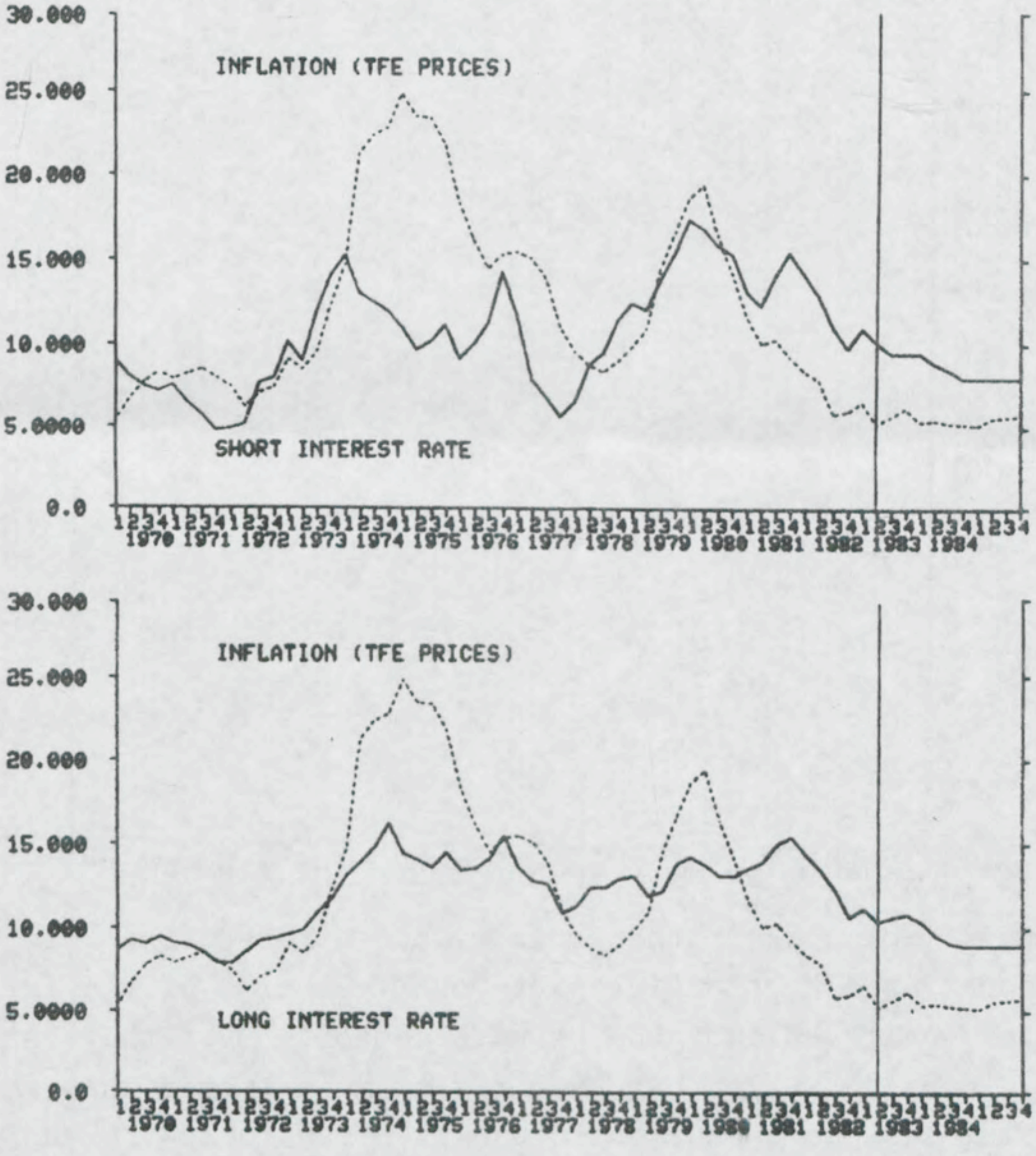
70. We see a moderate rise in dollar rates in the rest of this year - as the US makes some attempt, it is assumed, to tighten monetary policy. At home, inflation has come down rapidly, and we forecast it to stay down, despite some blips on the RPI. Inflationary expectations thus improve somewhat from present levels as people increasingly discount the likelihood of much rise in inflation. In addition of course interest rates are influenced by policy, particularly at the short end. We assume that in general monetary policy will be set in the way set out in the MTFS. More specifically we assume that after the current financial year interest rates are set in a way that keeps monetary growth on average within the target range - see table on page 33. For 1983-84, we have not attempted to constrain the aggregates in this way given the overrun on the PSBR but have assumed no change in short rates. On this basis, the path of short-term interest rates in the forecast is shown in the chart below. Interest rates in other countries may well stay below dollar rates especially in 1984 and 1985 when the dollar is assumed to depreciate. We foresee some fall in UK rates in 1984 when UK fiscal policy is assumed to be tightened.

INTEREST RATES, PERCENT



71. Real interest rates are forecast to fall back somewhat from current high levels. The relationship in the UK between interest rates and inflation is shown in the chart below (with inflation measured by a general price index for all final expenditure).

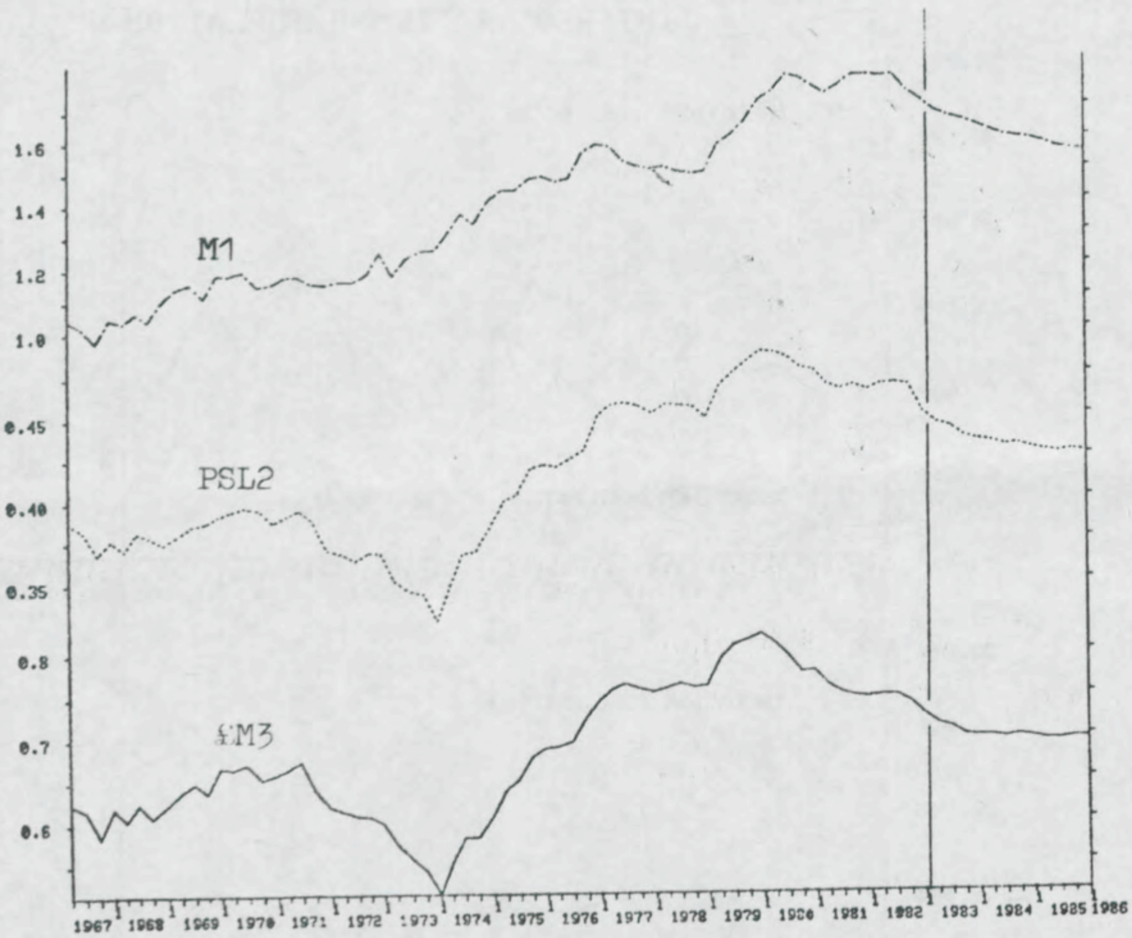
INTEREST RATES AND INFLATION



Monetary aggregates

72. Financial innovation, the abolition of exchange controls and the corset, together with large changes in inflation have made it difficult to understand - and hence predict - the path of some important monetary aggregates. The story of £M3 is familiar: having risen less than money income for most of the last twenty years (ie its velocity rose) from about 1979 it has risen faster than money GDP every year since.

VELOCITY (RATIO OF INCOME TO MONEY)



73. Analytical work in the Treasury has stressed the role of broad money as a substantial part (over a third) of the (gross) financial wealth held by the private sector. Over the last few years, financial wealth has been rising much faster than income, reflecting a rapid expansion in bank lending following the ending of controls, high net saving (in part perhaps a consequence of high real interest rates) and latterly rising asset prices.

The proportion of (broad) money in wealth is more influenced by relative interest rates than by the level of interest rates: it has therefore not been reduced very much by the high level of rates. But we are a long way from a full understanding of the demand for £M3.

74. Thus far the fluctuations in the income velocity of M1 in the chart on page 32 reflect fairly closely past experience, with nominal interest rates a major influence on the decision whether to hold money in the form of current or deposit accounts. However the behaviour of the components of M1 was not as expected and further innovation in the banking world, for example the development of interest-bearing current accounts and changes in transactions technology, are likely to affect the behaviour of the narrow aggregates.

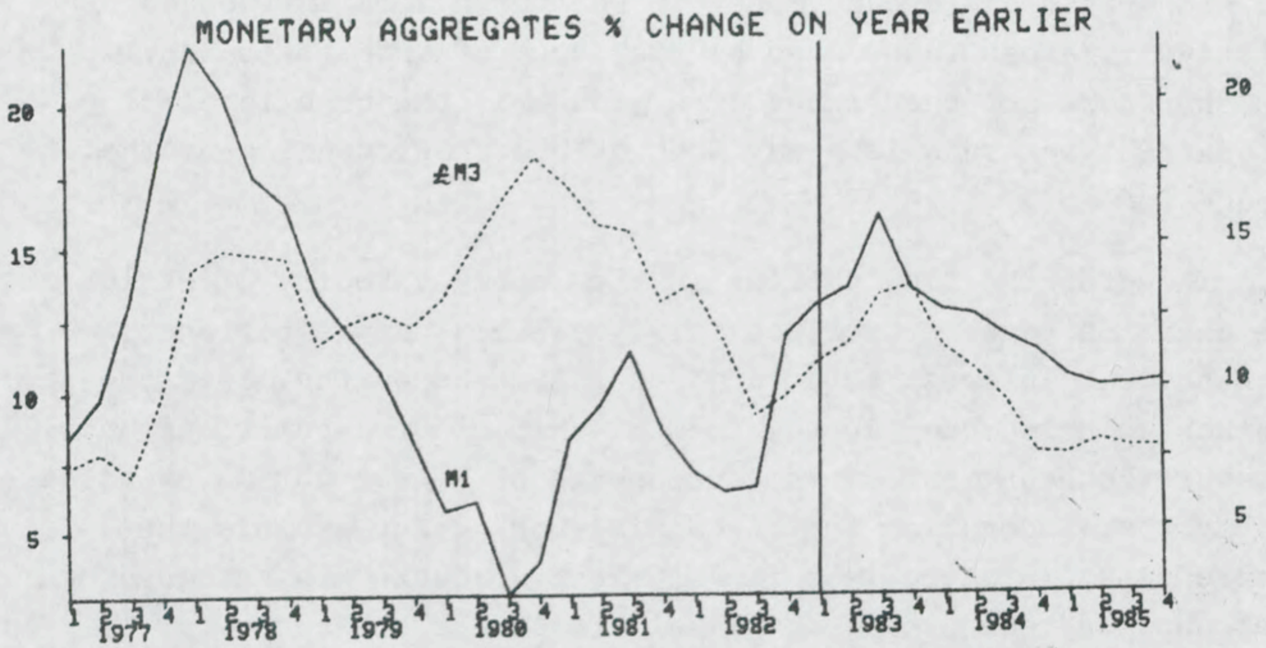
75. Beyond 1983-84 the growth in financial wealth slows down as the surplus of the personal sector continues to shrink and the growth in bank lending slows, and by the latter part of the period financial wealth, and so £M3, is rising more nearly in line with income.

76. M1 growth, which has picked up very much as expected in the last twelve months as a result of the steep fall in interest rates since late 1981, is expected to go on rising by 11-12 per cent over the next two years, as the response to lower interest rates is completed.

77. Forecast growth of the main monetary aggregates is shown in the table below; and in the chart overleaf:

per cent per annum

	MO	M1	£M3	PSL2	Target Range
<u>Target periods</u>					
1981-82	2	7	13	12	<u>6-10</u>
1982-83	3½	11¾	11½	11½	8-12
1983-84	5½	14	12½	13	7-11
1984-85	3½	10½	7½	8½	6-10
1985-86	3½	10	7½	8	5-9



78. The chart shows the growth rates (on a year earlier) on a quarterly basis. There are noticeable differences on occasion between statistics for quarters and those for banking months. Over the current target period (February 1983 to April 1984) the annualised growth in £M3 is expected to be about 1 per cent higher on a banking month basis than the nearest quarterly equivalent. The tables on pages 5 and 33 of this report show our forecast for the target periods.

ANNEX: COMPARISON OF FORECASTS

TREASURY FORECASTS

1. Table A below compares the current Treasury forecast with the last Budget forecasts and the one published with the Autumn Statement.

2. Successive comparisons of previous forecasts have revealed a progressively more pessimistic view of prospects for a recovery in world economic activity. The latest forecast suggests a further postponement of world recovery as measured by world trade in manufactures. Despite this, however, UK output is projected to increase slightly faster than earlier forecasts have indicated. The main reasons for this are a faster growth in consumption and the more expansionary fiscal and monetary conditions prompted by the higher PSBR in 1983-84. This increase in domestic demand along with the poorer prospects for world trade imply a faster rise in imports relative to exports. These features partly account for the worsening in the balance of payments. The prospects for inflation are little changed since the Budget though considerably better than foreseen in previous forecasts.

OUTSIDE FORECASTS

3. Table B compares the current Treasury forecast with two outside forecasts and a "consensus" obtained by averaging all the major outside forecasts. The major difference concerns the outlook for the PSBR with the Treasury projections, based on latest and more detailed information, much higher than all outside forecasters. This feature also partly explains the faster growth of monetary aggregates through this year in the Treasury forecast.

4. The Treasury inflation forecast for 1983 is more optimistic than most outside forecasts. The Treasury also foresee a slightly more buoyant picture for output.

5. Together these two features suggest that the Treasury has a more optimistic view of other influences on inflation, probably on commodity prices (including oil) and import prices generally. This may be the result of a more depressed outlook for world trade in the Treasury forecast. Certainly the Treasury forecast of export

volumes is more pessimistic than outside forecasts. Along with faster growth in import volumes in the Treasury forecasts this partly accounts for a substantially poorer prospect for the balance of payments in 1983 than the "consensus" forecast.

RE

COMPARISON OF TREASURY FORECASTS

TABLE A

	1981 FSBR/MTFS	1982 FSBR/MTFS	AUTUMN STATEMENT	1983 FSBR/MTFS	JUNE 1983
Money Supply £M3 *					
(% Change on year earlier)					
1982 Q1	8.0	14.5 (15.5)	13.4	13.8	13.7
1983 Q1	7.0	11.1 (11.6)	12.2	9.7	11.0
1984 Q1	6.0	8.9 (9.2)	8.4	9.0	11.5
1985 Q1	6.0	7.0 (7.3)	6.8	8.8	7.6
PSBR					
£billion (% of money GDP)					
1981-82	10.6 (4.3)	10.6 (4.2)	8.8 (3.5)	8.7 (3.4)	8.7 (3.4)
1982-83	8.9 (3.3)	9.5 (3.4)	9.0 (3.3)	7.5 (2.7)	9.0 (3.3)
1983-84	6.0 (2.0)	8.4 (2.8)	8.1 (2.8)	8.2 (2.8)	11.7 (4.0)
1984-85	3.3 (1.0)	6.7 (2.0)	6.5 (2.0)	8.0 (2.5)	8.0 (2.5)
Fiscal Adjustments (£ billion)					
1981-82	-	-	-	-	-
1982-83	-1.4	-	-	-	-
1983-84	-3.1	-0.3	-1.0	-	-
1984-85	-5.2	-2.1	-1.4	-½	+2
Nominal GDP (mp)					
(% Change on year earlier)					
1981	10.2	10.1	9.7	8.2	8.2
1982	10.1	10.6	8.9	8.0	8.2
1983	9.8	9.2	6.9	8.4	7.8
1984	9.8	9.9	8.9	8.5	7.6
RPI					
(% Change on year earlier)					
1981 Q4	10.2	11.9	11.9	11.9	11.9
1982 Q4	7.5	9.0	6.1	6.2	6.2
1983 Q4	7.4	7.1	4.7	5.8	5.6
1984 Q4	7.0	6.0	7.0	5.4	5.2
Interest Rates %					
Short Term					
1981-82	12.2	14.2	14.2	14.2	14.2
1982-83	11.5	13.5	10.4	11.3	11.3
1983-84	9.9	11.9	8.0	9.6	9.8
1984-85	9.0	10.2	8.9	7.5	8.4

* The 1981 FSBR/MTFS was based on the old monetary sector

	1981 FSBR/MTFS	1982 FSBR/MTFS	AUTUMN STATEMENT	1983 FSBR/MTFS	JUNE 1983
World Trade in Manufactures UK Weighted					
% Change on year earlier					
1981	3.0	4.1	4.3	3.3	3.3
1982	6.4	4.0	-2.0	-3.3	-2.9
1983	7.3	4.6	2.7	1.0	-0.7
1984	6.8	5.5	5.9	6.6	4.2
UK Exports of Goods and Services					
(% change on year earlier)					
1981	-5.3	-1.5	-1.9	-2.3	-2.3
1982	-0.4	3.3	-0.9	0.7	0.6
1983	3.4	3.7	0.2	0.9	0.3
1984	4.8	4.4	4.9	5.0	3.5
Average Earnings					
(private cyclically adjusted - % change on year earlier)					
1981 Q3	9.8	13.6	11.2	10.2	10.1
1982 Q3	6.9	9.0	9.7	10.0	10.2
1983 Q3	6.0	8.3	6.9	6.9	6.8
1984 Q3	5.4	7.4	8.2	6.9	6.5
Effective Exchange Rates					
1975 = 100					
1981	101.2	94.9	94.9	94.9	94.9
1982	100.4	88.5	91.3	90.6	90.6
1983	98.9	84.6	89.5	80.5	82.0
1984	96.7	81.9	84.6	81.8	81.0
Labour Costs Competitiveness					
(Ratio of UK to competitors costs 1975 = 100)					
1981 Q4	151.3	139.3	134.4	131.4	136.0
1982 Q4	150.8	136.2	139.2	132.2	134.6
1983 Q4	145.7	130.3	130.6	121.0	120.8
1984 Q4	145.2	129.8	123.3	121.0	118.1
Current Balance (£ billion)					
1981	2.8	8.3	6.0	6.0	6.0
1982	-0.8	4.2	3.7	4.0	4.1
1983	-1.4	2.9	0.2	1.5	-1.2
1984	-0.4	3.3	-0.3	1.5	-2.4

	1981 FSBR/MTFS	1982 FSBR/MTFS	AUTUMN STATEMENT	1983 FSBR/MTFS	JUNE 1983
Manufacturing Output					
(% Change on year earlier)					
1981	-6.6	-6.4	-6.4	-6.4	-6.5
1982	1.5	3.2	0.0	-0.6	-0.6
1983	0.9	2.2	0.2	1.8	1.8
1984	1.2	1.9	1.6	2.4	2.3
GDP Volume (fc)					
(% Change on year earlier)					
1981	-2.0	-2.0	-2.4	-2.5	-2.3
1982	1.2	1.4	0.7	0.7	1.1
1983	2.3	2.4	1.3	2.0	2.4
1984	2.2	2.8	2.5	2.7	2.3
Unemployment					
(UK sa excl school leavers - millions, new definition)					
1981 Q4	2.6	2.6	2.6	2.6	2.6
1982 Q4	2.8	2.8	2.9	2.9	2.9
1983 Q4	2.7	2.8	3.2	3.0	2.9
1984 Q4	2.7	2.8	3.3	3.1	2.9
I & C Companies' Financial Surplus/ Deficit, £ billion					
1981	-0.9	1.4	1.8	2.0	2.0
1982	-4.7	0.2	-0.8	1.1	1.2
1983	-2.4	-1.8	1.6	0.7	- .2
1984	-0.9	-0.9	0.5	2.3	1.0

RE

TABLE B

OUTSIDE FORECASTS

	TREASURY JUNE 1983	NIESR MAY 1983	PHILLIPS & DREW JUNE 1983	CONSENSUS FORECAST
£M3 % Change on year earlier				
1983 Q1	11.0	9.0	9.5	10.4
1984 Q1	11.5	10.0	9.0	9.2
1985 Q1	7.6	9.0	-	9.0
£M1 % Change over year earlier				
1983 Q1	13.0	12.0	11.1	12.5
1984 Q1	12.7	10.5	8.5	10.3
1985 Q1	10.4	9.0	-	9.6
Interest rates, short-term % (Treasury bill rate)				
1983 Q4	9.3	-	9.6	8.8
1984 Q4	7.8	-	8.5	9.0
PSBR £bn				
1983-84	11.7	7.3	8.2	8.0
1984-85	8.0	6.1	8.8	8.3
Exchange rate 1975 = 100				
1983 Q4	81.0	81.3	87.0	82.9
1984 Q4	80.0	79.3	80.0	80.7
Current Account £bn				
1983	-1.2	0.6	1.1	1.2
1984	-2.4	1.3	-0.1	0.5
Average earnings % change on year earlier				
1983	7.8	7.9	7.5	7.5
1984	6.6	7.9	7.4	7.5
RPI(CPI) % change on year earlier				
1983 Q4	5.6	6.5	(5.5)	6.2 (5.9)
1984 Q4	5.2	8.0	(7.3)	7.2 (6.8)
RPDI % change on year earlier				
1983	1.6	0.5	2.3	1.5
1984	0.9	-0.6	0.5	1.1

	TREASURY JUNE 1983	NIESR MAY 1983	PHILLIPS & DREW JUNE 1983	CONSENSUS FORECAST
Import Volume goods and services %				
1983	5.3	3.8	4.4	4.3
1984	4.9	2.2	2.8	3.8
Export Volume goods and services				
1983	0.3	2.0	2.3	2.0
1984	3.5	3.4	3.3	3.9
GDP Volume, % change on year earlier				
1983	2.4	2.4	2.4	2.1
1984	2.3	1.2	1.9	2.0
Unemployment million, Q4				
1983	2.9	3.1	3.1	3.1
1984	2.9	3.2	3.1	3.1

'Consensus' includes: National Institute (May)
London Business School (Feb)
Phillips & Drew (June)
OECD (Feb)
St James (Jan)
Cambridge Econometrics (June)
CBI (Mar)
Simon & Coates (June)

though results are not reported for some variables by some forecasters.

TABLE 1 SUMMARY

	1 GDP AT CONSTANT PRICES 1975=100	2 UK UNEMP NARROW ADJ(1)	3 CYC.PRIV EARNINGS % CHANGE OVER PREV.YR.	4 RPI % CHANGE OVER PREV. YEAR	5 PSBR(2)	6 PSBR(2) /NOMINAL GDP	7 CURRENT BALANCE	8 ICC'S NAFA	9 PERSONAL NAFA	10 EFFECTIVE EXCHANGE RATE	11 INTEREST RATES 3-MONTH INTER BANK	12 INTEREST RATES 20-YEAR GILTS	13 £M3 % CHANGE OVER PREV. YEAR
1981	105.5	2413	12.4	11.9	10665	4.30	6005	2039	16857	94.87	13.92	14.71	15.3
1982	106.7	2793	9.5	8.6	5433	2.01	4081	1218	13388	90.59	12.15	12.93	11.0
1983	109.2	2962	7.5	4.8	13688	4.71	-1166	-166	11601	81.97	10.16	10.93	12.4
1984	111.7	2895	6.8	5.8	8396	2.68	-2353	992	9247	81.00	8.82	9.64	9.8
1985	113.6	2927	7.1	5.3	7236	2.16	-633	219	8161	79.50	8.10	9.07	7.9
1981/82	105.7	2541	10.8	11.5	8699	3.43	4261	506	16054	92.31	14.18	14.92	14.5
1982/83	107.2	2874	9.1	7.1	9027	3.27	3849	1900	12240	87.95	11.34	12.11	10.4
1983/84	109.8	2939	7.0	5.2	11700	3.96	-2335	450	11453	82.07	9.77	10.71	12.5
1984/85	112.2	2891	6.7	5.5	7965	2.50	-1682	1126	8244	80.70	8.45	9.29	8.8
1985/86	113.9	2957	7.1	5.5	6854	2.01	-860	-158	8013	79.30	8.10	9.06	7.8
1981 QTR 1	105.7	2166	16.7	12.7	2185	3.64	2421	478	4813	101.40	13.33	13.78	17.2
QTR 2	105.1	2362	12.9	11.7	5938	9.70	1898	1076	4272	97.80	12.47	14.18	15.8
QTR 3	105.1	2515	10.1	11.2	2545	4.05	357	49	3921	90.60	14.22	15.20	15.5
QTR 4	106.2	2609	10.3	11.9	-3	.00	1329	436	3851	89.70	15.65	15.67	13.1
1982 QTR 1	106.2	2679	10.0	11.1	219	.33	677	-1055	4010	91.14	14.38	14.64	13.7
QTR 2	106.4	2742	9.1	9.4	1148	1.71	638	-109	3737	90.60	13.12	13.73	11.7
QTR 3	106.6	2837	10.2	8.0	1585	2.32	976	601	2870	91.41	11.19	12.49	9.1
QTR 4	107.5	2913	8.6	6.2	2481	3.56	1790	1781	2771	89.20	9.92	10.86	9.8
1983 QTR 1	108.3	3003	8.6	5.1	3813	5.38	445	-373	2862	80.60	11.14	11.35	11.0
QTR 2	108.7	2984	7.5	3.8	2367	3.31	-300	-263	3193	84.30	10.30	10.55	11.6
QTR 3	109.8	2932	6.8	4.9	3658	4.99	-465	-22	2931	82.00	9.60	10.81	13.3
QTR 4	110.0	2931	7.0	5.6	3850	5.15	-846	492	2615	81.00	9.60	11.01	13.6
1984 QTR 1	110.6	2909	6.8	6.4	1825	2.40	-724	243	2714	81.00	9.60	10.50	11.5
QTR 2	111.6	2902	6.7	6.0	2527	3.26	-749	44	2804	82.00	9.00	9.72	10.7
QTR 3	112.2	2880	6.5	5.6	2058	2.61	-484	323	1986	81.00	8.60	9.27	9.5
QTR 4	112.4	2890	7.0	5.4	1986	2.47	-396	382	1743	80.00	8.10	9.10	7.7
1985 QTR 1	112.7	2894	6.8	5.0	1394	1.71	-53	377	1711	79.80	8.10	9.08	7.6
QTR 2	113.4	2909	7.7	5.3	2056	2.47	-97	-217	2532	79.60	8.10	9.07	8.1
QTR 3	114.0	2937	7.3	5.2	1901	2.25	-247	-58	2202	79.40	8.10	9.06	7.8
QTR 4	114.2	2969	6.7	5.5	1885	2.18	-236	117	1716	79.20	8.10	9.05	7.9
1986 QTR 1	114.1	3015	6.8	6.0	1012	1.16	-280	0	1563	79.00	8.10	9.04	7.3

(1) CLAIMANTS BASIS.'NARROW' EXCLUDES SCHOOL LEAVERS
(2) FINANCIAL YEAR SEASONALLY ADJUSTED

TABLE 2 PRIVATE SECTOR FINANCIAL SUMMARY

PERCENTAGE CHANGES ON PREVIOUS YEAR (EXCEPT COL. 14)

	1 TFE DEFLATOR	2 REAL TFE	3 REAL GDP	4 NOMINAL GDPM	5 PRIVATE SECTOR FINANCIAL WEALTH EXCLUDING REVALUATIONS	6	7	8 PRIVATE SECTOR FINANCIAL WEALTH INCLUDING REVALUATIONS	9	10	11 BANK LENDING TO PRIVATE SECTOR	12 PRIVATE SECTOR HOLDINGS OF GILTS	13	14	15 REAL MONEY SUPPLY
					NET	GROSS	DOMESTIC	NET	GROSS	DOMESTIC		EXCL. REVALS.	INCL. REVALS.	AS A % OF GROSS WEALTH	
1981	10.52	-1.75	-2.32	9.53	28.61	22.03	18.70	24.23	20.26	16.24	16.53	15.64	8.14	21.62	4.35
1982	7.16	2.36	1.09	9.11	3.07	11.91	10.09	8.01	13.98	13.10	28.23	12.38	22.56	23.24	3.57
1983	5.89	3.24	2.40	7.32	9.46	11.02	11.23	14.87	13.22	14.38	15.77	8.71	18.21	24.27	6.12
1984	5.37	2.70	2.28	7.75	7.59	8.51	9.12	13.21	10.83	12.36	12.49	7.52	17.13	25.64	4.20
1985	5.60	1.89	1.66	7.24	5.54	7.46	7.22	7.89	8.46	8.61	11.84	5.30	9.20	25.82	2.13
1981/82	9.70	.17	-1.23	9.16	24.32	21.04	17.36	18.69	18.74	14.30	18.57	14.07	4.93	21.31	4.36
1982/83	6.70	2.39	1.44	8.75	2.09	10.40	9.10	8.88	13.28	13.16	26.20	11.69	25.09	23.53	3.43
1983/84	5.60	3.06	2.44	7.20	9.58	10.61	11.26	14.57	12.65	14.18	14.39	8.71	17.49	24.54	6.51
1984/85	5.30	2.61	2.21	7.69	7.15	8.05	8.40	13.12	10.53	11.85	12.15	6.79	16.93	25.96	3.36
1985/86	5.81	1.88	1.51	7.23	5.01	7.33	7.05	6.00	7.76	7.63	11.77	5.06	6.71	25.71	1.85
1981 QTR 1	11.79	-4.74	-3.83	10.92	28.84	21.11	19.58	32.62	22.63	21.65	18.22	18.07	24.53	23.92	4.81
QTR 2	10.20	-3.46	-3.40	8.97	32.90	23.19	20.49	28.82	21.49	18.19	12.75	16.83	9.83	21.95	5.06
QTR 3	10.45	-.13	-1.77	9.32	28.64	22.38	16.66	19.75	18.61	11.56	14.68	13.57	-1.82	20.30	4.62
QTR 4	9.41	1.47	-.22	8.99	24.08	21.46	18.08	17.64	18.70	14.34	20.29	14.11	2.52	20.53	3.37
1982 QTR 1	8.55	2.92	.56	9.33	11.68	17.12	14.21	10.26	16.50	13.36	25.68	11.78	9.19	22.42	4.72
QTR 2	8.06	3.45	1.18	9.81	-.36	10.63	7.91	.64	11.07	8.53	31.38	10.33	12.35	22.20	3.35
QTR 3	6.00	1.28	1.39	8.56	.48	11.19	11.30	10.67	15.55	17.58	30.74	14.86	36.37	23.96	2.88
QTR 4	6.22	1.83	1.22	8.77	.49	8.70	6.95	10.62	12.99	13.01	25.40	12.54	33.46	24.25	3.35
1983 QTR 1	6.59	3.01	1.94	7.93	7.75	11.09	10.23	13.45	13.44	13.54	18.95	9.02	19.51	23.62	4.12
QTR 2	5.26	2.32	2.20	6.55	11.97	12.06	12.12	21.87	16.03	17.77	18.00	10.38	28.25	24.54	6.04
QTR 3	5.64	4.21	3.07	7.46	9.44	10.28	10.93	13.64	12.00	13.36	13.96	7.79	14.98	24.59	7.22
QTR 4	6.07	3.41	2.37	7.36	8.68	10.63	11.63	11.11	11.64	13.05	12.75	7.64	11.79	24.28	7.05
1984 QTR 1	5.43	2.30	2.13	7.42	8.22	9.47	10.38	12.50	11.24	12.88	13.24	9.05	16.54	24.74	5.74
QTR 2	5.50	3.59	2.65	8.42	7.42	8.85	9.83	11.74	10.67	12.38	12.97	8.25	15.66	25.65	4.89
QTR 3	5.33	2.62	2.16	7.56	7.53	8.22	8.72	13.77	10.81	12.35	12.38	6.67	17.23	26.02	3.99
QTR 4	5.24	2.31	2.16	7.61	7.19	7.51	7.53	14.74	10.63	11.88	11.46	6.12	18.97	26.11	2.33
1985 QTR 1	5.17	1.93	1.87	7.20	6.47	7.62	7.51	12.25	10.04	10.86	11.87	6.13	15.88	26.06	2.33
QTR 2	5.68	1.67	1.60	7.19	5.55	7.49	7.28	8.39	8.70	8.95	11.91	5.00	9.71	25.89	2.29
QTR 3	5.74	1.91	1.60	7.24	5.25	7.30	6.98	6.31	7.75	7.61	11.51	4.73	6.47	25.71	1.98
QTR 4	5.81	2.05	1.57	7.31	4.90	7.42	7.13	5.01	7.47	7.19	12.05	5.34	5.52	25.64	1.94

TABLE 3 RETAIL PRICES INDEX AND ITS COMPONENTS

INDEX NUMBERS BASED ON JANUARY 1974=100

	1	2	3	4	5	6	7	8	9	10	11	12	13	14	15
	INDEX LEVELS					-ONE QUARTER PERCENTAGE CHANGES-					-FOUR QUARTER PERCENTAGE CHANGES-				
	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL
WEIGHTS(1)	219	128	73	581	SUM										
1981	277.5	318.2	368.3	286.4	295.0	2.3	4.8	2.9	2.5	2.8	8.5	18.1	19.5	10.5	11.9
1982	299.3	358.2	418.6	306.5	320.4	1.1	.9	3.5	1.5	1.5	7.8	12.6	13.6	7.0	8.6
1983	308.3	368.3	443.3	324.4	335.8	1.3	1.8	.7	1.4	1.4	3.0	2.8	5.9	5.8	4.8
1984	324.5	395.4	465.1	343.3	355.4	1.1	1.0	1.5	1.4	1.3	5.2	7.4	4.9	5.8	5.8
1985	340.7	412.3	494.7	361.8	374.1	1.4	1.4	1.6	1.3	1.3	5.0	4.3	6.4	5.4	5.3
1981 QTR 1	268.7	285.2	352.5	274.0	280.4	3.1	-.2	4.4	2.4	2.4	8.6	18.3	25.7	11.1	12.7
QTR 2	277.0	319.9	364.7	285.0	294.0	3.1	12.2	3.5	4.0	4.9	8.2	17.5	21.9	10.0	11.7
QTR 3	278.8	324.0	376.3	290.7	299.1	.7	1.3	3.2	2.0	1.7	7.5	16.3	19.2	10.2	11.2
QTR 4	285.6	343.7	379.8	295.9	306.5	2.4	6.1	.9	1.8	2.5	9.6	20.3	12.5	10.6	11.9
1982 QTR 1	297.7	346.7	391.4	298.0	311.6	4.2	.9	3.1	.7	1.7	10.8	21.6	11.0	8.8	11.1
QTR 2	304.1	365.0	417.7	305.5	321.5	2.2	5.3	6.7	2.5	3.2	9.8	14.1	14.5	7.2	9.4
QTR 3	297.0	364.6	428.8	309.2	323.0	-2.3	-.1	2.7	1.2	.5	6.5	12.5	14.0	6.4	8.0
QTR 4	298.5	356.7	436.4	313.5	325.4	.5	-2.2	1.8	1.4	.7	4.5	3.8	14.9	5.9	6.2
1983 QTR 1	302.1	348.9	442.6	316.0	327.4	1.2	-2.2	1.4	.8	.6	1.5	.6	13.1	6.0	5.1
QTR 2	307.5	364.5	441.9	322.7	333.8	1.8	4.5	-.2	2.1	2.0	1.1	-.1	5.8	5.6	3.8
QTR 3	309.5	377.7	440.7	327.2	338.7	.7	3.6	-.3	1.4	1.5	4.2	3.6	2.8	5.8	4.9
QTR 4	314.2	382.2	448.1	331.7	343.5	1.5	1.2	1.7	1.4	1.4	5.3	7.2	2.7	5.8	5.6
1984 QTR 1	320.2	385.1	455.9	336.0	348.2	1.9	.8	1.7	1.3	1.4	6.0	10.4	3.0	6.3	6.4
QTR 2	324.4	399.5	462.3	339.8	353.7	1.3	3.7	1.4	1.2	1.6	5.5	9.6	4.6	5.3	6.0
QTR 3	324.8	398.8	466.0	346.2	357.7	.1	-.2	.8	1.9	1.1	4.9	5.6	5.7	5.8	5.6
QTR 4	328.5	398.3	476.0	351.2	362.0	1.1	-.1	2.2	1.4	1.2	4.5	4.2	6.2	5.9	5.4
1985 QTR 1	334.1	396.2	482.1	355.0	365.7	1.7	-.5	1.3	1.1	1.0	4.4	2.9	5.7	5.7	5.0
QTR 2	339.4	414.3	492.5	359.4	372.4	1.6	4.6	2.2	1.2	1.9	4.6	3.7	6.5	5.7	5.3
QTR 3	342.1	417.2	496.0	363.9	376.3	.8	.7	.7	1.3	1.0	5.3	4.6	6.4	5.1	5.2
QTR 4	347.3	421.7	508.1	369.1	381.9	1.5	1.1	2.4	1.4	1.5	5.7	5.9	6.7	5.1	5.5
1986 QTR 1	353.6	424.5	517.1	374.9	387.7	1.8	.7	1.8	1.6	1.5	5.8	7.2	7.3	5.6	6.0

(1) THESE WEIGHTS ARE APPLICABLE TO INDICES BASED ON JANUARY 1974 = 100 AND DO NOT NECESSARILY SUM TO 1000

TABLE 4 EXCHANGE RATES AND COMPETITIVENESS

	1	2	3	4	5	6	7	8
	. . . E X C H A N G E	R A T E S . . .		. -----COMPETITIVENESS OF MANUFACTURES-----				
	EFFECTIVE EXCH.RATE	EXPORT WTD EXCH.RATE	DOLLAR/£ EXCH.RATE.	.RELATIVE . EXPORT PRICES	RELATIVE WHSALE PRICES	RELATIVE N.UNIT LAB.COSTS	IMPORT PRICE COMPET	RELATIVE PROFBLTY EXPORTS
1981	94.87	92.901	2.027	124.17	132.32	143.54	122.66	91.10
1982	90.59	89.741	1.750	116.74	128.94	137.23	121.83	90.38
1983	81.97	81.871	1.520	109.48	117.61	122.45	116.50	92.62
1984	81.00	79.529	1.582	110.28	117.44	119.87	114.97	94.14
1985	79.50	76.160	1.712	109.83	115.49	115.77	113.05	95.19
1981 QTR 1	101.40	99.089	2.309	133.02	140.78	154.00	124.96	91.07
QTR 2	97.80	95.807	2.077	127.59	135.44	146.55	124.25	90.81
QTR 3	90.60	89.039	1.839	118.38	126.41	137.60	121.31	91.28
QTR 4	89.70	87.671	1.883	117.67	126.65	136.00	120.10	91.24
1982 QTR 1	91.14	89.488	1.845	118.60	129.45	138.01	122.89	91.22
QTR 2	90.60	88.886	1.779	115.63	128.61	137.28	121.18	90.27
QTR 3	91.41	90.478	1.728	118.57	130.78	139.06	121.16	90.25
QTR 4	89.20	90.113	1.649	114.15	126.93	134.56	122.10	89.80
1983 QTR 1	80.60	80.569	1.532	106.78	115.20	120.65	117.50	91.56
QTR 2	84.30	84.252	1.553	112.51	121.02	125.63	116.98	92.40
QTR 3	82.00	81.984	1.499	109.76	117.68	122.73	116.13	93.09
QTR 4	81.00	80.680	1.496	108.89	116.56	120.79	115.37	93.44
1984 QTR 1	81.00	80.234	1.529	109.61	117.28	120.94	115.31	93.86
QTR 2	82.00	80.767	1.583	111.67	119.08	121.14	116.08	94.01
QTR 3	81.00	79.292	1.600	110.35	117.35	119.24	114.64	94.21
QTR 4	80.00	77.823	1.618	109.51	116.04	118.17	113.86	94.50
1985 QTR 1	79.80	77.157	1.654	109.50	115.76	117.31	113.44	94.86
QTR 2	79.60	76.485	1.693	109.91	115.61	116.28	113.34	95.09
QTR 3	79.40	75.808	1.734	110.01	115.52	114.99	113.03	95.27
QTR 4	79.20	75.189	1.769	109.90	115.07	114.49	112.41	95.55
1986 QTR 1	79.00	74.893	1.763	109.35	114.33	114.30	111.69	95.84

TABLE 5 BALANCE OF PAYMENTS

AT CURRENT PRICES,SEASONALLY ADJUSTED
RECORDED AND FORECAST £ MILLION *

	1 EXPORT GOODS	2 IMPORT GOODS	3 VISIB BAL	4 NON-OIL VISIBLE BALANCE	5 EXPORT SERV	6 IMPORT SERV	7 BAL SERV	8 TRANSFERS CRED	9 TRANSFERS DEB	10 BAL TRANSF	11 IPD CREDIT	12 IPD DEBIT	13 BAL IPD	14 INVIS BAL	15 CURRENT BALANCE
1981	50977	48107	2870	-242	16676	12615	4061	2502	4482	-1980	10097	9043	1054	3135	6005
1982	55545	53317	2228	-2377	17423	13809	3614	3124	5222	-2098	10010	9673	337	1853	4081
1983	59524	63323	-3799	-9679	18996	15072	3924	3435	5680	-2245	11131	10177	954	2633	-1166
1984	64348	70489	-6141	-11736	20795	16705	4090	3522	6112	-2590	13222	10933	2288	3788	-2353
1985	70178	76749	-6571	-12378	23229	18210	5019	4071	6592	-2521	15322	11883	3440	5938	-633
1981 QTR 1	11854	10223	1631	852	4012	2922	1090	607	1120	-513	2242	2029	213	790	2421
QTR 2	12229	11183	1046	176	4141	3109	1032	504	1063	-559	2350	1971	379	852	1898
QTR 3	13142	13342	-200	-915	4234	3270	964	589	1237	-648	2601	2360	241	557	357
QTR 4	13752	13359	393	-355	4289	3314	975	802	1062	-260	2904	2683	221	936	1329
1982 QTR 1	13470	13236	234	-464	4377	3320	1057	769	1271	-502	2203	2315	-112	443	677
QTR 2	13787	13664	123	-735	4427	3449	978	639	1309	-670	2576	2369	207	515	638
QTR 3	13702	13093	609	-704	4248	3505	743	772	1334	-562	2549	2363	186	367	976
QTR 4	14586	13324	1262	-474	4371	3535	836	944	1308	-364	2682	2626	56	528	1790
1983 QTR 1	14786	15017	-231	-1949	4671	3526	1145	818	1332	-514	2602	2557	45	676	445
QTR 2	14322	15382	-1060	-2386	4681	3738	943	859	1391	-532	2807	2458	349	760	-300
QTR 3	15016	16156	-1140	-2564	4785	3855	930	862	1373	-511	2738	2483	256	675	-465
QTR 4	15400	16768	-1368	-2780	4859	3953	906	896	1584	-688	2984	2679	304	522	-846
1984 QTR 1	15736	17176	-1440	-2865	4959	4043	916	848	1507	-659	3137	2678	459	716	-724
QTR 2	15951	17465	-1514	-2925	5094	4129	965	875	1562	-687	3243	2756	487	765	-749
QTR 3	16188	17792	-1604	-2974	5268	4230	1038	885	1465	-580	3356	2693	662	1120	-484
QTR 4	16473	18056	-1583	-2972	5474	4303	1171	914	1578	-664	3486	2806	680	1187	-396
1985 QTR 1	16891	18366	-1475	-2915	5612	4383	1229	982	1582	-600	3622	2829	793	1422	-53
QTR 2	17357	18895	-1538	-3019	5724	4495	1229	1021	1649	-628	3764	2925	840	1441	-97
QTR 3	17775	19524	-1749	-3195	5861	4621	1240	1023	1670	-647	3903	2994	909	1502	-247
QTR 4	18155	19964	-1809	-3249	6032	4711	1321	1045	1691	-646	4033	3135	898	1573	-236
1986 QTR 1	18485	20453	-1968	-3335	6191	4786	1405	1045	1701	-656	4124	3185	939	1688	-280

TABLE 6 INDUSTRY ACT FORECAST TABLE 2 (% CHANGES ON ONE YEAR EARLIER)

CONSTANT PRICE FORECASTS OF EXPENDITURE, IMPORTS AND GROSS DOMESTIC PRODUCT
£ MILLION AT 1975 PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
	CONSUMERS' EXPEND	GEN GOVT CON	FIXED INVEST	EXPRTS OF GOODS AND SERVCS	CHANGE IN STOCKS*	TOTAL FINAL EXPEND	LESS IMPRTS OF GDS AND SERVCS	LESS ADJUST TO FACTOR COST	GDP AT FACTOR COST (EXPEND MEASRE)	PLUS STAT ADJUST*	COMP GDP AT FACTOR COST	GDP (COMP) 1975 = 100	MAN OUTPUT 1975 = 100	TOTAL DOMESTIC DEMAND
1981	.4	.0	-8.9	-2.3	-.3	-1.8	-.5	-.3	-2.3	.0	-2.3	-2.3	-6.5	-1.6
1982	1.1	1.2	5.5	.6	1.1	2.4	5.0	2.2	1.5	-.4	1.1	1.1	-.6	2.9
1983	3.2	2.5	2.8	.3	1.2	3.2	5.3	2.6	2.6	-.2	2.4	2.4	1.8	4.1
1984	2.5	.4	3.8	3.5	.3	2.7	4.9	2.9	1.9	.4	2.3	2.3	2.3	2.5
1985	1.6	.3	2.3	4.4	-.2	1.9	2.5	2.0	1.7	.0	1.7	1.7	.9	1.2
1981 FIRST HALF	.2	.2	-11.3	-5.7	-2.0	-4.1	-10.2	.9	-2.6	-1.0	-3.6	-3.6	-11.2	-3.6
SECOND HALF	.6	-.2	-6.5	1.2	1.5	.7	9.9	-1.5	-2.1	1.1	-1.0	-1.0	-1.3	.5
1982 FIRST HALF	-.2	1.0	3.9	3.2	2.8	3.2	12.8	-.5	.5	.3	.9	.9	1.3	3.2
SECOND HALF	2.5	1.5	7.2	-1.9	-.6	1.6	-1.9	4.9	2.4	-1.1	1.3	1.3	-2.5	2.5
1983 FIRST HALF	3.4	3.2	3.9	-1.2	.4	2.7	1.8	3.5	2.9	-.8	2.1	2.1	-.3	3.8
SECOND HALF	3.1	1.8	1.7	1.8	2.0	3.8	9.0	1.6	2.3	.4	2.7	2.7	4.0	4.4
1984 FIRST HALF	3.2	.1	3.8	2.7	.4	2.9	6.5	3.5	1.6	.8	2.4	2.4	3.1	3.0
SECOND HALF	1.7	.7	3.7	4.4	.2	2.5	3.3	2.3	2.2	.0	2.2	2.2	1.4	1.9
1985 FIRST HALF	1.2	.6	2.2	4.7	-.3	1.8	2.0	1.7	1.7	.0	1.7	1.7	.7	1.0
SECOND HALF	1.9	-.1	2.3	4.0	-.2	2.0	2.9	2.3	1.6	.0	1.6	1.6	1.0	1.4

* AS PERCENTAGE OF GDP IN PREVIOUS YEAR

TABLE 7 EMPLOYMENT AND UNEMPLOYMENT IN UK

	1	2	3	4	5	6	7	8	9	10	11
	E M P L O Y M E N T (000'S)							UNEMPLOYMENT (1)			
	PUBLIC - NON-TRADING -		PRIVATE AND PUBLIC TRADING								
	CENTRAL GOVT	LOCAL AUTH	MANUF	OTHER	TOTAL	OF WHICH NAT IND	LABOUR SUPPLY	WIDE UNADJ	REG SCHOOL LEAV	NARROW, ADJ 000'S	NARROW, ADJ P-C
1981	2218	2792	6109	13038	24157	1596	26953	2520	100	2413	9.9
1982	2216	2770	5759	12951	23696	1496	27022	2917	123	2793	11.5
1983	2191	2761	5499	13019	23470	1454	27175	3089	125	2962	12.3
1984	2157	2733	5451	13213	23554	1423	27348	2973	76	2895	12.0
1985	2119	2705	5435	13397	23656	1391	27481	3002	74	2927	12.1
1981 QTR 1	2210	2814	6300	13121	24445	1640	26977	2306	69	2166	8.8
QTR 2	2217	2799	6149	13040	24205	1595	26915	2392	71	2362	9.7
QTR 3	2222	2781	6033	13019	24055	1585	26954	2616	114	2515	10.3
QTR 4	2225	2775	5955	12976	23931	1565	26968	2769	148	2609	10.7
1982 QTR 1	2225	2776	5878	12978	23857	1530	27006	2862	111	2679	11.0
QTR 2	2220	2770	5806	12965	23761	1502	27015	2797	97	2743	11.3
QTR 3	2214	2766	5718	12940	23638	1480	27028	2939	135	2838	11.7
QTR 4	2207	2769	5634	12924	23534	1473	27042	3070	151	2913	12.0
1983 QTR 1	2207	2770	5547	12955	23479	1465	27094	3199	125	3003	12.4
QTR 2	2200	2766	5503	12997	23466	1458	27159	3051	110	2984	12.4
QTR 3	2186	2759	5483	13044	23472	1450	27203	3047	147	2933	12.2
QTR 4	2174	2751	5463	13085	23473	1445	27247	3059	122	2932	12.2
1984 QTR 1	2162	2742	5455	13131	23490	1440	27290	3013	31	2910	12.1
QTR 2	2161	2736	5449	13186	23532	1425	27333	2903	43	2902	12.1
QTR 3	2163	2730	5451	13241	23585	1420	27368	2967	120	2880	11.9
QTR 4	2142	2724	5453	13295	23614	1410	27403	3010	113	2891	12.0
1985 QTR 1	2138	2718	5448	13346	23650	1400	27437	3006	40	2894	12.0
QTR 2	2140	2710	5441	13379	23670	1395	27471	2901	35	2909	12.0
QTR 3	2113	2701	5432	13416	23662	1388	27496	3022	117	2937	12.1
QTR 4	2088	2693	5423	13452	23656	1382	27521	3081	106	2969	12.3
1986 QTR 1	2064	2684	5409	13481	23638	1375	27545	3121	34	3015	12.4

(1) COLS 8 TO 11 ON CLAIMANTS BASIS.

TABLE 8 MONEY SUPPLY COUNTERPARTS TABLE

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10	11	12	13	14
		SALES OF PUB. SECTOR DEBT TO NON BANKS												
	PSBR	GILTS	OTHER PS LNG. TM	NATSAV	T+LA BILLS	LA DEPOSITS	CTDS	OTHER	BANK LENDING PRIV. SECTOR	DOM COUNTER -PARTS	NET EXTE-RNALS	NON -DEP LIABS	RES.	INCR. IN £M3
1981	10583	8095	-446	4183	38	-492	-94	-209	11217	10725	255	1741	674	9913
1982	5419	6112	562	3511	126	-929	1007	-62	17861	12953	-2489	2088	3	8379
1983	13183	5952	-515	2795	-186	-125	-45	0	11287	16594	-802	3055	7	12744
1984	8410	4905	-216	2046	30	-236	98	0	11437	13220	-2796	2212	-1	8211
1985	7236	5055	-200	1889	164	-174	84	0	13407	13825	-2784	2000	1	9042
1981/82	8688	7098	-527	4227	63	-51	401	-46	14939	12462	-900	1656	680	10586
1982/83	8788	4632	698	2947	181	-1067	598	178	14051	14672	-2404	2556	-53	9659
1983/84	11700	6899	-407	2456	-70	-352	-65	0	12021	15260	-1213	2856	16	11207
1984/85	7965	5127	-200	1958	36	-252	187	-1	12197	13307	-2911	2100	0	8296
1985/86	6854	4890	-160	1900	161	-148	-9	1	13347	13566	-3010	2000	0	8556
1981 QTR 1	2048	2911	-229	1439	-181	-123	-70	-403	2321	1025	1008	378	41	1696
QTR 2	5859	2089	9	1362	-130	1	-124	400	678	2930	34	497	552	3019
QTR 3	2523	1066	-161	572	163	-41	-141	-371	2984	4420	-403	553	-366	3098
QTR 4	153	2029	-65	810	186	-329	241	165	5234	2350	-384	313	447	2100
1982 QTR 1	153	1914	-310	1483	-156	318	425	-240	6043	2762	-147	293	47	2369
QTR 2	1250	865	179	434	-114	-102	-91	-66	3277	3422	-1255	438	97	1826
QTR 3	1429	2472	454	577	243	-412	589	-29	5223	2758	-458	809	-223	1268
QTR 4	2587	861	239	1017	153	-733	84	273	3318	4011	-629	548	82	2916
1983 QTR 1	3522	434	-174	919	-101	180	16	0	2233	4481	-62	761	-9	3649
QTR 2	2300	2193	-241	589	-158	-169	38	0	3023	3071	250	806	94	2609
QTR 3	3567	2060	-28	675	-16	-89	-170	1	3011	4145	-350	807	-77	2911
QTR 4	3794	1265	-72	612	89	-47	71	-1	3020	4897	-640	681	-1	3575
1984 QTR 1	2039	1381	-66	580	15	-47	-4	0	2967	3147	-473	562	0	2112
QTR 2	2477	1831	-50	519	47	-63	-28	-1	3170	3392	-752	550	-1	2089
QTR 3	1958	900	-50	521	-12	-63	62	0	2827	3427	-817	550	1	2061
QTR 4	1936	793	-50	426	-20	-63	68	1	2473	3254	-754	550	-1	1949
1985 QTR 1	1594	1603	-50	492	21	-63	85	-1	3727	3234	-588	450	1	2197
QTR 2	2006	1141	-50	484	51	-37	18	1	3597	3995	-674	550	0	2771
QTR 3	1801	806	-50	506	46	-37	-2	0	2728	3260	-767	550	0	1943
QTR 4	1835	1505	-50	407	46	-37	-17	0	3355	3336	-755	450	0	2131
1986 QTR 1	1212	1438	-10	503	18	-37	-8	0	3667	2975	-814	450	0	1711

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PPS/CHANCELLOR

file no TEB/CA/01

copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/EST
PS/MST
PS/Home Secretary
PS/Foreign Secretary
PS/Secretary of State for Education and Science
PS/Lord President of the Council
PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Trade and Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Parliamentary Secretary to the Treasury
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 20 June, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

27 June 1983

EB Division
H M Treasury
01-233-5503

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ECONOMIC BRIEF: CONTENTS SOURCES

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Queen's Speech 22 June stated that Goverment would 'pursue policies designed to increase economic prosperity and to reduce inflation. They will seek a further reduction in inflation ... continue to maintain firm control of public expenditure and a responsible financial strategy based upon sound money and lower public borrowing ... promote growth in output and opportunities for employment by encouraging industry to be adaptable and efficient and to compete successfully.' Chancellor's forthcoming speech in Debate on Address Wednesday 29 June will be his first major speech on economic policy as Chancellor.]

Intend to consolidate and build on progress already made in creating conditions for sustainable recovery. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. Current economic situation

Modest recovery is under way, not just in sectors like North Sea and house-building, but also in many parts of manufacturing. GDP up 3 per cent since Spring 1981. Restocking now taking place. Private investment recovering and retail sales remain buoyant. Other indicators - including recent CBI reports (latest Trends Inquiry 27 June - see B5), and CSO cyclical indicators - point in direction of continued gradual recovery. With inflation lower and evidence (eg from US and Germany) that world economy is picking up, good prospects that recovery will be sustained. (See also Section B.)

3. Disappointing May overseas trade figures?

See G1-3, also B12.

4. Economic achievements of 1979-83 term of office?

Dramatic fall in inflation; income tax rates lower and allowances higher at all levels; improved fiscal environment for business and industry; progress on privatisation; measures to encourage competition, widen choice and extend property ownership; removal of wide range of Government regulation and restrictions; public spending brought under control; number of public service employees reduced and more efficient systems of management introduced. Changed attitudes about responsibilities and pay. Greatly improved efficiency in industry points to stronger base for sustained recovery.

5. Does Chancellor stand by his forecast of fall in unemployment next year?

[Guardian 31 May: Mr Lawson reported as saying '... in my judgment all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment'.]

Employment always responds to changes in output with some delay. Good progress on inflation and output has been made over past year. Much will now depend upon factors outside Government's control, including developments in world economy and our ability to hold down domestic costs. But room for some optimism about prospects. (See also Section C.)

6. What about rise in mortgage rate?

See E7.

7. Isn't money supply out of control?

See E2.

8. Latest ½ point cut in base rates (15 June): just a political gesture?

See E4.

9. CBI critical of high interest rates/exchange rate?

[CBI Press Notice following monthly Council meeting 15 June when, conducted post-Election review of full range of policies affecting business. CBI saw Chancellor Wednesday 22 June and to see PM Monday 27 June.]

CBI not critical: like Government, would like to see lower interest rates. Also stress need not for lower exchange rate per se but less volatility. In line with Williamsburg consensus (see F5).

10. Cuts in public spending on their way?

Of course Government cannot rule out changes to public spending plans if need arises - as Prime Minister made clear during election campaign. Government 'have to look at public spending every year and afresh' (Weekend World 5 June). (See also K1.)

11. Summer Finance Bill 'bonanza for the rich'?

Summer Bill result of choices made by Opposition about first Finance Bill. Measures need to be seen in context of whole Budget. Child Benefit is being increased to record levels and personal allowances raised by 14 per cent. Bill extends this 14 per cent increase to higher rate bands and investment income surcharge threshold. (See also Section J.)

12. When will the alleged secret manifesto be brought out and implemented?

There is no secret manifesto. The published manifesto sets out Government's intentions fully and frankly. Their actions will be consistent with these.

13. Select Committee on Procedure (Finance) Report: Government response?

[Report published 16 June makes number of major recommendations relating to Parliamentary control of borrowing, of non-'supply' expenditure and public expenditure as a whole, and of long term expenditure projects. Also major proposals for budgetary reform, and proposals relating to contingencies fund and to provision of financial information. Report would, if fully implemented, lead to major shift of power in financial area from Executive to Legislature.]

Committee have produced substantial piece of work with large number of recommendations across whole range of financial procedure affecting expenditure, taxation and borrowing. Government will want to consider them carefully. Detailed comment inappropriate at this stage.

14. Latest IMF views on world outlook

See T2 and 4.

BULL POINTS

Output and Demand

- GDP(A) over 3 per cent up on 1981 Q2 trough.

- Industrial output in three months to April up 3-3½ per cent on 1981 Q2 trough.

- Manufacturing production recovered 1 per cent in three months to April on previous three (chemical and allied industries and electrical engineering showing strongest improvement).

- Consumers' expenditure in 1983 Q1 3 per cent up on a year earlier.

- Retail sales rose 1½ per cent in three months to May on previous three.

- Substantial stock turnround in 1983 Q1.

Prospects

- CBI (June) Enquiry showed (i) total order books strongest since November 1979; (ii) net balance of firms expecting increase in output positive for fifth successive month; (iii) balance reporting excessive finished goods stocks lowest since November 1979; (iv) balance expecting increase in domestic prices still historically low.

- Fixed investment (private sector) set to rise 3-4 per cent in both 1983 and 1984.

- Housing starts in 3 months to April 14 per cent up on year earlier (private sector starts up 15 per cent).

- CSO's cyclical indicators point to continuing upswing in the business cycle.

- Outside forecasts recently suggest higher GDP growth this year than Budget estimate (perhaps 2-2½ per cent).

Financial Strategy

- Government borrowing amngst lowest in industrialised world.

- Public expenditure planning total in FSBR for 1983-84 (£119.3 billion) below total published in 1983 White Paper and £¾ billion below planning total in Autumn Statement. First time since 1977 that Government not increased spending plans in course of Survey.

- Short-term interest rates down about 7 points since autumn 1981.

- Official external foreign currency debt down from $22 billion in May 1979 to less than $12 billion at end-May 1983. Remaining debt now smaller in relation to imports than at any time since Second World War.

Inflation, Costs and Profits

- RPI inflation 3.7 per cent (May) - lowest since March 1968. Forecast at 6 per cent by end-1983, though may be doing better than expected.

- Output per head (manufacturing) risen 17 per cent since end-1980 and at record levels. Output per head and output per hour now 9½ and 12½ per cent above previous cyclical peak in H1 1979. Manufacturers' unit wage and salary costs up 2½ per cent in 1983 Q1 on year earlier - compares very favourably with major competitors.

- Cost competitiveness (manufacturing) improved around 20 per cent since early 1981 (assuming £ effective of 84).

- ICC's profits up 15 per cent between 1981 and 1982. Real profitability also improving slightly.

- Company liquidity at best level since mid-1979.

Labour Market

- Working days lost (1982 -5.3 million) well below 12 million average of preceding 10 years. In 1981 UK in middle of international league table.

Freedom, Enterprise and Initiative

- Many controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls.

- Further 13 enterprise zones announced in 1982 (total now 24).

- Civil Service now 648,700 (1 April 1983) - cut of 11½ per cent since Government took office. On target to achieve smallest Civil Service since war by 1984 (630,000). LA manpower (GB) cut by 106,000 (4½ per cent) between June 1979 and December 1982.

- Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost ½ million public sector tenants bought their houses since May 1979; further ¼ million in process of buying.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Evidence for recovery?

[GDP (0) - the best short-term indicator of the three GDP measures - rose ½ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; GDP(O) now over 3 per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production in three months ending April was 1½ per cent up on previous three; underlying industrial output now around 3-3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1 per cent higher in three months to April than in previous three.]

GDP has recovered over 3 per cent since spring of 1981, and industrial output has recovered around 3-3½ per cent. Manufacturing production three months to April increased 1 per cent on previous three and expectations (eg recent CBI reports, CSO leading indicators) are for further increases. Consumers' expenditure in 1983 Q1 up 3 per cent on year earlier. Retail sales at record level - 5½ per cent higher in three months to May compared with year earlier. De-stocking in second half 1983 (£720 million at 1975 prices) has been turned round into modest restocking (£120 million) in first quarter this year.

2. UK suffered worse recession than major competitors?

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (average measure) fall of almost 4 per cent - though not strictly comparable measure.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most against difficult international trade background. Growing signs of world recovery - particularly in US - should make going easier.

3. Prospects for UK economy good?

Total output forecast to grow in 1983 (2 per cent) and to be growing slightly faster (2½ per cent) in 1984 H1, with inflation remaining moderate. Recent outside forecasts in broad agreement on outlook for this year, though output growth expected to be slightly higher at 2½ per cent. CSO's cyclical indicators point to continuation of upswing in business cycle.

4. Latest (June) CBI Industrial Trends Inquiry

[See Commentary for details.]

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, Sir James Cleminson has pointed out that, while Inquiry results are encouraging, not all manufacturing industry has benefited yet from this steady but modest increase in business activity.

5. Is recovery sustainable?

Recovery has been modest but against very difficult world background; many indicators point to continuing growth. Longer term prospects look good so long as we stick to sound financial policies and work for greater competitiveness, efficiency and enterprise. Containment of costs also of crucial importance if lower inflation to be translated into lasting growth and jobs. Much progress already made (lower inflation and interest rates, improvements in productivity and competitiveness and encouragement of competitive market forces); need to consolidate further.

6. Government over-optimistic?

Nearly all major outside forecasts see prospect of continued modest recovery in 1983 (GDP up around 2-2½ per cent), modest price inflation (around 6 per cent by end 1983) and further growth in 1984.

7. Domestic industry missing out on the consumer spending spree?

[For details of consumer spending see Commentary. Buoyancy, particularly of retail sales contrasts sharply with movements in consumer goods production. In three months to April latter was only ½ per cent up on preceding three months and was little changed from its level a year earlier.]

Consumer goods production figures disappointing. However, CBI's June Trends I shows that output expectations are particularly strong for consumer goods sector and May trade figures showed fall in value of consumer goods imports from April level. But scope remains for further improving competitiveness by moderating wage settlements and improving product design, etc.

8. Latest construction and engineering industry indicators suggest recovery over?

[Construction output and orders have fallen in recent months though housing remains relatively buoyant. Total engineering orders fell 1 per cent in 1983 Q1 compared with previous quarter, reflecting continuing weakness of domestic orders.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4. Given this performance, some pause not surprising though latest figures are disappointing. But not too much weight should be placed on one quarter's figures, particularly when set against background of general recovery. Engineering domestic orders disappointing but export orders have risen by over 26 per cent in 1983 Q1 over previous quarter, and latest forecast by Engineering Employers Federation expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984.

9. Hasn't recent investment performance been weak?

[Total fixed investment in 1983 Q1 over ½ per cent up on 1982 H2 level. Manufacturing investment (including leasing) in 1983 Q1 over 4 per cent down on 1982 Q4 and over 5 per cent down in latest six months compared previous six. But total capital expenditure by manufacturing, distribution and service industries up 1 per cent latest six months compared previous six.]

Manufacturing investment has been disappointing (over 4 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment, likely to recover later this year (see B10). Fixed investment in other sectors has been stronger: total fixed investment rose 1 per cent in 1983 Q1 on previous quarter; investment in distributive and service industries (excluding shipping and leased assets) grew by almost 2 per cent on same comparison.

10. Investment intentions?

Latest DOI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. Outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984. First time since July 1979 that majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

11. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 5½ per cent in year to 1983 Q1; and overall improvement of around 17 per cent since end 1980. Some slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Also, manufacturing output now rising. Overall performance since 1981 better than could have been expected on past experience.

12. Trade figures suggest that recovery will hit balance of payments 'stop' just as in the old days?

May figures affected by 'erratic' items and oil. Recent rise in imports and form it has taken are consistent with other indicators of industrial recovery (see also Section G).

13. High real interest rates choking off recovery?

Real interest rates are high whilst economy adjusts to low levels of inflation - just as real interest rates were negative when inflation was accelerating in 1970s. Real interest rates in UK not particularly high by international standards. Expect some fall in real interest rates in developed countries as inflation brought firmly under control.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D. NB June unemployment figures to be published Thursday 30 June.]

1. Unemployment figures (new basis)/ other labour market indicators?

[May fall in 'headline' total largely reflects favourable seasonal factors and impact of new provisions for over 60s to get automatic credits. Vacancies are on a slowly rising trend (though fell slightly in May). Overtime worked broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	June	Sep	Dec	Mar	Apr*	May*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.17	3.05
Adult sa unemployment (millions)	2.77	2.87	2.95	3.03	3.02	2.97
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+26	+13 [+23]	-10 [+24]
Vacancies (000s)**	105	107	118	126	135	131

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

The unemployment figures continue to be affected by special factors. Large fall in headline total masks underlying upward trend. Although there are indications that this upward trend has eased, the improvement is modest. Other labour market indicators are mixed.

2. True level of UK unemployment really much higher than published figure?

Gross exaggerations are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed.

3. But official figures take no account of unregistered unemployment/non-claimants?

Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Some estimates of number involved will appear in article to be published in Department of Employment Gazette on 30 June.

4. Budget measures just Government attempts to 'fiddle' the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First of these removed around 104,000 from May unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

5. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.' 1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84.]

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies. As 1983 PEWP made clear: 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

6. Chancellor's forecast ~~of~~ fall in unemployment next year?

[Guardian 31 May: Mr Lawson said; '... in my judgment all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment'.]

See A5

7. Unemployment in UK worse compared with other countries?

[On standardised definitions in April 1983 UK unemployment on new basis was 13.7 per cent (compared with 5.5per cent in 1979), Canada 12.4 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.0 per cent (compared 5.9 per cent), Germany 7.6 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was greater in Germany (39.8 per cent - rise of 2.2 points in unemployment rate - in May), and Canada (28.4 per cent - 2.6 points in April) than in UK (8.4 per cent - 1.0 points - in May).

8. Cost of unemployment

Changes in unemployment affect public finances according to underlying circumstances, eg changes in world trade, UK competitiveness, relative UK earnings etc. Not sensible to talk as if 'cost of unemployment' a single figure. Unemployment and supplementary benefit to people counted as unemployed currently expected to total about £5.7 billion in 1983-84 (DHSS estimate in 1983 PEWP). Comparable figures for uncollected taxes and national insurance contributions cannot be given - would be largely hypothetical. Widely circulating figures at £15 billion or more are without meaning. There can be no basis for estimating what public finances would look like if all the unemployed were working.

9. Government don't care about unemployment? Should do something about it?

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Cuts in NIS have reduced tax on jobs. Also Government creating sound foundations for sustainable growth in employment by (i) maintaining firm financial policies designed to reduce inflation and interest rates further (ii) encouraging competition, enterprise and initiative by number of 'supply side' measures. But Governments cannot do everything. Much depends on world developments and private sector's ability to hold down costs and improve competitiveness.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in May, compared 4.0 per cent in April].

12 monthly rate of inflation again fell sharply in May to 3.7 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year

RPI scarcely rose at all between June and September last year. As a matter of simple arithmetic there is likely to be an increase in the 12 month change over corresponding period in 1983. It was made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year perhaps to about 6 per cent; if anything progress since then has been better than expected.

3. Effect of higher mortgage rates/lower exchange rate on RPI?

[1¼ percentage points increase in mortgage interest rate (to 11¼ per cent) announced by Building Societies' Association on 22 June will add around 0.4 per cent to RPI, mainly in July.]

Mortgage rate/exchange rate only one factor amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS), likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies. Outcome could still be better than Budget forecast of 6 per cent RPI inflation by 1983 Q4.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2. Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. TPI increase

12 monthly increase in TPI (3.2 per cent) over year to May 1983, now ½ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

6. Comparison with competitors

[April figures UK inflation 4.0 per cent compared 3.3 per cent in West Germany, 3.9 per cent (annual change on new index) in US, 9.1 per cent in France, 16.4 per cent in Italy, 6.6 per cent in Canada, and 2.0 per cent in Japan; 4.8 per cent weighted average 'major 6'.]

UK inflation now lower than average of major OECD 6 and well below France, Italy and Canada, but still some way to go to match West Germany and Japan.

PAY

7. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.7 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase 7¼ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings 8.2 per cent in April, compared 4.0 per cent growth in RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. Recommendations of Review Bodies

Government published on 12 May its decisions on Reports from the Armed Forces Pay Review Body and from the Doctors' and Dentists Review Body. The recommendations have been accepted. Two reports from the Top Salaries Review Body on the salaries of the higher civil service, senior officers in the Armed Forces and the judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, were deferred for consideration after the Election.

E MONETARY AND FINANCIAL POLICY

1. What is Government's monetary policy in its second term?

Government continues to adhere to 1983 MTFS. Growth of M1, £M3 and PSL2 within last year's target range of 8-12 per cent. Target is 7-11 per cent for 1983-84.

2. Is the money supply out of control?

[M1, £M3 and PSL2 grew by 1.5 per cent, 0.8 per cent, and 0.8 per cent respectively in banking May (seasonally adjusted). Annualised growth rates of first 3 months of current target period produces rates of growth well above target range.]

Early days yet for new target range. First two months of target period affected by surge of public sector borrowing. Annualising rates of growth highly misleading when using only a few months figures. Target range is for a year as a whole, not particular months.

3. Is there a change in emphasis away from the money supply towards the exchange rate?

No. Government looks at whole range of factors in assessing financial conditions. This includes the exchange rate.

4. Does recent fall in base rates despite high monetary growth indicate a change in policy?

No. We look at a variety of indications of financial conditions. The evidence from real interest rates, inflation and the exchange rate is that monetary conditions remain sound.

5. Any prospect of a further fall in interest rates?

Sound monetary conditions and low inflation offer best basis for sustainable reductions in interest rates. Interest rate reductions are desirable, but only if not jeopardising this strategy.

6. Bank lending

[Rise of £0.9 billion in banking May after £0.2 billion in April and £0.6 billion in March banking months.]

Continues at levels well below levels reached last summer. Recent slackening continues.

7. Government view of mortgage rate increase?

[Building Societies Association announced 22 June changes in recommended interest rates, to take effect from 1 July. Mortgage rate will rise from 10 per cent to 11¾ per cent and ordinary share rate from 6¾ per cent to 7¾ per cent (basic rate tax paid).]

Sorry that mortgage rate has gone up, but level of building society interest rates a matter for them, not Government. Societies have to decide their own rates in relation to demand for mortgages, which has been very strong in recent months, and level of other rates. (For effect on RPI see D3).

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 9 per cent in effective terms, 9 per cent against the dollar, 9 per cent against the D-Mark, 20 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms and on 28 March reached record low against dollar of $1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets. In the run up to the General Election the £ strengthened, but has now fallen back to its effective levels in early May.

	October average	24 June noon	% change Oct - 17 June
$/£	1.6977	1.5460	-8.9
DM/£	4.2932	3.9037	-9.1
Y/£	460.12	367.79	-20.1
£ effective	92.5	84.6	-8.5

2. Exchange rate policy/Government wants lower exchange rate?

Government has no target for exchange rate although it is taken into account in interpreting domestic monetary conditions in Government's attitude to interest rate movements. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible, whether pound is rising or falling - though intervention cannot hope to prevent movement in face of strong market pressures - or, by itself, influence the rate in other than the short term. [See E3 on interest rate-exchange rate policy.]

3. Overvaluation of sterling cause more than half rise in unemployment since 1979?

[TCSC second report on international monetary arrangements: 'Chairman's draft' says only half rise in unemployment due to world recession but 'overvaluation of sterling was a major element'.]

No. Unemployment has risen more in UK than other countries over whole period since 1979 because our problems have been more deepseated than theirs. If UK wage bargainers had reacted quicker to outside events in 1979-81 - as wage bargainers in some other countries did - then certainly the rise in unemployment would have been less.

4. There should be a joint real - or nominal - exchange rate and monetary target for future?

[Proposals in 'Chairman's draft' appended to TCSC second report on international monetary arrangements.]

The two would be bound to conflict. Which should take priority? Sensible policy is the one Government has adopted. Performance of monetary aggregates is interpreted taking account of movement of exchange rate. This policy very similar to that operated in West Germany - and quoted with approval in the report. Would be wrong to try to turn this into some mechanistic rule.

5. Williamsburg Summit 28-30 May

[See also T1-2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets, bearing in mind their conclusions on the Jurgensen report (see F7).

6. Jurgensen Report - significance?

[Jurgensen report on exchange market intervention, commissioned at Versailles Summit, published 29 April.]

Report covers only narrow topic of intervention. It aims at giving better understanding of the methods, motives and effects of past intervention. Therefore did not make any policy recommendations. Does not herald an early return to fixed exchange rates. Although it notes importance of broader economic policies in determining the exchange rate it did not consider wider issues of greater policy convergence or IMF surveillance. These questions were considered at Williamsburg and will be taken further in IMF.

7. Jurgensen Report - verdict on UK policy?

Report's findings confirm approach taken by UK Government. Government have always felt that intervention could be useful at times to help steady and calm disturbed market conditions. But always considered that consistent pursuit of sound, counter-inflationary monetary and fiscal policies is only long-term solution to problem of exchange rate instability, and that trying to solve problem through intervention alone would be misguided and ineffective.

8. Improve UK competitiveness directly by engineering further fall in exchange rate?

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging - and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset the effects. Confidence would collapse and jobs would be destroyed. CBI at last Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

9. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Thus for example West Germany's cost competitiveness deteriorated 20 per cent between 1970 and 1980 but she maintained her 20 per cent of main manufacturing countries' exports. Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars: their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

10. Situation has been made less stable by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations.)

11. Join EMS exchange rate mechanism (ERM)?

Difficulties over membership remain. In particular, sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

12. Impact on inflation of movements in sterling?

See D3.

13. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

1. May trade figures and current account

[Current account deficit just over £300 million in May, compared just over £100 million in April; cumulative current account surplus in first five months of 1983 £33 million, but £717 million surplus in last six months.]

Trade figures erratic month to month. Picture in May further confused because main reason for deterioration in current account was large increase (some £190 million) in imports of identifiable erratic items - precious stones, ships, aircraft and North Sea installations.

2. Trade in manufactures in deficit?

[Trade in manufactures was in deficit some £660 million in first quarter - on balance of payments basis. (NOT FOR USE Deficit on bop basis for year to May was roughly £1½ billion.) In 1982 trade in manufactures was £2½ billion in surplus.]

Deterioration in balance on manufactured trade not in itself cause for concern: a natural counterpart of improved oil balance we have enjoyed in recent years. Oil has enabled us to import more: if we had not done so it is true that we would have had even larger current account surpluses, but there would also have been larger offsetting capital outflows - is that what Opposition want? With low level of domestic inflation and prospects of reviving markets overseas, industry now has opportunity to increase level of exports and to improve market shares at home and abroad - provided costs kept under firm control.

3. Deteriorating oil balance?

Balance on trade in oil has fallen back to last autumn's levels following unusually high surpluses over the winter. Several reasons for high surpluses last winter; one was high level of domestic oil production, which has fallen back a bit since the spring; others were milder than usual winter weather and heavy drawing on stocks by UK companies, both of which tended to reduce imports and divert domestic production into exports.

4. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI Industrial Trends reports show encouraging improvement in order books and expectations of rise in deliveries over next few months.

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Recent rise in imports and form it has taken is consistent with other indications of economic revival. Increases seem to be concentrated in goods for use by industry (materials, fuels, capital equipment) rather than for consumption. May figures are in line with this overall view.

6. Import prices

Welcome news on inflation front is that non-oil import prices fell in May after increasing in recent months. Improvement probably reflects sterling's recovery since March.

7. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which - at a surplus of £1.1 billion - were down £0.6 billion on 1981.

8. Current account 1983 forecasts

[FSBR forecast £1½ billion current account surplus in 1983 (down from £4 billion in 1982.]

Ne forecast to be published will be in Autumn, as usual. Will incorporate Treasury's latest assessment of prospects for current account at time when outlook will have become clearer. [NOT FOR USE: Treasury are updating Budget forecast but not for publication.]

TRADE POLICY

9. Protectionism

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P5.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers'. They emphasised importance of working through GATT.

10. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

11. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

H FISCAL POLICY AND THE PSBR

1. Does Government plan to tighten/weaken fiscal policy?

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal policy?

[Aim is to achieve trend reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. PSBR has been reduced (but see H5 and 7-8). Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - lower PSBR over run of years implies lower interest rates - still holds true.

5. Why did 1982-83 PSBR overshoot?

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

6. Public expenditure out of control?

No. Simply less underspending on plans than was assumed at Budget time. No question of any failure of public expenditure control system. Only two extremely minor breaches of cash limits and year ended with large part of the Contingency Reserve unspent.

7. PSBR overshooting this year - tax increases or expenditure cuts in the offing?

[Budget forecast £8.2 billion, 2¾ per cent. As result of last year's overshoot and high figures for CGBR recently, many - but not all - outside forecasters now predict an overshoot.]

Too early to form new view about prospect for this year. Next official forecast will be published with Autumn Statement. Government intend to continue firm control of public spending and borrowing.

8. But high CGBR in April and May surely means PSBR overshooting?

[CGBR in April to May £2.9 billion compared with £1.9 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion - next forecast at time of Autumn Statement.

9. Do PSBR overshoots mean higher interest rates?

Yes, lower PSBRs do lead to lower interest rates. But effect of overshoots limited because they do not signal change of strategy. PSBR over a run of years is what really counts.

10. Government misleading public over PSBR outlook?

No. Must remember PSBR difference between two large aggregates and always difficult to assess likely end-year borrowing. FSBR contained strong 'health warnings', so can hardly be accused of misleading people.

11. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

12. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

13. UK fiscal policy tightest in world?

[IMF report said UK fiscal contraction over last 3 years was largest of any major country; OECD calls for prudent fiscal relaxation.]

Agree we have had more success in controlling borrowing than many other countries. They are now trying to emulate us. IMF and OECD support our commitment to cutting inflation and interest rates.

J TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also J18). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes.

2. Early Finance Bill?

Resolutions paving way for new Finance Bill were taken on 23 June. Bill will be introduced this week. Since it is hoped that House will complete consideration of the Bill before Summer Recess, Bill does not contain all those proposals contained in original Finance Bill that were not enacted before General Election. Bill restores original Budget proposals on higher rate tax thresholds, investment income surcharge threshold, increase in limit for mortgage interest relief, increase in CTT threshold and rate bands, and increase in profits limits for 'small companies' rate of corporation tax. Bill also contains small number of essential provisions (see J3). Budget proposals on oil taxation that were not enacted in Finance Bill 1983 will be contained in an Oil Taxation Bill to be introduced in the autumn.

3. What are the other provisions in the Summer Finance Bill?

Bill contains technical amendments to Business Expansion Scheme and Assured Tenancies Scheme. There will be a provision to relieve from CGT and stamp duty local constituency associations of political parties who transfer property as result of the recent boundary changes. Also a provision exempting from Development Land Tax operations in connection with installation of telecommunications systems, and a measure to prevent individuals who receive interest-free loans from their employers from obtaining excessive relief under the mortgage interest relief provisions.

4. What is to happen to proposals announced in Budget but not in the summer Finance Bill?

New Treasury Ministers will be urgently considering these proposals. Will examine detailed issues that have arisen on various proposals since Budget and consider representations received on measures in original Finance Bill. Where appropriate will publish draft clauses - or revised draft clauses - so that 1984 Finance Bill can be prepared with benefit of fullest possible consultation.

5. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in income tax allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

6. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession and need for responsible fiscal and monetary policies. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

7. Government's own figures prove average family now pays more tax than in 1978-79?

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax net of child benefit in 1983-84 than they did in 1978-79.

8. Budget benefits for lower paid

Budget provided help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

9. Tax cuts favour the rich?

1979 reductions in absurdly high top rates of income tax reduced these to EC levels as part of package which included 3p reduction in basic rate and substantial increase in thresholds. Right that 1983 Budget should increase higher rate thresholds by same percentage as allowances. This increase not a measure for so-called rich; will benefit middle management. If threshold for higher tax rate kept at £12,800 - figure on which Opposition insisted before General Election - then, assuming no other allowances, a two earner couple would start to pay higher rate tax when their joint income was still less than twice average male earnings.

10. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rose in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out. Following is based on 1983-84 earnings levels taking, for illustrative purposes, the 6½ per cent earnings increase for 1983-84 used by Government Actuary.]

Tax reductions will be greater than effect of increase in NICs for all but a small minority. [IF PRESSED: Those who will lose out are married contracted out at about 1½ times average earnings and single contracted out at between ¾ and 1½ times average earnings.]

11. Average worker with mortgage only 19p a week better off after Budget?

[Calculation for particular type of individual in Answer to Sheldon PQ as follows: £2.02 income tax cut, minus 40p NIC increase, minus £1.43 recovery of excess mortgage tax relief.]

Wrong to treat repayment of tax underpaid last year as a tax increase. Annex to Mr Sheldon's PQ also showed this individual over £6 a week better off than last August, as result of cut in income tax in last Budget and fall last year in mortgage interest rates.

12. Money spent on mortgage interest relief ceiling increase could be better spent on public sector housing investment?

Government has already done much here. In this year's Budget, previous Chancellor increased by 20 per cent the eligible expenses limits for home improvement grants and gave local authorities additional capital spending allocations for approved 'enveloping' schemes. But also right to increase ceiling for mortgage interest relief when increasing evidence that the old limit was inhibiting first time buyers.

13. Increasing subsidies to home owners while reducing them to coucil tenants?

True that subsidies to local authorities have dropped. But direct help to tenants (ie including Housing Benefit) has more than doubled since 1979 - an increase of over £1 billion.

14. Effect on people with mortgages of MIRAS and recovery of excess tax relief?

Tax payments will go up as result of MIRAS but mortgage payments will go down. Borrowers entitled to ask building society to reduce their monthly payments in such a way that their net position is unchanged. When mortgage interest rates fell last year, PAYE codes were not altered and people received more relief than they were entitled to. Recovery of this excess relief, which increases tax payments, allows people to pay tax that should have been paid last year by easy instalments. In no sense an increase in tax burden.

15. Some people not getting mortgage interest relief as a result of switch to MIRAS?

No one entitled to the relief will be deprived of it. A number of people with bank mortgages have not been brought into the new scheme. A few of these have also lost the relief through their tax coding. Anyone in that position should contact their tax office, who will put matter right as quickly as possible.

16. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut (see J17). Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

17. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Prime Minister said (23 June) during Debate on Queen's Speech that Government hoped to abolish NIS (cost £1.2 billion in full year) during present Parliament.

18. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

The Committee has produced a long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to the UK and are not amenable to easy solutions. The Manifesto (see J1) accorded high priority to the traps, and the Government will be examining the draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings.

19. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

PUBLIC EXPENDITURE PLANS

1. Further cuts in public expenditure?

[The Times 22 June on ways to reduce spending over next 10 years article says PM was 'told that no further cuts above those already planned were possible']

Present expenditure plans cover next 3 years only. These plans as revised by Budget show steady decline in ratio of public spending to GDP. They are starting point for next public expenditure survey, now imminent. Proposals for increases or reductions to plans are looked at during survey.

2. Capital spending plans lower in 1983-84 than 1982-83?

Immediate problem not making more funds available but getting local authorities and nationalised industries to spend capital provision available to them. Reduction in planned expenditure compared with last year's plans reflects fact that those plans were not realised.

3. Over-run on spending plans for 1982-83 suggests failure of public spending control?

No. (See H6).

4. Implications for 1983-84 and later years?

[1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. Total shortfall for 1982-83 compared plans announced in 1982 Budget thought at Budget time likely to be £2.2 billion but now likely to be much smaller.]

Not clear that expenditure was accelerating in any underlying sense in last weeks of 1982-83. There are one or two items of expenditure that could have fallen either side of 31 March, but in the event fell inside 1982-83. Wrong therefore to draw conclusions either about likelihood of expenditure overshooting in 1983-84 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

5. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments and health authorities to reclaim VAT on contracted out services thus removing a disincentive to contracting out.

6. IMF conjuring trick?

[Hamish McRae's column in Guardian 24.6.83 criticises present classification of UK's increased contribution to the IMF]

No conjuring trick - classification follows agreed national accounts conventions. But Guardian got it wrong in saying that if IMF lent our money to eg National Enterprise Board (NEB) there would also be no public expenditure effects:- public expenditure would be increased (planned total includes market and overseas borrowing of NEB).

LOCAL GOVERNMENT

7. Local authority overspending?

Local authority current expenditure in England some £¾ billion in excess of guidance issued by the Environment Secretary. (About half of overspending due to GLC and ILEA. All of the eighteen highest overspenders in Labour control). Overspending approximately £1 billion in GB overall. Local authorities were warned at the time of the last Rate Support Grant (RSG) settlement that such overspending would lead to holdback of grant. Details will be announced shortly.

8. RSG settlements 1984-85?

Government recognises that authorities need long notice of broad features of settlement; accordingly early announcements of grant quanta and planning totals are intended.

9. LA capital underspending

[Report by Alan Budd published 27 June offers suggestions for boosting capital spending]

Latest estimates suggest that local authorities underspent their capital cash limits by a little under £1 billion in 1982-83. This is disappointing, because it follows underspending of £¾ billion in 1981-82 but represents significant improvement on £1½ billion underspending forecast last autumn. Steps were taken then to reduce underspend: PM wrote to local authority associations; local authorities invited to apply for extra allocations (about £½ billion issued), and allowed to spend without limit on improvement grants. These measures seem to have been very successful. Steps have also been taken to reduce risk of underspending in 1983-84: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems including supplementary allocations), LAs can spend above allocations on improvement grants, and eligible expenditure limits raised in Budget by 20 per cent, also new 'enveloping' provisions (where whole streets being renovated) announced in Budget.

10. Revenue implications of capital projects

Concern about revenue implications should not inhibit full use of allocations: plans for relevant LA current expenditure allow for financing costs of full planned capital programmes; many capital projects have no immediate running costs eg roads, reclamation of derelict land; others will reduce running costs by rationalisation. Government cannot guarantee there will be no underspending - LAs take the decisions. But Government will be monitoring closely, and will take further action, if needed, to encourage full use of provision.

11. Control of local authority rates

Bill will be introduced early in 1984 giving power to curb rate increases of selected overspending authorities in England and Wales from 1985-86. Selection will be on basis of past performance. Powers already exist in Scotland. Bill will also provide fall-back powers to be used if it proves necessary for general limit on rate increases. Wide consultation will precede legislation. Will publish White Paper shortly.

12. Business Rates

Rates now biggest single tax paid by industry. Excessive increases damage jobs. Bill (see K11) will also require authorities to consult representatives of non-domestic ratepayers before setting rates, and will derate empty industrial property. In meantime, considering reducing statutory maximum non-domestic empty premises rate. Also, rate level below which business ratepayer may pay by instalments will be raised.

13. Other rates reforms

Propose to make each main rating and precepting authority provide annual statement to each ratepayer. Council tenants paying inclusive rents will receive separate advice of rates level.

14. Reform of Local Government Structure

Propose to simplify structure by abolishing upper tier in London and areas of metropolitan counties. Functions to be transferred to lower tier or assumed by new joint boards comprised of nominated elected members of lower tier. ILEA also to be replaced by joint board. Special arrangements for London Transport. White Paper with details this autumn. Wide consultation, including staf, before legislation. Bill to be introduced early next Session; aim for changeover on 1 April 1986.

FALKLANDS EXPENDITURE

15. What has defending Falklands cost so far and foreseeable future cost?

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion).

16. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10½ million spent in 1982-83; further £5 million expected to be spent in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

17. Cost of paying compensation for war damage

Too soon to say. Bulk of claims for civilian compensation settled in 1982-83 at £2.2 million. Remainder expected to be settled in 1983-84, but no accurate figure as claims still being processed. Total expected to be in region of £3½ million.

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1929, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K6.)

3. Civil service efficiency?

Civil Service unions say drive for efficiency, motivated largely by Government's determination to reduce size of civil servce, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments have explored option cuts of 5 per cent and 10 per cent and stated needs for extra staff. No decisions have been taken.

5. Management and Personnel Office

MPO now part of Cabinet Office. Lord Gowrie, Privy Council Minister of State and Arts Minister responsible for day to day issues, Mr Barney Hayhoe, Treasury Minister of State, answers in the Commons. Prime Minister, as before, in charge.

6. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of

their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative by July 1983.

7. Civil service pay negotiations for 1983 - non-industrials

Council of Civil Service Unions representing the non-industrial civil service have signified their acceptance of the agreement reached with Treasury. The agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. The cost is to be met from within the provision already made for Civil Service administrative expenditure.

8. Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] Chancellor wrote to colleagues on 20 June seeking agreement for officials to make an opening offer.

9. Civil Service pay in 1984-85?

[Press speculation about a possible civil service pay cash limit.]

No decision has been taken on the provision for pay in central government cash limits for 1984-85.

10. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

11. Top Salaries Review Body and the higher civil service

See D9.

M SOCIAL SECURITY

1. Next November's uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, Government has reverted to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May. Social Services Secretary put detailed proposals to Parliament on 23 June.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May - which was 3.7 per cent. Social Services Secretary gave detailed proposals to Parliament on 23 June for individual benefits. (Public Service pensions, under current legislation, will be uprated in line with State retirement pension.) Certain benefits - like Child Benefit, to be increased by substantially more.

2. 3.7 per cent uprating fails to price-protect pensions?

[Opposition will argue that inflation in year to November was forecast at 6 per cent at Budget time (although signs we are doing slightly better than this).]

No. Pensioners and other beneficiaries retain 2.7 per cent real increase in pensions given at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6 minus 2.7 = 3.3 per cent uprating. So beneficiaries better off under new system. In addition, under historic method, inflation in year from May 1983 automatically taken into account in 1984 uprating.

3. Supplementary benefit uprating?

[Last November supplementary benefit uprated for first time in line with RPI broadly adjusted for housing costs, yielding increases ½ per cent lower than for other benefits. This year supplementary benefit uprated similarly by increase in RPI less housing in year to May.]

As in last uprating, supplementary benefit will be uprated in line with increase in RPI less housing in year to May. This means an uprating of 4.3 per cent, ie 0.6 per cent age points higher than for most other benefits.

4. Cost of upratings?

Improvements Government has announced will add about £1½ billion to social security budget in full year but are within Government's expenditure plans as announced in last Budget.

5. Future price protection?

[Manifesto renewed undertaking given for period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit].

Manifesto renewed pledge, which we more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. Imprudent in present circumstances to promise more. But in November 1983 uprating both 'pledged' and 'unpledged' benefits will be price-protected. And in last Parliament most 'unpledged' benefits increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, substantially so.

6. Improvements?

[These include:

Families

(i) 11 per cent increase in child benefit to £6.50 a week, highest ever real level, similar increase for one parent benefit;

(ii) £1 increase in children's needs allowance in housing benefit from April 1984, on top of 50p in November: helps 700,000 low paid families with children;

Unemployed

(iii) restoration of 5 per cent abatement of unemployed benefit;

(iv) higher long term rate of supplementary benefit to be available to unemployed men over 60 from June;

(v) men between 60 and 65 no longer need to 'sign on' to safeguard pension entitlement;

(vi) main supplementary benefit disregard up from £2,500 to £3,000; single payments disregard up from £300 to £500; new separate £1,500 disregard for life assurance policies;

Sick and disabled

(vii) abolition of 'invalidity trap' (ie inability of invalidity pensioners to qualify for long term supplementary benefit rate): pensioners over 60 get long term rate immediately, ofter after 1 year. Helps 55,00 sick and disabled;

(viii) therapeutic earnings limit - amount disabled and chronic sick can earn with doctors' approval before benefit withdrawn - up from £20 to £22.50 per week;

(ix) new mobility supplement for war pensioners;

Pensioners

(x) 14 per cent increase in pensioners' earnings limit - up from £57 to £65 per week.]

Substantial and wideranging improvements designed to aid most groups of beneficiaries.

N EUROPEAN COMMUNITY

1. UK refunds for 1983

Stuttgart European Council agreed to basic net refund of £450 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly 66 per cent. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

4. UK objectives on EC budget for longer-term?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

5. Will UK agree to new 'own resources'?

We have agreed that review of the EC's future financing should consider inter alia question of extent and timing of EC's requirements for resources. This does not prejudge the outcome. HMG remains unconvinced of need for new 'own resources'.

6. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guideline on its rate of growth. Key measures remain price restraint and curbs on surplus production.

7. UK Government response to Commission request for advance to meet cash crisis?

Commission has right to invite these advances. We have agreed that, in view of current cash position, an advance should be made in June.

8. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

9. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of growth of guarantee expenditure.

10. Costs of CAP to UK consumers

Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to reduction in the cost of food to consumers could well involve increased costs to taxpayers.

11. European Monetary System exchange rate mechanism

See F7.

P INDUSTRY

[CBI views on policies affecting industry - see A9. NB Industrial and commercial companies appropriation accounts 1983 Q1 to be published Wednesday 29 June.]

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £2 billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[Gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, rose almost 15 per cent between 1981 and 1982; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

3. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Provisional figure of liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. 'Battle looming between Treasury and DTI over cost of export credits?

[Observer 19 June speculation.]

There is no dispute: but of course the whole range of Government payments to industry is always subject to continuous assessment.

6. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

7. Loan Guarantee Scheme?

[Nearly 9,400 guarantees already issued - about half to new businesses. Total lending under scheme over £310 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

8. New Enterprise Zones

Proposed sites for nine new zones in England were announced by Environment Secretary 15 November though one of these (NE Derbyshire) is not now going ahead; sites for two new zones for Scotland, one for Northern Ireland and two for Wales have also been announced. Meanwhile, the report from consultants published 26 April shows that the zones in general appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. Approach to improving nationalised industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. EFLs for 1983-84 currently total £2.5 billion.

INVESTMENT

3. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

4. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

5. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to May 1983 5.9 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

6. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

7. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

8. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

9. Future privatisation?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will

become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

10. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £500 million. Full details of receipts will be published shortly.

11. What sales included in special asset sale targets for future years?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive.

12. Action in this Session of Parliament?

Queen's Speech specifically refers to re-introduction of British Telecom legislation and proposals to transform Royal Ordnance Factories into Companies Act companies as precursor to introducing private capital. British Telecom largest privatisation ever. Legislation to permit other privatisations will be introduced as and when needed.

13. Employee share-ownership?

Many shares in previous privatisations have been bought by companies' own employees and managers which is truest public ownership of all. Around 100,000 employees have taken up shares in privatised companies. Employees, for example, given free offers of shares (British Aerospace, Cable and Wireless, Amersham, Britoil, ABP); preference in allocation of shares (BAe, C&W, Amersham, Britoil, BP, ABP); provision for matching shares - one for each share subscribed for - (BAe, Amersham, Britoil, BP, ABP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company (NFC). Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.

S NORTH SEA AND UK ECONOMY

1. Will OPEC agreement hold? BNOC prices?

Whether OPEC's agreement works will depend on OPEC. Price negotiations matter for BNOC's judgment. But North Sea prices will obviously be related to prices of closely-competing crudes. BNOC will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985? Effect on revenues?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about impact on economy of falling North Sea output. Effect of falling output on revenues will be muted because of tendency of revenues to lag behind output.

5. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields will be reintroduced as soon as possible.

6. Benefits of North Sea should be used to strengthen economy?

Without North Sea revenue taxes would be higher or public expenditure lower. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

7. Are we really any better off for North Sea oil?

We are clearly better off for North Sea oil than we would have been without it. At today's prices, the cost of extracting it is far below the cost of buying oil on the world market. (But this was not always true. At pre-1974 prices, it would have been cheaper to import oil and devote resources used in developing the North Sea to produce exports.).

8. Revenues from oil being frittered away on consumption/unemployment benefits?

[Opposition spokesman on trade, Mr John Smith MP, has repeatedly accused Government of 'frittering away' on unemployment benefit the £20½ billion on North Sea revenues received since May 1979.]

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. IMF's World Economic Outlook

[IMF's World Economic Outlook published 16 June; concerning IMF's forecasts see T4.]

IMF give further support to the consensus reached at successive international meetings and most recently at Williamsburg upon need to pursue prudent monetary and fiscal policies to consolidate progress made in reducing inflation and to help reduce interest rates. The IMF also stress that any change to more expansionary policies would risk kindling inflationary expectations.

3. New 'Bretton Woods'?

[Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.]

UK will play full part in considering with our partners conditions for improving international monetary system. UK view is that prudent policies among major countries offer best prospects for stable and durable system. Premature conference which ended in disagreement would be damaging.

4. World recovery under way?

[Encouraging signs of recovery particularly in US and Canada where industrial production rose sharply in first quarter and housing starts have risen. In Europe, industrial production also rose slightly in first quarter, and business confidence has improved. IMF now expect about 2 per cent growth in seven major economies and 1 per cent rise in world trade this year, broadly comparable with FSBR forecast.]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). Most forecasters expect recovery to accelerate during course of this year (with output rising by perhaps 1½-2 per cent) and to continue into next year.

5. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.6 to 3.9 per cent), UK (9.5 to 3.7 per cent), Japan (2.8 to 2.0 per cent), Canada (11.3 to 6.6 per cent) France (13.8 to 9.1 per cent), Germany (5.3 to 3.0 per cent), Italy risen slightly (from 15.2 to 16.4 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation have helped lay basis for signs of recovery being seen both in UK and rest of world this year.

6. Prospects for US economy?

[Industrial production has risen for past 6 months, retail sales have begun to improve. Preliminary estimates suggest that GNP rose strongly by about 1½ per cent in second quarter after rising ½ per cent in first quarter.]

Welcome further signs that recovery underway in US although too early to be sure recovery firmly established.

7. US Budget

[Senate and House of Representatives have now agreed compromise budget resolution for FY 1984 which provides for 5 per cent growth in defence spending and additional taxes of $12 billion contributing to a budget deficit of $170-179 billion dollars compared with Administration's initial proposal of $190 billion. Budget now has to be ratified by both Houses. President Reagan has threatened to veto any major tax increases.]

Share widely expressed concern over potential size of budget deficit. Important that Administration and Congress should agree firm measures to put deficit on convincing downward paths in medium run if US interest rates are not to rise again as economy recovers.

8. US has relaxed monetary policy?

[M1 has grown very rapidly in recent weeks following slight fall in April and is well above its 4-7 per cent target range set out in February. M2 and M3 are within their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates, Fed is keen to sustain recovery but remains solidly committed to preventing any resurgence of inflation.

9. International Debt

[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil) falls in interest rates since last summer, recent rises in commodity prices and expected growth in world trade during this year will help to improve underlying conditions.

10. Why is legislation on quotas/GAB needed?

[On 23 June the International Monetary Arrangements Bill was introduced in UK Parliament and draft IMF (Increase in Subscription) Order laid.]

IMF Interim Committee agreed in February that quotas should be increased by 47.5 per cent. Earlier, Ministers of Group of Ten had decided that commitments under IMF General Arrangements to Borrow should be increased. The draft legislation presented to Parliament implements our share of these decisions.

11. What is timetable?

Interim Committee urged implementation of decisions increasing IMF resources by end of 1983.

12. Fund running out of money?

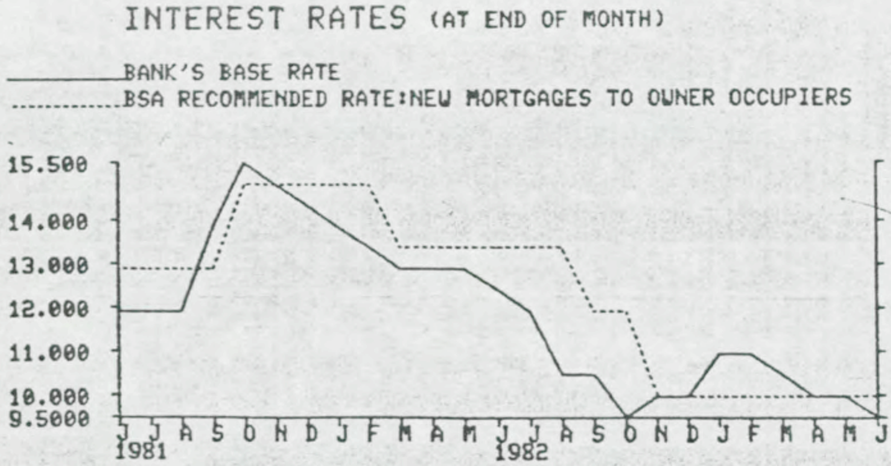
[The Times 27 June suggests Fund would need to raise additional resources to meet commitments over next few years.]

GAB/quota increases will provide fund with substantial resources, and we hope the Saudis will see their way to lending the third tranche of the SAMA loan. However we have always made clear that possibility of borrowing by the Fund in private markets should remain open, in light of evolution of its commitments and available resources.

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 27 JUNE 1983

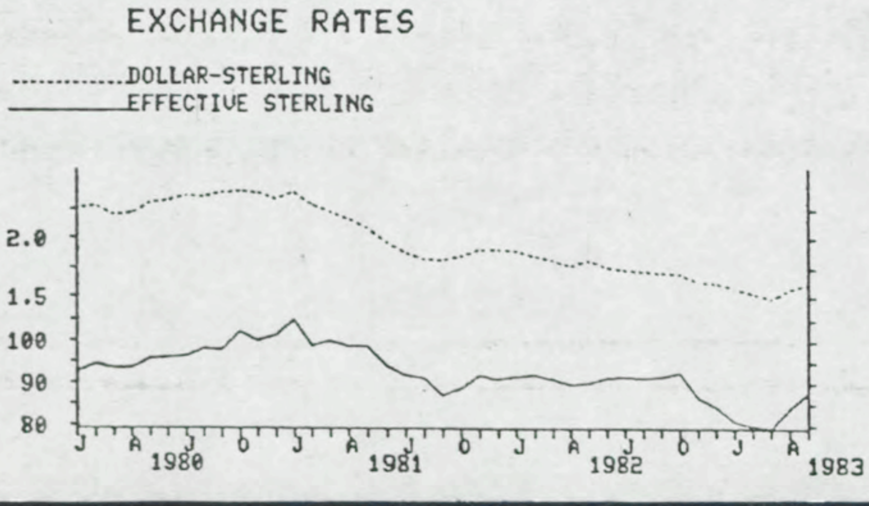
Financial Conditions

1. Bank base rates were reduced to 9½ per cent on 15 June. They are now at their lowest level for five years, apart from the period last autumn when they briefly fell to 9 per cent. Short rates have been fairly steady since base rates were cut and as yet there are no signs that markets expect any further changes in interest rates in the short term. The Building Societies announced on 22 June a 1¼ per cent increase in the mortgage rate, to 11¼ per cent, effective from 1 July. This was against the background of mounting financial pressures resulting from both inadequate inflows and very strong mortgage demand. Apart from the last six months, mortgage rates are still at their lowest level since the summer of 1978.



2. The base rate cut took place after relatively large rises in the monetary aggregates in April and May. However, these rises mainly reflected the high level of Government borrowing at the turn of the financial year. Also other indicators do not suggest lax monetary conditions. Real interest rates remain high (and perhaps somewhat higher than last autumn) and there are no signs of a build up in inflationary pressures.

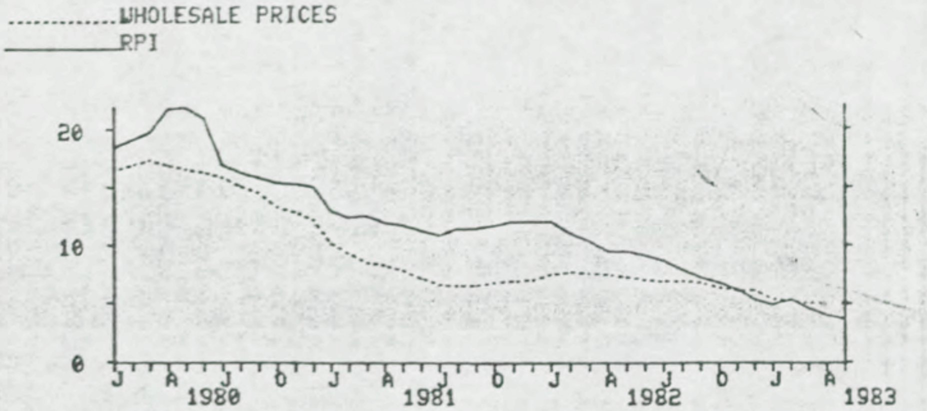
3. The <u>effective exchange rate</u> is now around 84½ (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.



Inflation, real incomes and consumer spending

4. Inflation continues to fall. The 12-monthly increase in retail prices was 3.7 per cent in May, its lowest level for over fifteen years. Other measures of inflation tend to show somewhat larger increases (the RPI has been benefitting from exceptionally low increases in food prices and previous cuts in mortgage interest rates), though still a declining trend.RPI inflation will tend to rise through the second half of the year as some of the favourable influences are removed from the 12-monthly comparison. The mortgage rate increase will add about 0.4 per cent to the July RPI (published in August).

INFLATION(12 MONTHLY % CHANGES)



5. Average settlements in manufacturing are currently running at about 5-6 per cent, some 1½ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was 7¾ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round.

6. In the first four months of 1983 average earnings grew around 3 per cent faster than both the RPI and the TPI suggesting large improvements in both gross and net real earnings. On a longer term comparison the growth in real take-home pay has been more modest as has the movement in per capita real personal disposable income (which includes the net income of those out of work as well as those in work).

7. Much of the recovery in total domestic demand during 1982 reflected the growth in consumer spending itself partly reflecting lower inflation and the summer 1982 abolition of HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Although consumers' expenditure fell back slightly in 1983 Q1 it is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

Year-on-year % changes

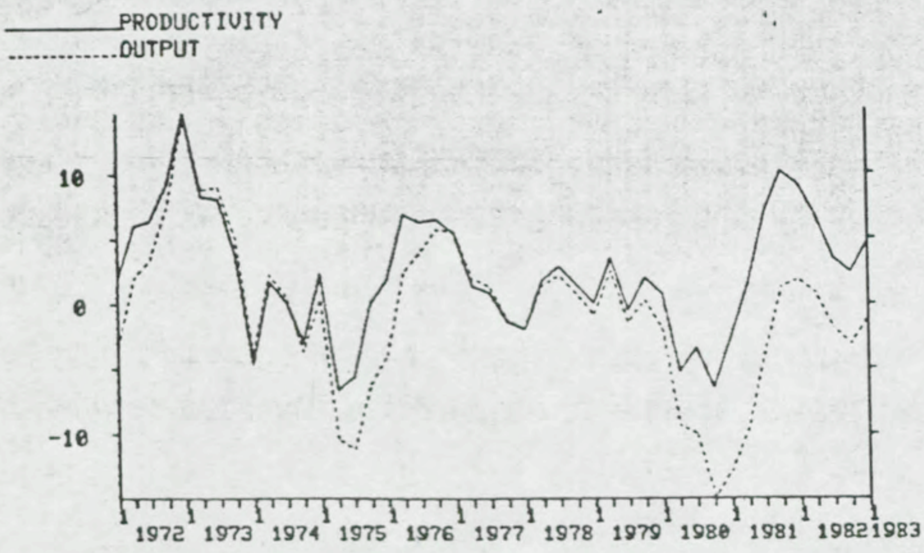
		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.0	4.3
3 months to May		na	5½*

* provisional

Costs, Company Finances and Investment

8. Manufacturing output per head was up by 5½ per cent in the year to 1983 Q1, and some 17 per cent above its trough level at the end of 1980 - an impressive improvement for this stage of the economic cycle. Continued productivity gains, coupled with further wage moderation, have brought down the increase in manufacturers' unit wage and salary costs to around 2½ per cent in the year to 1983 Q1. This compares favourably with our major competitors. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index, but world oil prices have weakened and, after allowing for the lower exchange rate, prices of materials and fuels purchased by manufacturers are only some 3 per cent higher than in the autumn.

MANUFACTURING PRODUCTIVITY(4 QTR % CHANGES)



9. Nominal profits of industrial and commercial companies improved during 1982 - both for oil and non-oil firms - though from an historically low level and after a period of real declines because of inflation. This improvement is reflected in small increases in pre-tax real rates of return (the movement of real interest rates is discussed in the second paragraph) and in a strengthening of the company sector's financial position.

REAL NET PRE-TAX RATES OF RETURN

	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

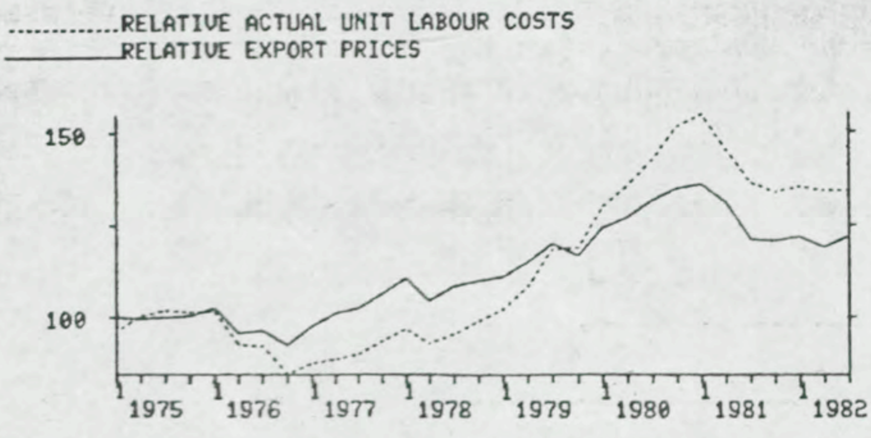
The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

10. Total fixed investment has been broadly flat since mid-1982, with increases in distribution and services roughly offsetting a continued fall in manufacturing. After substantial destocking (over £700 million at 1975 prices) in the second half of 1982 modest restocking (of £95 million) resumed in the first quarter of this year. Manufacturers reduced stocks further in 1983 Q1, but at a much slower rate than in 1982 H2.

Competitiveness and Trade

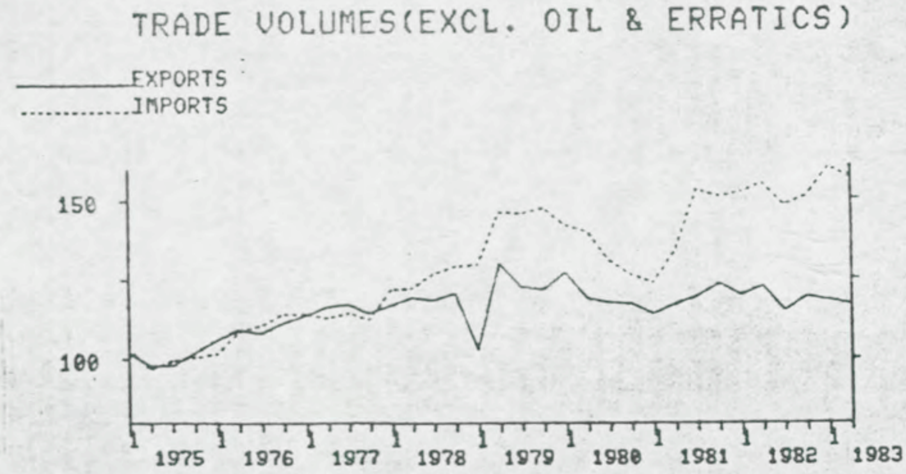
11. Manufacturing trade competitiveness can be measured in a number of ways although the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (partly reflecting the lower exchange rate, partly lower pay settlements and higher productivity) though remaining substantially worse than in the mid-1970s.

MEASURES OF MANUFACTURING TRADE COMPETITIVENESS



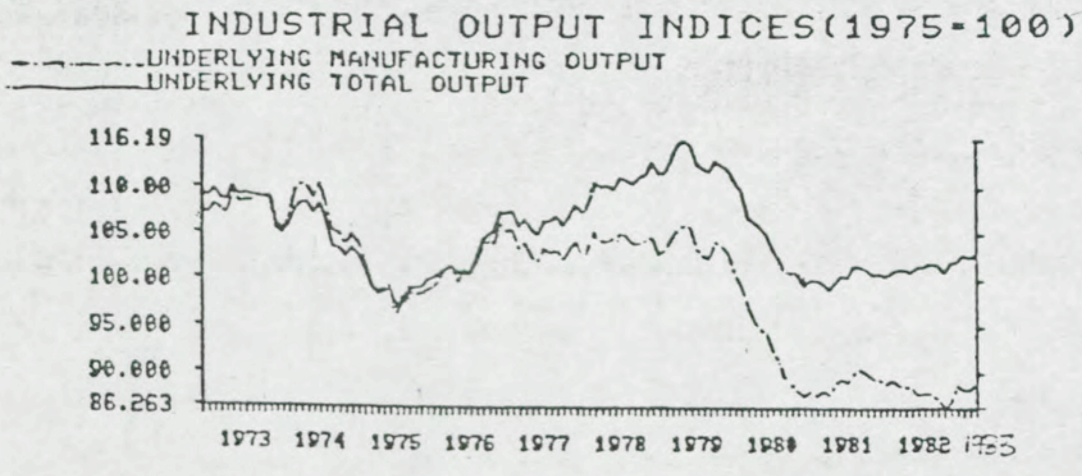
NB. Upward movements in the indices represent lower competitiveness.

12. The deficit on the current account increased from a revised £110 million in April to £302 million in May. However, the figures remain very erratic and it is hard to discern any clear trends. The main reason for the deterioration was the large increase in imports of erratic items (precious stones, ships, aircraft and North Sea installations) and of oil. Though this was partly offset by a marked reduction in imports of finished manufactures - particularly consumer goods other than cars. The underlying volume of non-oil exports has remained broadly flat in the last six months. Recent rises in import volumes are consistent with the turnround in stockbuilding and the underlying increase in output.

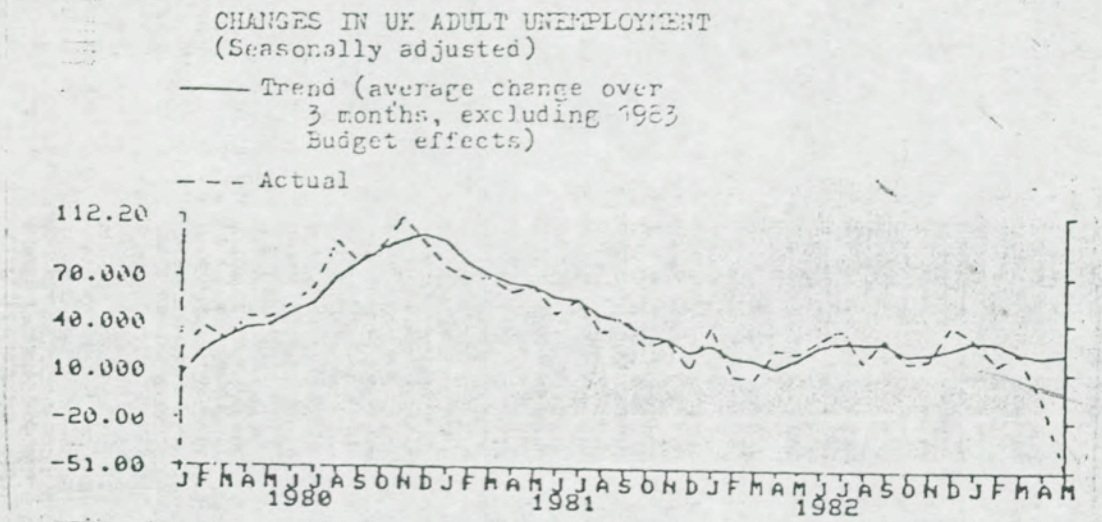


Demand, Output and Unemployment

13. In 1982 real domestic demand - using the expenditure components of GDP - was 2½ per cent higher than a year earlier. In the first quarter of this year there was growth of almost 2 per cent largely resulting from the turnround in stockbuilding. There is also growing evidence that a modest recovery in domestic supply is underway. Total output (GDP(O)) rose by ½ per cent between 1982 Q4 and 1983 Q1; GDP(A) is now over 3 per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.



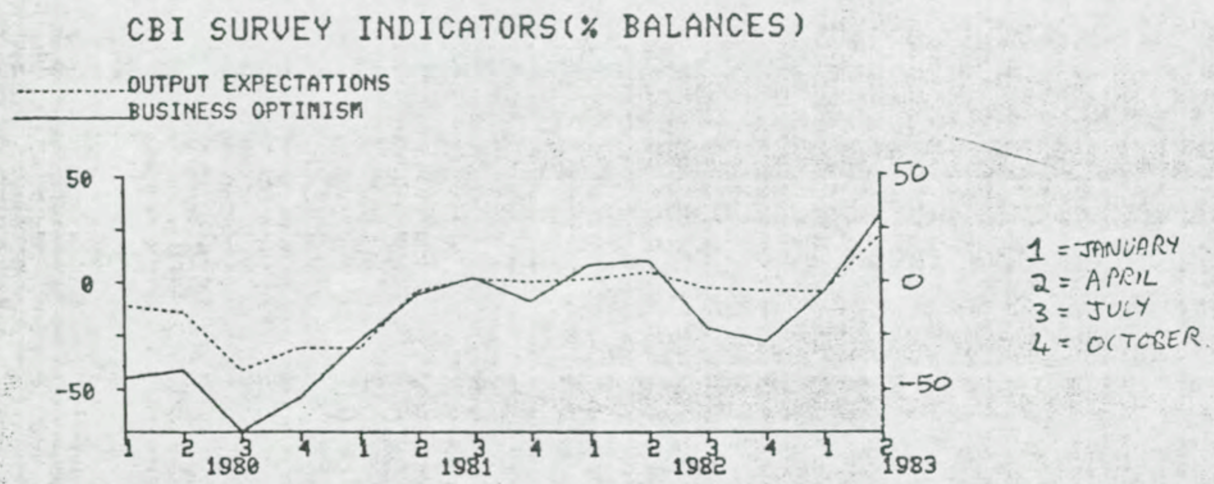
14. However, the underlying level of unemployment is still rising. In May, the UK total (not seasonally adjusted) was 3.05 million (12.8 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). These figures were substantially lower than those for April but this reflects the effects of the Budget provision of automatic national insurance credits for men over 60. Allowing for the latter, the adult total rose by 23,000, a slightly smaller rise than in March and April. Notified vacancies fell by 3,000 in May to 131,000 but their trend still appears to be upward. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.



Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. However, specific indicators confirm the patchiness of the recovery. In the three months to May car production increased by 18 per cent compared to the previous three months. On the same comparison steel production was 20 per cent higher but remained 4½ per cent below the rate of production achieved in the same period a year earlier. Total engineering orders fell 1 per cent in 1983 Q1 compared with the previous quarter, but export orders rose by over 26 per cent on the same comparison and latest forecast published by the Engineering Employers Federation expects mechanical engineering output to rise by around 7 per cent between mid-1983 and the end of 1984. The volume of new construction orders fell back 3 per cent in the three months ending April. Total housing starts have fallen since February but in the three months to April were 7 per cent higher than in the previous three months.

16. The CBI's April Industrial Trends Survey contained encouraging signs with improved business optimism (the highest net balance since 1976), order books and output expectations, and investment intentions. The results also pointed to a slowdown in destocking and job shedding. This message was further confirmed in their May and June Enquiries which showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output has been positive for five successive months and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The June Enquiry contained encouraging results for consumer goods industries whose recent production had not matched the buoyancy of consumer spending.



The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

17. The Government forecast published with the Budget expects inflation to stabilise around the 6 per cent level by the end of 1983 (recent evidence suggests that progress on inflation has been better than expected). GDP is expected to rise by 2 per cent between 1982 and 1983 with a similar increase in manufacturing output. Recent outside forecasts expect slightly higher GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6 per cent by the end of the year. Consumers' spending and stockbuilding are the main expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in

unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth though possibly at a slower rate than in 1983.

<u>Key indicators to be published in week ending 31 June</u>

Mon	27 :	CBI trends inquiry (June)
Wed	29 :	ICC's appropriation account (1st qtr)
	:	Personal income, expenditure and savings (1st qtr)
Thurs	30 :	Industrial stoppages (May)
	:	Employment (Apr)
	:	Overtime and short-time (Apr)
	:	Unemployment (June)

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PS/CHANCELLOR

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Mr Salveson (for transmission to No.10)
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PS/Lord President of the Council
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PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Parliamentary Secretary to the Treasury and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY WEEKLY BRIEF

Attached is the latest version of this Brief. Changes from the previous Brief, of 6 June, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN
20 June 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

[Programme for new Parliament will be set out in Queen's Speech Wednesday, 22 June. Chancellor's speech in subsequent Debate on Address will constitute his first major statement on economic policy in Government's second term of office.]

Intend to consolidate and build on progress already made in creating conditions for healthy economy. Will maintain sound financial policies conducive to lower inflation and take further measures to promote enterprise and encourage competition.

2. What about employment?

As obstacles to more efficient working of economy are cleared away, new job opportunities will open up. But Government will continue to help ease process of adjustment with special employment measures and assistance for training. Important that people do not frustrate process by perpetuating inefficient practices or demanding pay increases that undermine improvement in competitiveness already made.

3. Current economic situation

Modest recovery is under way, not just in sectors like North Sea and house-building, but also in many parts of manufacturing. Major destocking has come to an end. Private investment recovering and retail sales remain buoyant. Other indicators - including recent CBI reports, and CSO cyclical indicators - point in direction of continued recovery. With inflation lower and evidence (eg from US and Germany) that world economy is picking up, good prospects that recovery will be sustained. (See also Section B.)

4. Economic achievements of 1979-83 term of office?

Dramatic fall in inflation; income tax rates lower and allowances higher at all levels; improved fiscal environment for business and industry; privatisation measures; measures to encourage competition, widen choice and extend property ownership; removal of wide range of Government regulation and restrictions; public spending brought under control; number of public service employees reduced and more efficient systems of management introduced. Changed attitudes about responsibilities and pay. Greatly improved efficiency in industry points to stronger base for sustained recovery.

5. Latest ½ point cut in base rates: just a political gesture?

No; justifed by overall assessment of monetary conditions. [For material on monetary developments/policy mortgage rate prospects etc see Section E; exchange rate policy see Section F.]

6. CBI critical of high interest rates/exchange rate?

[CBI Press Notice following monthly Council meeting 15 June when conducted post-Election review of full range of policies affecting business. CBI to see Chancellor Wednesday 22 June and PM Monday 27 June.]

CBI not critical: like Government, want to see interest rates brought down further. Also stress need not for lower exchange rate per se but less volatility. In line with Williamsburg sentiments (see F4).

7. When will the alleged secret manifesto be brought out and implemented?

There is no secret manifesto. The published manifesto sets out our intentions fully and frankly. Our actions will be consistent with these.

8. Fiscal policy and public spending in Government's second term?

See Sections H and K.

9. Select Committee on Procedure (Finance) Report: Government response?

[Report published 16 May makes number of major recommendations relating to Parliamentary control of borrowing, of non-'supply' expenditure and public expenditure as a whole, and of long term expenditure projects. Also major proposals for budgetary reform, and proposals relating to contingencies fund and to provision of financial information. Report would, if fully implemented, lead to major shift of power in financial area from Executive to Legislature.]

Committee have produced substantial piece of work with large number of recommendations across whole range of financial procedure affecting expenditure, taxation and borrowing. Government will want to consider them carefully. Detailed comment inappropriate at this stage.

BULL POINTS

As at 20.6.83

Output and Demand

Increasing signs of continuing gradual recovery. GDP has recovered by 2½-3 per cent since spring 1981. Underlying industrial output in the three months to April was around 3-3½ per cent above its trough in the second quarter of 1981 (largely oil). Manufacturing production in three months to April rose by 1 per cent on the previous three (chemical and allied industries and electrical engineering showing strongest improvement). Car and steel production up 18 and 20 per cent respectively in 3 months to May on preceding 3. [BUT NOTE: recovery remains modest and patchy.]

Consumers' expenditure, on preliminary estimates was little changed in first quarter of 1983 but still 3 per cent up on year earlier. Retail sales rose by 1½ per cent in three months to May on preceding 3. In first 4 months of 1983 17 per cent more cars were registered than same period a year earlier. Import penetration of cars, at 56¾ per cent, was down on 1982 average of 57¼ per cent. Far less destocking in 1983 Q1 -only £42 million by manufacturers and distributors, compared with £900 million in second half of 1982.

Prospects

CBI's May Industrial Trends Enquiry seemed to confirm previous CBI reports (particularly the detailed April Quarterly Survey) in pointing to continued improvements in business climate. It showed encouraging improvements in total and export order books (former now stronger than in any enquiry since November 1974). Balance of firms expecting further increase in output was positive for fourth successive month. Balance of firms reporting excessive finished stocks lowest since November 1979. April Survey showed highest level of business optimism since 1976. DOI's May Investment Intentions Survey indicates a rise of 3-4 per cent in investment (manufacturing and distributions services) in both 1983 and 1984 [NB manufacturing investment expected to fall by 4 per cent between 1982 and 1983 but underlying trend expected to turn upwards later this year.]

Housing starts (total) in 3 months to April up 14 per cent on year earlier (though have fallen since February); private sector starts up 15 per cent on same comparison. New construction orders up 10 per cent in 1983 Q1 compared with year earlier; private housing orders up 46 per cent on same comparison.

Total engineering orders rose 3 per cent to February compared with previous 3 months and export orders up 25 per cent on same comparison. The CSO's cyclical indicators point to a continuing upswing in the business cycle. Recent outside forecasts suggest slightly higher growth (GDP) this year than our own Budget estimate of 2 per cent.

Financial Strategy

PSBR: government borrowing now amongst lowest in industrialised world. Public expenditure planning total in FSBR for 1983-84 (at £119.3 billion) below total published in 1983 White Paper and about £¾ billion below planning total announced in Autumn Statement. First time since 1977 that a Government has not increased its spending plans in course of Survey. Fall in ratio between public expenditure and GDP from 44½ per cent in 1981-82 to 44 per cent in 1982-83 (expected outturn) should fall again to 43½ per cent in 1983-84 and 41½ per cent in 1985-86. Short-term interest rates have fallen by about 7 points since autumn 1981. Official external foreign currency debt reduced from $22 billion in May 1979 to less than $12 billion at end-May 1983.

Inflation

RPI inflation over the 12 months to May was 3.7 per cent - the lowest figure since March 1968 and it appears we may now be doing a little better than expected. Inflation is forecast to remain moderate, stabilising around 6 per cent by end-1983. Underlying 12-monthly increase in average earnings was 7¾ per cent in April and continues steady fall since beginning of 1980/81 pay round.

Productivity and Competitiveness

Manufacturing output per head has risen about 17 per cent since end 1980. Output per head and output per hour now about 9½ and 12½ per cent higher than previous cyclical peak in 1H 1979. Manufacturers' unit wage and salary costs up around 2½ per cent in 1983 Q1 on a year earlier. Compares very favourably with major competitors. Cost competitiveness (manufacturing) improved by around 20 per cent since early 1981 (based on sterling effective rate of 84).

Company Finances

Industrial and commercial companies' gross trading profits (net of stock appreciation, excluding North Sea) up 15 per cent in 1982 on average 1981 level. Real profitability also improving - pre-tax real rate of ICC's (excluding North Sea) estimated up from 3½ per cent n 1981 to 4 per cent in 1982 - but recovery from very low base. Latest DOI company liquidity survey showed encouraging improvement in liquidity between 1982 Q4 and 1983 Q1. Company liquidity at best level since mid-1979.

Labour Market

Underlying level of unemployment still rising but some evidence that rate of increase is slackening. Notified vacancies still appear on an upward trend (although fell slightly in May). CBI's April Survey pointed to some slowdown in rate of demanning in manufacturing over next few months. Further special employment measures announced in Budget, eg part time Job Release scheme, extension of Enterprise Allowance scheme; on full range of employment and training schemes Government is spending over £2 billion in 1983-84, directly helping about ¾ million people. Total number of working days lost in 1982 (5.3 million) well below average of 12 million for preceding 10 years. Latest international comparison of industrial disputes showed that, in 1981, UK occupied a middle ranking position compared with other countries.

Freedom, Enterprise and Initiative

Long list of controls abolished in last Parliament: pay, dividends, prices, exchange controls, office development permits, industrial development certificates and HP controls. Further 13 enterprise zones announced in 1982 bringing total to 24.

Civil service now 648,700 (1 April 1983) - reduction of 11½ per cent since Government took office. On target to achieve smallest Civil Service since War by 1984 (630,000). LA manpower (GB) cut by 106,000 (approximately 4½ per cent) between June 1979 and December 1982. Owner occupation at highest ever level: 56 per cent of all dwellings in 1981. Almost ½ million public sector tenants bought ther houses since May 1979; further ¼ million in process of buying. Quangos abolished or reduced expected to exceed 440 by April 1984. 36,000 Government forms abolished. MOD saved 5,000 staff and £10 million by contracting out cleaning. Up to and including 1982/83 special asset sales worth £2 billion; further £2½ billion expected over next 3 years.

Economic Briefing Division, HM Treasury, 01-233-5514/5503

B ECONOMIC ACTIVITY AND PROSPECTS

[NB GDP (1983 Q1) figures to be published Tuesday 21 June.]

1. Recent output figures

[GDP (0) the best short-term indicator of the three GDP measures - rose ¾ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; level now 2½-3 per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production in three months ending April was 1½ per cent up on previous three; underlying industrial output now around 3-3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1 per cent higher in three months to April than in previous three.]

GDP has recovered 2½-3 per cent since spring of 1981, and industrial output has recovered around 3-3½ per cent. Manufacturing production three months to April increased 1 per cent on previous three. Expectations (eg recent CBI Trends inquiries) are for further increases in manufacturing output, and recent forward indicators (eg recent CBI reports, CSO indices of leading indicators) point to continued gradual recovery both in manufacturing and more generally.

2. Domestic industry missing the consumer spending spree?

[For details of consumer spending see Commentary. Buoyancy, particularly of retail sales, contrasts sharply with movements in consumer goods production. In three months to April latter was only ½ per cent up on preceding three months and was little changed from its level a year earlier.]

Consumer goods production figures disappointing. However, CBI's May Trends Enquiry suggested that higher output expected across much of manufacturing including consumer goods firms. Clearly there remains scope for further improving competitiveness by moderating wage settlements and improving product design, etc.

3. UK suffered worst of major industrialised countries since 1979?

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (output measure) fall of about 4 per cent - though not strictly comparable measure.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most.

4. Prospects for UK economy

[March Industry Act Forecast published in FSBR summarised in Commentary.]

Total output forecast to grow significantly in 1983 (2 per cent) and to be growing slightly faster (2½ per cent) in 1984 H1, with inflation remaining moderate. Recent outside 'forecasts in broad agreement on outlook for this year, with output growth expected to be, if anything, slightly higher than in Budget time forecast.

5. Where will growth come from?

Economy is now growing. Total output 2½-3 per cent above 1981 trough; underlying industrial output up 3-3½ per cent on same comparison; manufacturing production (particularly chemicals and allied industries and electrical engineering) has also begun to increase, though recovery remains modest and patchy. With inflation at lower level, and lower interest rates, conditions are favourable for further growth in demand and activity.

6. Latest (May) CBI Industrial Trends Enquiry

[See Commentary for details.]

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, as Sir James Cleminson has pointed out: 'The improvement is still uneven and is led by consumer and export demand'.

7. Latest construction industry indicators suggest recovery over?

[Construction output, on provisional estimates, fell 1 per cent between 1982 Q4 and 1983 Q1 (earlier estimates indicated 1½ per cent increase) but remains 4 per cent up on year earlier; new housing output rose 4 per cent in 1983 Q1 on preceding quarter. Total construction orders rose 6 per cent in 1983 Q1 on preceding quarter; private housing orders up 29 per cent on same comparison. Total housing starts up 7 per cent in three months to April on preceding three.]

Construction output - particularly housebuilding - recovered relatively rapidly last year - by almost 9 per cent in year to 1982 Q4. Given this performance, some pause not surprising though latest figures are disappointing. But not too much weight should be placed on one quarter's figures, particularly when forward indicators both for construction and output more generally remain encouraging.

8. Recent private investment performance?

[Manufacturing investment (including leasing) in 1983 Q1 over 4 per cent down on 1982 Q4 and over 5 per cent down in latest six months compared previous six. But total capital expenditure by manufacturing, distribution and service industries up 1 per cent latest six months compared previous six.]

Manufacturing investment has been disappointing (over 4 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment, and CBI latest DOI investment intentions Survey point to recovery later this year (see B9). Fixed investment in other sectors has been stronger: total fixed investment rose 3-4 per cent in 1982 and in 1983 Q1 investment in distributive and service industries (excluding shipping and leased assets) grew by almost 2 per cent on previous quarter. Housing starts and new construction orders are encouraging, and April CBI survey showed improvement in manufacturing investment intentions: for first time since July 1979, majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

9. Investment intentions?

Latest DOI investment intentions survey indicates 4 per cent fall in manufacturing investment between 1982 and 1983 but also suggests underlying trend should start to turn upwards later this year. Outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984.

10. Continued destocking threat to recovery?

[For latest statistics see Commentary. NB Whole economy stockbuilding figures for 1983 Q1 to be published Tuesday 21 June.]

Manufacturers' and distributors' destocking in 1983 Q1 was, as expected, much smaller than stock reductions in 1982 H2, and latest (May) CBI Enquiry shows further drop in net percentage balance of firms reporting excessive finished goods stocks - now at lowest level since November 1979.

11. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 5½ per cent in year to 1983 Q1; and overall improvement of around 17 per cent since end 1980. Some slowdown in 1982 against background of some fall in manufacturing output (after some recovery in 1981). But slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Overall performance since 1981 better than could have been expected on past experience.

12. CSO's indices of leading cyclical indicators

All four composite indices have risen over last few months. Taken together, indicators point to continuing upswing in business cycle.

13. Outside forecasts

[GDP profile in recent major assessments and in March IAF:

Per cent change

	IAF (Mar)	Cambridge Econometrics (June)	Phillips & Drew (June)	Simon & Coates (June)	NIESR (May)	CBI (Mar)	LBS* (Feb)**	OECD* (Feb)
1983 on 1982	+2	2½	+2½	+2½	+2½	+2	+1¾	+1½
1984 on 1983	+2½***	2½	+2	1½	+1¼	+2½	+2	+1¾***

* Taking no account of Budget measures

** More recent LBS projections pointed to GDP growth around 2-3 per cent in 1983, 2½-4 per cent in 1984, depending on assumptions about General Election outcome.

*** 1984 H1 on 1983 H1]

Nearly all major outside forecasts see prospect of continued modest recovery (GDP up around 2-2½ per cent in 1983) and modest price inflation around 6-7 per cent range by end 1983.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[May fall in 'headline' total largely reflects favourable seasonal factors and impact of new provisions for over 60s to get automatic credits. Vacancies are on a slowly rising trend (though fell slightly in May). Overtime worked broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	June	Sep	Dec	Mar	Apr*	May*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.17	3.05 (12.8%)
Adult sa unemployment (millions)	2.77	2.87	2.95	3.03	3.02	2.97 (12.4%)
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+26	+13 [+23]	-10 [+24]
Vacancies (000s)**	105	107	118	126	135	131

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

The unemployment figures continue to be affected by special factors. Large fall in headline total masks underlying upward trend. Although there are indications that this upward trend has eased, the improvement is modest. Other labour market indicators are mixed.

2. True level of UK unemployment really much higher than published figure?

Gross exaggerations are in circulation, relying heavily on assumptions, eg out-dated estimate of one million fall in labour force between 1979 and 1981, and including those benefiting from special employment measures - who are not unemployed. Latter 'adjustment' to official figures is clearly inappropriate; former is corroborated by most recent statistics. Between 1979 and 1981, small reduction in labour force due to lower 'activity rates' was insufficient to offset increases in population, and labour force grew by ¼ million.

3. But official figures take no account of unregistered unemployment/non-claimants?

Long been recognised that, for variety of reasons, some people seeking work do not appear in statistics of claimants. On other hand, recognised that some claimants not actively seeking work. Some estimates of number involved will appear in article to be published in June Department of Employment Gazette.

4. Employment/Social security measures in Budget just Government manipulating the figures?

[Changes announced in Budget: automatic credits for men aged 60-65 and higher scale supplementary benefit for man over 60, plus part-time JRS and enterprise allowance. First of these removed around 104,000 from May unemployment count; taken together, Budget measures will probably have 'register effect' of about 160,000 by March 1984, rising to about 180,000 by March 1985.]

No. Social security measures will help poorest section of unemployment over 60's and remove needless obligation. Part-time JRS will mean jobs for the unemployed because a part-time replacement must be recruited.

5. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.']

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies.

6. But didn't the new Chancellor forecast a fall in unemployment next year?

[Guardian 31 May: Mr Lawson said; '... in my judgement all the signs are that there is every prospect that by next year we will see the start of a fall in the level of unemployment'.]

Chancellor was simply pointing out that prospects were not nearly as bad as some were suggesting. As have said before, unemployment may turn out to be better than expected. There is always some degree of uncertainty about the future. Much will depend on factors outside Government's direct control - such as developments in the world econony and our ability to hold down domestic costs. And we should not forget good progress made over last year on inflation and output.

7. How has unemployment moved in relation to the 1983 PEWP assumption?

1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84. These unemployment assumptions have not been changed from those given Government Actuary last November, except insofar as they have been revised onto the new (claimants) basis.

8. Could the outturn for unemployment be better than assumed in Cmnd 8789?

Yes. This is made clear in Cmnd 8789 which says (para 9 of Part I, and page 65 of Part II): 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

9. Unemployment in UK compared with other countries

[On standardised definitions in April 1983 UK unemployment on new basis was 13.7 per cent (compared with 5.5per cent in 1979), Canada 12.4 per cent (compared 7.4 per cent), US 10.0 per cent (compared 5.7 per cent), Japan 2.5 per cent (compared 2.1 per cent), France 8.0 per cent (compared 5.9 per cent), Germany 7.6 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was greater in Germany (39.8 per cent - rise of 2.2 points in unemployment rate - in May), and Canada (28.4 per cent - 2.6 points in April) than in UK (8.4 per cent - 1.0 points - in May).

10. Government's special employment measures

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Includes £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) new Job Splitting Subsidy to encourage extension of part time work. From 1 October Job Release Scheme will include new scheme for part-time job release for up to 40,000 more people and from 1 August Enterprise Allowances will be available throughout UK within overall cash limit of £25 million in 1983-84.

11. Recent productivity gains inimical to higher employment/lower unemployment?

Probably true in short run. But as experience in Japan and many other countries clearly demonstrates, higher productivity essential for longer term growth and employment opportunities.

12. Cost of unemployment/Effect on PSBR?

Changes in unemployment affect public finances according to underlying circumstances, eg changes in world trade, UK competitiveness, relative UK earnings etc. Not sensible to talk as if 'cost of unemployment' a single figure. Unemployment and supplementary benefit to people counted as unemployed currently expected to total about £5.7 billion in 1983-84 (DHSS estimate in 1983 PEWP) comparable figures for uncollected taxes and national insurance contributions cannot be given.

13. Total cost of unemployment £ 15/16/17 billion?

This is a figure without meaning. There can be no basis for estimating what public finances would look like if all the unemployed were working.

D PRICES AND EARNINGS

PRICES

1. Inflation rate

[12 monthly RPI increase 3.7 per cent in May, compared 4.0 per cent in April].

12 monthly rate of inflation again fell sharply in May to 3.7 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year

RPI scarcely rose at all between June and September last year. As a matter of simple arithmetic there is likely to be an increase in the 12 month change over corresponding period in 1983. It was made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year perhaps to about 6 per cent; if anything progress since then has been better than expected.

3. Effect of lower exchange rate ?

Budget forecast took into account, among other factors, depreciation of £ since the autumn. Since then fall has been partly reversed. But exchange rate only one factor amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS); likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2. Beyond that policies will continue to be directed towards further progress in reducing inflation. Underlying trend has been downward since 1980.

5. TPI increase

12 monthly increase in TPI (3.2 per cent) over year to May 1983, now ½ per cent lower than for RPI (3.7 per cent) because of Budget increase in tax allowances.

6. Comparison with competitors

[April figures UK inflation 4.0 per cent compared 3.3 per cent in West Germany, 3.9 per cent (annual change on new index) in US, 9.2 per cent in France, 16.5 per cent in Italy, 6.6 per cent in Canada, and 2.0 per cent in Japan; 4.8 per cent weighted average 'major 6'.]

UK inflation now lower than average of major OECD 6 and well below France, Italy and Canada, but still some way to go to match West Germany and Japan.

PAY

7. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.6 per cent so far in 1983 . Latest average earnings index (April) shows 8.2 per cent increase (underlying increase 7¾ per cent) on year earlier; but this is still influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

8. Pay settlements too high?

[Year on year growth average earnings 8.2 per cent in April, compared 4.0 per cent growth in RPI.]

Pay settlements have continued to come down in last couple of years, which is sign of greater realism. But inflation has come down more, and earnings over past year have risen much faster than prices. Improved employment prospects depend on lower earnings growth, and that means lower pay settlements.

9. Recommendations of Review Bodies

Government published on 12 May its decisions on Reports from the Armed Forces Pay Review Body and from the Doctors' and Dentists Review Body. The recommendations have been accepted. Two reports from the Top Salaries Review Body on the salaries of the higher civil service, senior officers in the Armed Forces and the judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, were deferred for consideration after the Election.

E MONETARY AND FINANCIAL POLICY

1. What is Government's monetary policy in its second term?

Government continues to adhere to 1983 MTFS. Growth of M1, £M3 and PSL2 within last year's target range of 8-12 per cent. Target is 7-11 per cent for 1983-84.

2. Is the money supply out of control?

[M1, £M3 and PSL2 grew by 1.5 per cent, 0.8 per cent, and 0.8 per cent respectively in banking May (seasonally adjusted). Annualised growth rates of first 3 months of current target period produces rates of growth well above target range.]

No. Signs of moderation last month. First two months of target period affected by surge of public sector borrowing. Annualising of rates of growth highly misleading when using only a few months figures. Target range is for a year as a whole, not particular months.

3. Is there a change in emphasis away from the money supply towards the exchange rate?

No. Government looks at whole range of factors in assessing financial conditions. This includes the exchange rate.

4. Does recent fall in base rates despite high monetary growth indicate a change in policy?

No. We look at a variety of indications of financial conditions. The evidence from real interest rates, inflation and the exchange rate is that monetary conditions remain sound.

5. Any prospect of a further fall in interest rates?

Sound monetary conditions and low inflation offer best basis for sustainable reductions in interest rates. Interest rate reductions are desirable, but only if not jeopardising this strategy.

6. Would higher US interest rates mean reversal of recent falls in UK interest rates?

Not really.

7. Did Government engineer interest rate fall to stop Building Society rates rising?

[Building Society Association meet 22 June.]

Building Societies decide their rates on the basis of their needs. The reduction in base rates was associated with the Bank's lower dealing rates on 13 and 14 June. There were other important developments in the money markets, notably the marked fall in interbank rates the preceding week.

8. Bank lending

[Rise of £0.9 billion in banking May after £0.2 billion in April and £0.6 billion in March banking months.]

Continues at levels well below levels reached last summer. Recent slackening continues.

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 9 per cent in effective terms, 10 per cent against the dollar, 9 per cent against the D-Mark, 21 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms and on 28 March reached record low against dollar of $1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets. In the run up to the General Election the £ strengthened, but has now fallen back to its effective levels in early May.

	October average	17 June noon	% change Oct - 17 June
$/£	1.6977	1.5295	-9.9
DM/£	4.2932	3.8889	-9.4
Y/£	460.12	365.09	-20.7
£ effective	92.5	84.0	-9.2

2. Exchange rate policy

Government has no target for exchange rate and considers that recent events suggest that in current conditions pursuit of a target would not be viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible.

3. Government wants lower exchange rate?

[Report in The Times 11 June said officials advised new Chancellor to cut interest rates to prevent further rise in pound.]

Government's approach to exchange rate is symmetrical whether pound is rising or falling. It is one, but only one, of factors taken into account in interpreting domestic monetary conditions, in Government's attitude to interest rate movements. Similarly, market intervention has been provided in both directions in recent months, but intervention cannot hope to prevent movement in face of strong market pressures - or, by itself, influence the rate in other than the short term. [See E3 on interest rate-exchange rate policy.]

4. Williamsburg Summit 28-30 May

[See also T1-2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets, bearing in mind their conclusions on the Jurgensen report (see F6).

5. Jurgensen Report - significance?

[Jurgensen report on exchange market intervention, commissioned at Versailles Summit, published 29 April.]

Report covers only narrow topic of intervention. It aims at giving better understanding of the methods, motives and effects of past intervention. Therefore did not make any policy recommendations. Does not herald an early return to fixed exchange rates. Although it notes importance of broader economic policies in determining the exchange rate it did not consider wider issues of greater policy convergence or IMF surveillance. These questions were considered at Williamsburg and will be taken further in IMF.

6. Jurgensen Report - verdict on UK policy?

Report's findings confirm approach taken by UK Government. Government have always felt that intervention could be useful at times to help steady and calm disturbed market conditions. But always considered that consistent pursuit of sound, counter-inflationary monetary and fiscal policies is only long-term solution to problem of exchange rate instability, and that trying to solve problem through intervention alone would be misguided and ineffective.

7. Improve UK competitiveness directly by engineering further fall in exchange rate?

As previous Chancellor said in Budget Speech, devaluation brought about by monetary and fiscal laxity would be damaging - and to seek it as deliberate act of policy - as some of Opposition propose - would be great mistake. Would be signal to world of willingness to accommodate rising inflation, an inflation that would undoubtedly be fuelled by demands for higher wages to offset the effects. Confidence would collapse and jobs would be destroyed. CBI at last Monthly Council meeting made no mention of devaluation but stressed need for less volatility.

8. Non price competitiveness

Government has stressed need to improve design and quality, to meet delivery dates, and improve after-sales service. Such factors cannot be easily measured but are at least as important as cost competitiveness. Thus for example West Germany's cost competitiveness deteriorated 20 per cent between 1970 and 1980 but she maintained her 20 per cent of main manufacturing countries' exports. Japan managed to increase her share over this period from 12 to over 15 per cent despite slight deterioration in cost competitiveness. UK industry equally capable of non-cost improvements - witness, for example, Jaguar cars: their drive for higher quality secured them an increase in overseas sales in 1982 of 56 per cent over previous year.

9. Situation has been made less stable by abolition of exchange controls?

Opposition spokesmen seem to forget the lesson they surely should have learnt in 1967 and 1976. All our experience is that exchange controls have little effect in the face of strong market movements. They did not control leads and lags in trade payments, nor the movement of massive funds invested in sterling by non-residents. (To attempt to control either would cause unacceptable disruption in trade and commercial relations.)

10. Join EMS exchange rate mechanism (ERM)?

Government considers that recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

11. Impact on inflation of fall in sterling before April?

See D3.

12. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

[NB Overseas trade and balance of payments on current account in May to be published Friday 24 June]

1. Balance of payments so far this year?

1983 Q1 balance of payments figures showed current account surplus of £445 million after £4 billion surplus last year. Invisibles surplus in Q1 was £0.7 billion.

2. April trade figures

[Current account in deficit in April £180 million; current account in three months to April £400 million in surplus].

Trade figures erratic month to month. Underlying level of non-oil imports now seems to be increasing as activity picks up.

3. Trade in manufactures in deficit?

[Trade in manufactures was in deficit £664 million in first quarter - on balance of payments basis. In 1982 trade in manufactures was £2½ billion in surplus.]

Exports of manufactures have held up well. Higher manufactured imports one way in which we have benefited from N Sea oil.

4. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI quarterly Industrial Trends Survey shows sharp improvement in order books and expectations of rise in deliveries over next few months.

5. Import trends

Having shown little change during 1982, imports have risen in 1983. Largest increases in imports of basics and semi-manufactures.

6. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which - at a surplus of £1.1 billion - were down £0.6 billion on 1981.

7. Current account 1983 forecasts

FSBR forecasts £1½ billion current account surplus in 1983 (down from £4 billion in 1982). Import volumes 1983 on 1982 expected to increase 5 per cent - reflecting resumption of growth in UK economy. Export volumes not expected increase significantly until world economy starts to pick up, with only 1 per cent growth in exports forecast for 1983 on 1982.

TRADE POLICY

8. Protectionism

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P5.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers' They emphasised importance of working through GATT.

9. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

10. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

H FISCAL POLICY AND THE PSBR

1. Does Government plan to tighten/weaken fiscal policy?

Policy evolves but commitment to overall strategy is unchanged.

2. Progress on fiscal policy?

[Aim is to achieve trend reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.]

Have made progress. PSBR has been reduced (but see H3 and 7). Continuity, firmness and stability of policies have made major contribution to reducing inflation and interest rates.

3. Government's financial strategy has replaced monetary targets with PSBR target?

No. Have always emphasised need for consistent fiscal and monetary policies.

4. PSBR/interest rates link discredited?

Never said relationship between interest rates and PSBR simple or direct. Certainly does not operate month to month. Basic principle - lower PSBR over run of years implies lower interest rates - still holds true.

5. Why did 1982-83 PSBR overshoot?

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

6. Public expenditure otu of control?

No. Simply less underspending on plans than was assumed at Budget time. No question of any failure of public expenditure control system. Only two extremely minor breaches of cash limits, and year ended with large part of the Contingency Reserve unspent.

7. PSBR overshooting this year - tax increases or expenditure cuts in the offing?

[Budget forecast £8.2 billion, 2¾ per cent. As result of last year's overshoot and high figures for CGBR recently, many - but not all - outside forecasters now predict an overshoot.]

Too early to form new view about prospect for this year. Next official forecast will be published with next Autumn Statement. Government intend to continue firm control of public spending and borrowing.

8. But high CGBR in April and May surely means PSBR overshooting?

[CGBR in April to May £2.9 billion compared with £1.9 billion in 1982-83.]

Too early to say. Budget forecast is £8.2 billion - next forecast at time of Autumn Statement.

9. Doesn't PSBR overshoot mean higher interest rates?

Yes, a lower PSBR probably would have meant lower interest rates. But effect of overshoot limited because it does not signal a change of strategy. PSBR over a run of years is what really counts.

10. Government misleading public over PSBR outlook?

No. Must remember PSBR difference between two large aggregates and always difficult to assess likely end-year borrowing. FSBR contained strong 'health warnings', so can hardly be accused of misleading people.

11. PSBR uncertainty exposes inadequacy of Government's strategy?

No. Strategy not based on fine-tuning the PSBR. PSBR is not a target.

12. Cyclically adjusted PSBR better guide to policy?

Government fiscal policy has taken account of recession. Acid test is level of interest rates at which PSBR can be financed, not value at some hypothetical cyclically adjusted level of output.

13. UK fiscal policy tightest in world?

[IMF report said UK fiscal contraction over last 3 years was largest of any major country; OECD calls for prudent fiscal relaxation.]

Agree we have had more success in controlling borrowing than many other countries. They are now trying to emulate us. IMF and OECD support our commitment to cutting inflation and interest rates.

J TAXATION

1. Government's tax objectives?

Manifesto said that further improvements in allowances and lower rates of income tax remain a high priority, together with measures to reduce the poverty and unemployment 'traps' (see also J13). Manifesto also referred to encouraging wider ownership, through lower taxes on capital and savings, encouraging individuals to invest directly in company shares and encouraging the creation of more employee share schemes.

2. Early Finance Bill?

Before Dissolution, Government stated its intention to introduce early Bill to restore original Budget proposals on higher rate thresholds, investment income surcharge threshold, increase in ceiling for mortgage interest relief to £30,000, CTT thresholds and bands and profits limits for small companies rate (38 per cent) of corporation tax. The other matters to be included in the Bill will be announced in due course.

3. Government's tax record?

Over period 1979-83 Government cut basic and higher rates of income tax, achieved a 6 per cent real increase in allowances, cut NIS from 3½ per cent to 1 per cent, reformed CGT, CTT and DLT regimes, greatly improved the tax arrangements for profit sharing and share option schemes, introduced new reliefs for investment in unquoted companies (Business Expansion Scheme), improved incentives for charitable giving and cut tax bureaucracy. Not a bad start.

4. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession and need for responsible fiscal and monetary policies. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

5. Government's own figures prove average family now pays more tax than in 1978-79?

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax net of child benefit in 1983-84 than they did in 1978-79.

6. Budget benefits for lower paid

Budget provided help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children will also benefit from 11 per cent increase in Child Benefit to highest real level since its introduction, and from generous increases in FIS.

7. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rise in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out.]

Tax reductions will be greater than effect of increase in NICs for all but a minority. [BACKGROUND: Those who will lose are contracted out with about 1½ times average earnings and a very small number of contracted in.]

8. Effect on people with mortgages of MIRAS and recovery of excess tax relief?

Tax payments will go up as result of MIRAS but mortgage payments will go down. Borrowers entitled to ask building society to reduce their monthly payments in such a way that their net position is unchanged. When mortgage interest rates fell last year, PAYE codes were not altered and people received more relief than they were entitled to. Recovery of this excess relief, which increases tax payments, allows people to pay tax that should have been paid last year by easy instalments. In no sense an increase in tax burden.

9. Average worker with mortgage only 19p a week better off after Budget?

[Calculation for particular type of individual in Answer to Sheldon PQ as follows: £2.02 income tax cut, minus 40p NIC increase, minus £1.43 recovery of excess mortgage tax relief.]

Wrong to treat repayment of tax underpaid last year as a tax increase. Annex to Mr Sheldon's PQ also showed this individual over £6 a week better off than last August, as result of cut in income tax in last Budget and fall last year in mortgage interest rates.

10. Some people not getting mortgage interest relief as a result of switch to MIRAS?

No one entitled to the relief will be deprived of it. A number of people with bank mortgages have not been brought into the new scheme. A few of these have also lost the relief through their tax coding. Anyone in that position should contact their tax office, who will put matter right as quickly as possible.

11. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut. Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

12. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Government's intention is to abolish the surcharge when this can be responsibly afforded: substantial cost (£1.2 billion in a full year) cannot be disregarded.

13. What action is planned to reduce poverty and unemployment traps?

[Draft Meacher committee report, not approved by full TCSC, published on 16 June.]

The Committee has produced a long, detailed and generally thorough draft report, which recognises that the traps have grown up over many years, are not unique to the UK and are not amenable to easy solutions. The Manifesto (see J1) accorded high priority to the traps, and the Government will be examining the draft report with care. Long-term solution to traps is best achieved by maintaining public expenditure restraint, thus allowing tax thresholds to be increased (as in Budget), and by sustained improvement in economic performance leading to higher real earnings.

14. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

15. Keith Committee Report on Enforcement Powers of Revenue Departments

First part of report published 23 March. Second part should be ready later this year. Very substantial document deserves careful study and full consultation; inevitably lengthy process. Some aspects controversial: all the more need for careful consideration and consultation. Report draws attention to scale of 'black economy' -Government is concerned about tax evasion; numbers of investigation staff in Revenue Departments have been increased.

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. Following the Election, how firm are Government's expenditure plans for future years as published in February 1983 White Paper and revised in the Budget?

Existing PEWP plans as revised by Budget are starting points for next public expenditure survey, now imminent. Government stated during Election campaign that intend to stick to published expenditure plans for next three years.

2. Capital spending plans lower in 1983-84 than 1982-83?

Immediate problem not making more funds available but getting local authorities and nationalised industries to spend capital provision available to them. Reduction in planned expenditure compared with last year's plans reflects fact that those plans were not realised.

3. Over-run on spending plans for 1982-83 suggests failure of public spending control

No. (See H6).

4. Implications for 1983-84 and later years?

[1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. Total shortfall for 1982-83 compared plans announced in 1982 Budget thought at Budget time likely to be £2.2 billion but now likely to be much smaller.]

Not clear that expenditure was accelerating in any underlying sense in last weeks of 1982-83. There are one or two items of expenditure that could have fallen either side of 31 March, but in the event fell inside 1982-83. Wrong therefore to draw conclusions either about likelihood of expenditure overshooting in 1983-84 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

5. Can public expenditure spending be prevented from rising sharply in future years?

Government's spending plans covering next three years show steady decline in ratio of public spending to GDP. Government has said that will keep firm control on future levels of public spending.

6. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness, eg intention is to allow Government Departments to reclaim VAT on contracted out services thus removing a disincentive to contracting out.

LOCAL GOVERNMENT

7. Local authority overspending?

Local authority current expenditure in England some £¾ billion in excess of guidance issued by the Environment Secretary. (About half of overspending due to GLC and ILEA. All of the eighteen highest overspenders in Labour control). Overspending approximately £1 billion in GB overall. Local authorities were warned at the time of the last Rate Support Grant (RSG) settlement that such overspending would lead to holdback of grant. Details will be announced shortly.

8. RSG settlements 1984-85?

Government recognises that authorities need long notice of broad features of settlement; accordingly early announcements of grant quanta and planning totals are intended.

9. LA capital underspending in 1982-83

Latest estimates suggest that local authorities underspent their capital cash limits by a little over £1 billion in 1982-83, following underspending of £¾ billion in 1981-82. Steps were taken last autumn to reduce the underspend: PM wrote to local authority associations; local authorities invited to apply for extra allocations (well over £¼ billion issued), and allowed to spend without limit on improvement grants. Extra £150 million made available to Housing Corporation.

10. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83. Steps taken to reduce further underspending: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems including supplementary allocations), LAs can spend above allocations on improvement grants and eligible expenditure limits raised in Budget by 20 percent, also new 'enveloping' provisions (where whole streets being renovated) announced in Budget.

11. Revenue implications of capital projects

Concern about revenue implications should not inhibit full use of allocations: plans for relevant LA current expenditure allow for financing costs of full planned capital programmes; many capital projects have no immediate running costs eg roads, reclamation of derelict land; others will reduce running costs by rationalisation. Government cannot guarantee there will be no underspending - LAs take the decisions. But Government will be monitoring closely, and will take further action, if needed, to encourage full use of provision.

12. Reform of local government structure?

GLC and Metropolitan County Councils have proved to be extravagant and unnecessary tier of local government. Manifesto pledged abolition. Environment Secretary will shortly announce details of timing of legislation and consultation.

13. Legislation to limit rates?

Average level of rate increases could be moderated significantly if minority of overspending Labour-controlled councils followed Government guidance. Legislation will be introduced to give powers selectively to limit rate increases where budgets are excessive, and also to impose if necessary general rate limits. Details will be announced in due course.

14. Green Paper on Domestic Rating System

Government has been carefully considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc.

FALKLANDS EXPENDITURE

15. What has defending Falklands cost so far and foreseeable future cost?

Costs of operation, of replacing equipment lost during conflict, and of garrison, were about £730 million in 1982-83. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion).

16. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10 million now expected to be spent in 1982-83; further £5 million in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

17. Cost of paying compensation for war damage

Too soon to say. Expected that bulk of claims for civilian compensation will be settled in 1982-83, and remainder in 1983-84, but no accurate figure as claims still being processed. Total expected to be in region of £3½-4 million.

PAC REPORT

[PAC Report including item on non-competitive contracts for MOD published 19 May, another referring to non-competitive contracts for drugs on 26 May.]

L CIVIL SERVICE MANPOWER AND PAY

1. Size of civil service

Since May 1929, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Privatisation?

Civil Service Unions say that Government services and establishments are being 'privatised' to meet arbitrary manpower targets, and that more than a third of fall in Civil Service numbers by 1984 will be accounted for by privatisation or 'hiving-off'. In fact, privatisation and hiving off will only account for about 12 to 15 per cent of total manpower savings. Departments have been asked to look at scope for further privatisation and contracting out. (See also K6.)

3. Civil service efficiency?

Civil Service unions say drive for efficiency, motivated largely by Government's determination to reduce size of civil servce, has taken no account of effects of cuts, specifically reduced quality of service. Government do not accept that reductions in manpower have been pursued regardless of effects on efficiency and effectiveness. 630,000 target not arbitrary: Departmental targets have been adjusted according to needs. Great savings already made with little effect on provision of services. No conflict between central manpower control and Financial Management Initiative (see 6 below).

4. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments exploring option cuts of 5 per cent and 10 per cent and stating needs for extra staff. No decisions have been taken.

5. Management and Personnel Office

MPO now part of Cabinet Office. Lord Gowrie, Privy Council Minister of State and Arts Minister responsible for day to day issues, Mr Barney Hayhoe, Treasury Minister of State, answers in the Commons. Prime Minister, as before, in charge.

6. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of

their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Departments now moving into first stage of implementing action. Government is committed to publish a central report on the initiative by July 1983.

7. Civil service pay negotiations for 1983 - non-industrials

Council of Civil Service Unions representing the non-industrial civil service have signified their acceptance of the agreement reached with Treasury. The agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. The cost is to be met from within the provision already made for Civil Service administrative expenditure.

8. Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increase in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] First meeting of the JCC pay sub-committee to discuss the claim held on 21 April. Pay offer deferred until after General Election.

9. Civil Service pay in 1984-85?

[Press speculation about a possible civil service pay cash limit.]

No decision has been taken on the provision for pay in central government cash limits for 1984-85.

10. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

11. Top Salaries Review Body and the higher civil service

See D10.

M SOCIAL SECURITY

1. Government intentions for next uprating?

[Under Social Security and Housing Benefits Act, passed at end of last Parliament, will revert to 'historic' method of uprating. Uprating still made in November, but no longer based on inflation forecast, but on actual inflation in year to May, now known to be 3.7 per cent.]

Under legislation passed at end of last Parliament, uprating no longer based on inflation forecast - which proved inaccurate 5 times out of 7 - but on actual inflation in year to May (now known to be 3.7 per cent). Social Services Secretary will put detailed proposals to Parliament in very near future. Public Services pensions, under current legislation, will be uprated in line with state retirement pension.

2. Historic RPI fails to price-protect pensions?

[Opposition will argue that inflation in year to November forecast at 6 per cent at Budget time - although signs we are doing slightly better than that - while uprating likely to be only 3.7 per cent].

No. Beneficiaries retain 2.7 per cent real increase in pensions at November 1982 upratings. In last Parliament, Government made clear that had old forecast method been used there would have been adjustment to reflect this. Full adjustment would have implied 6-2.7 = 3.3 per cent uprating. Most 'unpledged' benefits were increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, were increased substantially in real terms.

3. 'Unpledged' benefits?

[Manifesto renewed pledge given period of last Parliament to 'continue to protect retirement pensions and other linked long term benefits against rising prices'. Pledge does not cover other benefits, most importantly supplementary allowance, unemployment benefit, housing benefit, child benefit].

Manifesto renewed pledge, which we more than fulfilled over last Parliament, to protect pensions and linked long term benefits against inflation. This covers benefit expenditure of nearly £20 billion. Imprudent in present circumstances to promise more. But in last Parliament most 'unpledged' benefits were increased by more than rate of inflation: some, such as Family Income Supplement, Mobility Allowance, were increased substantially in real terms.

4. Budget improvements in social security?

[Chancellor announced:

(a) 11 per cent increase in child benefit to £6.50 in November;

(b) restoration of 5 per cent abatement of unemployment benefit;

(c) 'invalidity trap' being abolished (inability of invalidity pensioners to qualify for long term rate of supplementary benefit); pensioners under 60 will get long term rate after one year; those over 60 immediately. Helps 55,000 sick and disabled people;

(d) higher scale (long term) rate of supplementary benefit to be available to unemployed men over 60 on supplementary benefit effective from June (in addition, men between 60 and 65 no longer need to 'sign on' in order to safeguard pension entitlement);

(e) therapeutic earnings limit (amount disabled and chronic sick can earn - with doctor's approval - before benefit withdrawn) up from £20 to £22.50; and

(f) new mobility supplement for war pensioners (broadly equivalent civilian mobility allowance but with £2.10 war pensioners preference premium).]

(g) main supplementary benefit capital disregard up from £25000 to £3000; single payment disregard up from £300 to £500; new separate disregard of £15000 for life assurance policies.

Various improvements to help on top of basic uprating.

N EUROPEAN COMMUNITY

1. UK refunds for 1983

Stuttgart European Council agreed to basic net refund of £450 million in respect of 1983. This produces average refund rate over four years 1980-83 of nearly 66 per cent. Appropriate figures will be entered in 1984 draft budget.

2. Deal is conditional, surely this is bad?

Nothing conditional about 1983 agreement. The sums will be entered in and paid from 1984 budget.

3. Longer-term budget negotiations

European Council agreed that they would reach conclusions in December on Community's future financing, including ways of limiting expenditure on CAP, accommodating enlargement, and solving problems of budgetary imbalance. Commission will prepare proposals in these areas. UK will negotiate on them in constructive spirit.

4. UK objectives on EC budget for longer-term?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

5. Will UK agree to new 'own resources'?

We have agreed that review of the EC's future financing should consider inter alia question of extent and timing of EC's requirements for resources. This does not prejudge the outcome. HMG remains unconvinced of need for new 'own resources'.

6. Reforms in Common Agricultural Policy?

European Council invited Council of Ministers to consider number of reforms to operation of CAP designed to reduce its cost. UK will be in forefront of those arguing for implementation of measures to achieve effective control of agricultural expenditure and observance of strict guideline on its rate of growth. Key measures remain price restraint and curbs on surplus production.

7. UK Government response to Commission request for advance to meet cash crisis?

Commission has right to invite these advances. We have agreed that, in view of current ~~cost~~ cash position, an advance should be made in June.

8. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

9. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of growth of guarantee expenditure.

10. Costs of CAP to UK consumers

Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to reduction in the cost of food to consumers could well involve increased costs to taxpayers.

11. European Monetary System exchange rate mechanism

See F7.

P INDUSTRY

[CBI views on policies affecting industry - see A6.]

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £2 billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[Gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, rose almost 15 per cent between 1981 and 1982; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

3. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Provisional figure of liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

6. Loan Guarantee Scheme?

[Nearly 9,400 guarantees already issued - about half to new businesses. Total lending under scheme over £310 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

7. New Enterprise Zones

Proposed sites for nine new zones in England were announced by Environment Secretary 15 November though one of these (NE Derbyshire) is not now going ahead; sites for two new zones for Scotland, one for Northern Ireland and two for Wales have also been announced. Meanwhile, the report from consultants published 26 April shows that the zones in general appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. Approach to improving Nationalised Industries' performance?

Reform of nationalised industries is central to economic recovery. Best way to improve performance in long term is to expose the industries to market forces, through reduction of monopoly, and through privatisation. Meanwhile, tight financial framework ensures that disciplines commonplace in private sector are also imposed on State industries. Challenging performance aims are being set and top class managers have been appointed. Rolling programme of Monopolies and Mergers Commission investigations set up in previous Parliament will continue.

2. EFLs for 1982-83 and 1983-84?

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. EFLs for 1983-84 currently total £2.5 billion.

INVESTMENT

3. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

4. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

5. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to April 1983 7.5 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

6. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

7. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

8. Why privatise?

Privatisation key element in economic strategy which will be pursued with renewed vigour in this Parliament. It opens up new areas to disciplines of market forces, promotes competition and efficiency, and improves the quality of service to consumers. Already substantial record of achievement; British Aerospace, Cable and Wireless, National Freight Consortium, Amersham International, Britoil, Associated British Ports, International Aeradio, some British Rail subsidiaries and certain NEB holdings, including Ferranti and Faireys, have been transferred to private sector. So far, privatisation programme has brought in receipts of over £2 billion.

9. Future ~~privatisations~~ privatisation?

Wytch Farm oil field sale to be completed this year. British Telecom, Rolls Royce, British Airways, BGC's offshore oil interests, substantial parts of British Steel, of British Shipbuilders and of British Leyland, and as many as possible of Britain's airports, will

become private sector companies. We will prepare for introduction of private finance into Royal Ordnance Factories. We will continue to identify and prepare other potential candidates for privatisation. We aim to introduce substantial private control into the National Bus Company and increase competition in, and attract private capital into, the gas and electricity industries.

10. <u>Special asset sales in 1982-83</u>?

Estimated outturn for 1982-83 around £500 million. Full details of receipts will be published shortly.

11. <u>What sales included in special asset sale targets for future years</u>?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive.

S NORTH SEA AND UK ECONOMY

1. Will OPEC agreement hold? BNOC prices?

Whether OPEC's agreement works will depend on OPEC. Price negotiations matter for BNOC's judgment. But North Sea prices will obviously be related to prices of closely-competing crudes. BNOC will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels. If oil prices were to fall further, Chancellor remains ready to take appropriate action. Position would need to be reviewed in light of circumstances at the time.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985? Effect on revenues?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about impact on economy of falling North Sea output. Effect of falling output on revenues will be muted because of tendency of revenues to lag behind output.

5. What remains of Budget proposals on oil taxation?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling were all included in the truncated Finance Act. Bill to abolish royalties on future fields will be reintroduced as soon as possible.

6. Benefits of North Sea should be used to strengthen economy?

Without North Sea revenue taxes would be higher or public expenditure lower. Revenues ease task of controlling public borrowing. This will help to achieve lower level of interest rates to benefit of industry and economy as a whole. Will thus provide income for day when oil runs out. But keep revenues in perspective. Estimated at about 6 per cent of total General Government receipts in 1983-84.

7. Are we really any better off for North Sea oil?

We have been spared fall in real national income that other industrial countries have suffered following oil price rises. But North Sea oil costly to produce, so we are not necessarily any better off than we would have been had oil prices not risen. No need therefore for possession of oil to require a contraction in our industrial base.

8. Revenues from oil being frittered away on consumptions/unemployment benefits?

No. We are using the oil revenues to reduce the PSBR and interest rates, leaving more room for the private sector to borrow and invest: an essential step towards creating a strong and growing economy.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. New 'Bretton Woods'?

[President Mitterand and Mr Muldoon, among others, have been reported recently as calling for new international conference to examine monetary problems.]

Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.

3. World recovery under way?

[Encouraging signs of recovery particularly in US and Canada where industrial production rose sharply in first quarter and housing starts have risen. In Europe, industrial production also rose slightly in first quarter, and business confidence has improved. According to Press Reports OECD Secretariat has revised up forecast for growth in industrialised countries this year to 2 per cent (from 1½ per cent December 1982 forecast).]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). The recovery is likely to accelerate during the course of this year and into early next year, with output rising by perhaps 1½ per cent in 1983.

4. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.6 to 3.9 per cent), UK (9.5 to 3.7 per cent), Japan (2.8 to 2.0 per cent), Canada (11.3 to 6.6 per cent) France (13.9 to 9.1 per cent), Germany (5.0 to 3.3 per cent), Italy risen slightly (from 15.2 to 16.4 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation have helped lay basis for signs of recovery being seen both in UK and rest of world this year.

5. Prospects for US economy?

[Industrial production has risen for past 6 months, retail sales have begun to improve, and GNP rose by about ½ per cent in first quarter although this mainly due to slower destocking.]

Welcome further signs that recovery underway in US although too early to be sure recovery firmly established.

6. US Budget

[Senate passed budget resolution for 1984 in May providing for tax increases of £9 billion and 6 per cent rise in real defence spending contributing to budget deficit of $179 billion. House of Representatives proposed lower deficit of $175 billion partly due to higher tax increases of $30 billion and lower defence spending. House and Senate will now meet in conference to try to reach compromise. Neither of proposals acceptable to President Reagan who has threatened to veto any major tax increases.]

Share widely expressed concern over potential size of budget deficit. Important that firm measures to reduce deficit be agreed if US interest rates are not to rise again, as economy recovers.

7. US has relaxed monetary policy?

[M1 has grown very rapidly in recent weeks following slight fall in April and is well above its 4-7 per cent target range set out in February. M2 and M3 are within their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates, Fed is keen to sustain recovery but remains solidly committed to preventing any resurgence of inflation.

8. What about a fresh allocation of Special Drawing Rights? Why not allocate SDRs exclusively to LDC's?

IMF will be examining desirability of further SDR allocation, in light of current trends in growth, inflation, and international liquidity. We have an open mind about case for further allocation. The Fund's Articles require SDR allocations to be issued to all member pro rota with their quota.

9. International Debt

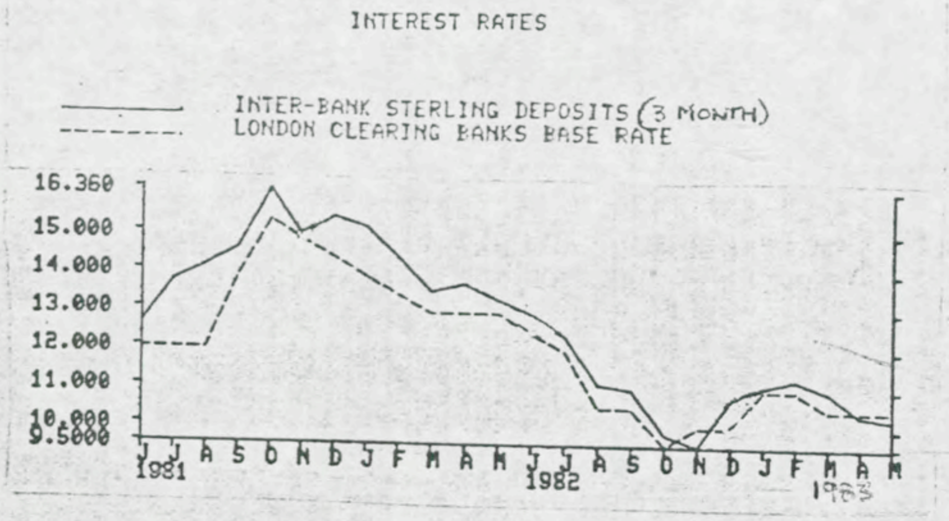
[Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar.]

Glad to see many of largest debtors now undertaking adjustment programmes, often with IMF assistance. Although some short term financing difficulties may remain, (eg Brazil), falls in interest rates last summer, recent rises in commodity prices and expected growth in underlying conditions have improved due to world trade during this year.

COMMENTARY ON RECENT UK ECONOMIC DEVELOPMENTS: 20 JUNE 1983

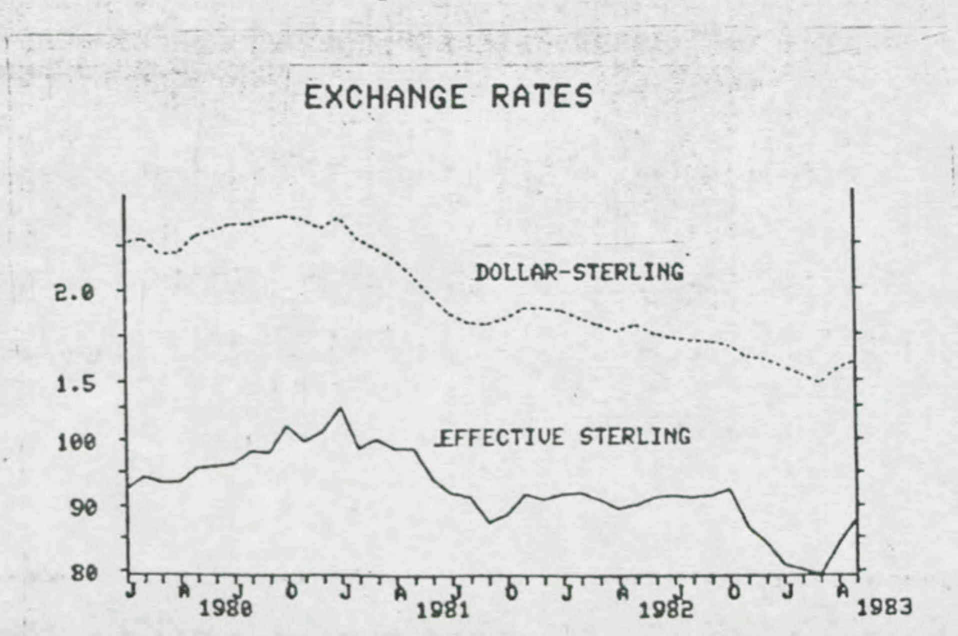
Financial Conditions

1. The monetary aggregates M1, £M3 and PSL2, all grew within the 8-12 per cent target range for 1982-83. The relatively large rises in the aggregates in April and May mainly reflected the high level of Government borrowing at the turn of the financial year. Real monetary growth has risen steadily this year. Real interest rates remain relatively high (and perhaps somewhat higher than last autumn) and other indicators, such as falling inflation, do not suggest lax monetary conditions.



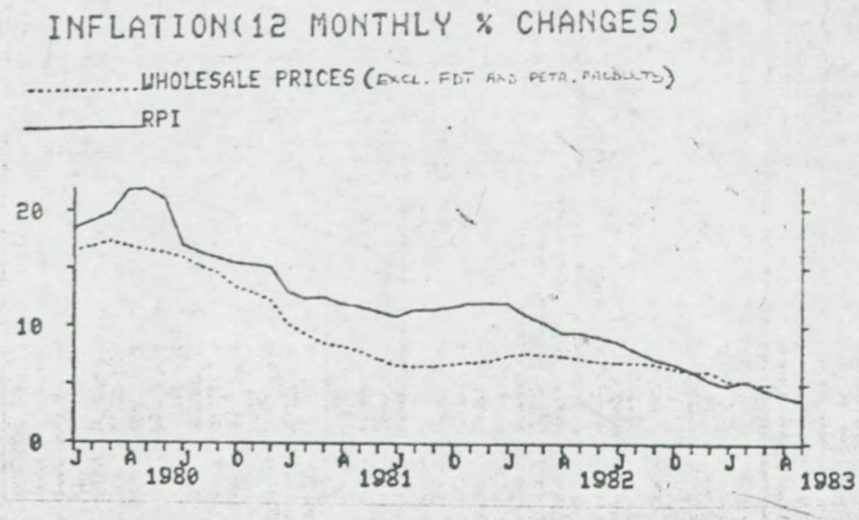
2. The PSBR is estimated at £9.2 billion in 1982-83. This represents 3¼ per cent of GDP which is slightly lower than the comparable figure for 1981-82 (3½ per cent) but somewhat higher than the estimate published with the 1983 Budget (2¾ per cent of GDP), mainly reflecting less than expected underspending by central government. Public sector borrowing as a percentage of GDP has been on a downward trend and is only around a third of its level in the mid-1970s.

3. The effective exchange rate is now around 85 (1975 = 100), somewhat lower than the 90-91 range occupied for most of the period summer 1981-autumn 1982.



Inflation, real incomes and consumer spending

4. Inflation continues to fall. The 12-monthly increase in retail prices was 3.7 per cent in May, its lowest level for over fifteen years. Other measures of inflation tend to show somewhat larger increases (the RPI has been benefitting from exceptionally low increases in food prices and the cuts in mortgage interest rates), though still a declining trend.



5. Average settlements in manufacturing are currently running at about 5-6 per cent, some 1½ per cent lower than in the 1981-82 pay round, but still significantly above the level of price inflation. The underlying 12-monthly increase in average earnings was 7¼ per cent in April and continues the steady fall since the beginning of the 1980/81 pay round.

6. In the first four months of 1983 average earnings grew around 3 per cent faster than both the RPI and the TPI suggesting large improvements in both gross and net real earnings. On a longer term comparison the growth in real take-home pay has been more modest as has the movement in per capita real personal disposable income (which includes the net income of those out of work as well as those in work).

REAL INCOME GROWTH

Year-on-year % changes

	Per Capital RPDI	Net Real Earnings (using the TPI)
1980	+1.1	+2.8
1981	-1.8	-1.6
1982	-1.1	-0.4
1983 Q1	na	+3.3
1983 April	na	+4.5

7. Much of the recovery in total domestic demand during 1982 reflected the growth in consumer spending, itself partly reflecting lower inflation and the summer 1982 abolition of HP controls. The slight fall in real personal disposable income in 1982 was offset by a fall in the savings ratio. Although consumers' expenditure appears to have changed little in 1983 Q1 it is still somewhat higher than a year ago. And retail trade remains buoyant.

CONSUMER SPENDING (VOLUME)

Year-on-year % changes

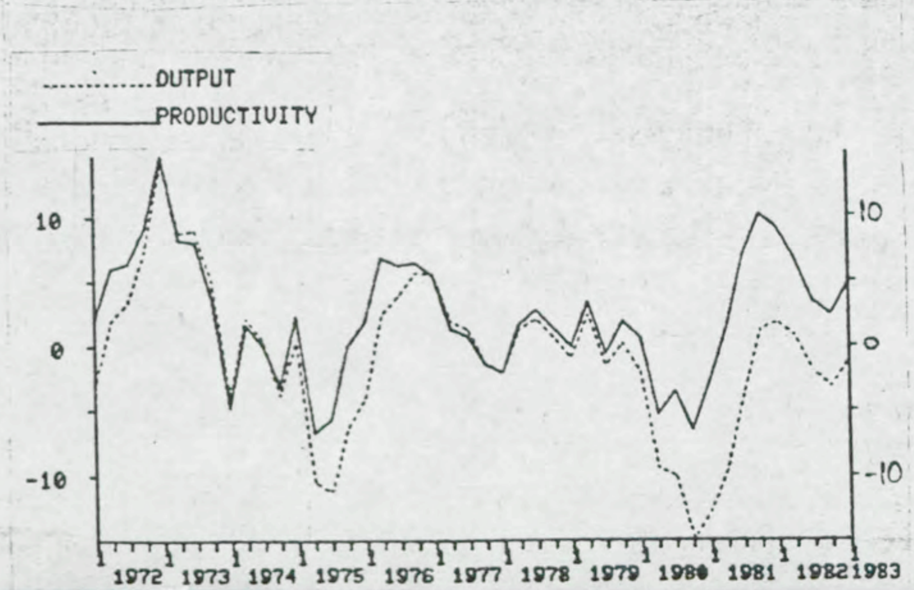
		Consumers' Expenditure	Retail Sales
1982	H1	0.0	0.9
	H2	2.2	4.2
1983	Q1	3.4*	4.3
3 months to May		na	5½*

* provisional/preliminary

Costs, Company Finances and Investment

8. Manufacturing output per head was up by 5½ per cent in the year to 1983 Q1, and some 17 per cent above its trough level at the end of 1980 - an impressive improvement for this stage of the economic cycle. Continued productivity gains, coupled with further wage moderation, have brought down the increase in manufacturers' unit wage and salary costs to around 2½ per cent in the year to 1983 Q1. This compares favourably with our major competitors. The increase would be lower still if a broader labour costs measure were used which incorporated the cuts in the National Insurance Surcharge. Industrial (non-oil) commodity prices (in SDR's) have risen strongly since the autumn according to the Economist index, but world oil prices have weakened and, after allowing for the lower exchange rate, prices of materials and fuels purchased by manufacturers are only some 3 per cent higher than in the autumn.

MANUFACTURING PRODUCTIVITY(4 QTR % CHANGES)



9. Nominal profits of industrial and commercial companies improved during 1982 - both for oil and non-oil firms - though from an historically low level and after a period of real declines because of inflation. This improvement is reflected in small increases in pre-tax real rates of return (the movement of real interest rates is discussed in the first paragraph) and in a strengthening of the company sector's financial position.

REAL NET PRE-TAX RATES OF RETURN

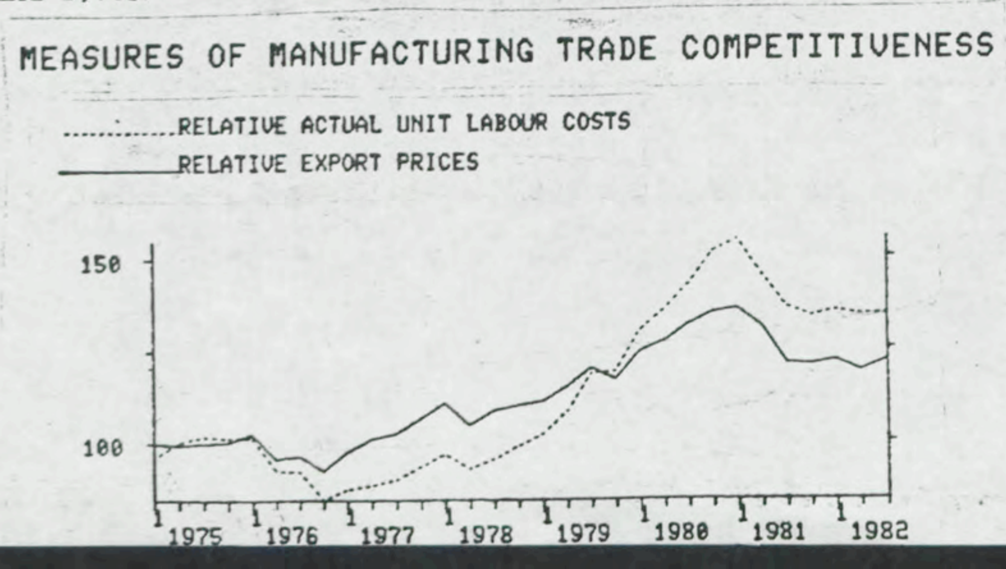
	Non-North Sea ICC's	Manufacturing
1960-70 (average)	11	10
1980	4	3½
1981	3½	2
1982	4	na

The latest DOI Survey of Company Liquidity showed a marked improvement in 1983 Q1 in the liquidity of the 200 large companies covered. It is now at its best level since the middle of 1979 and the greatest improvement was in manufacturing.

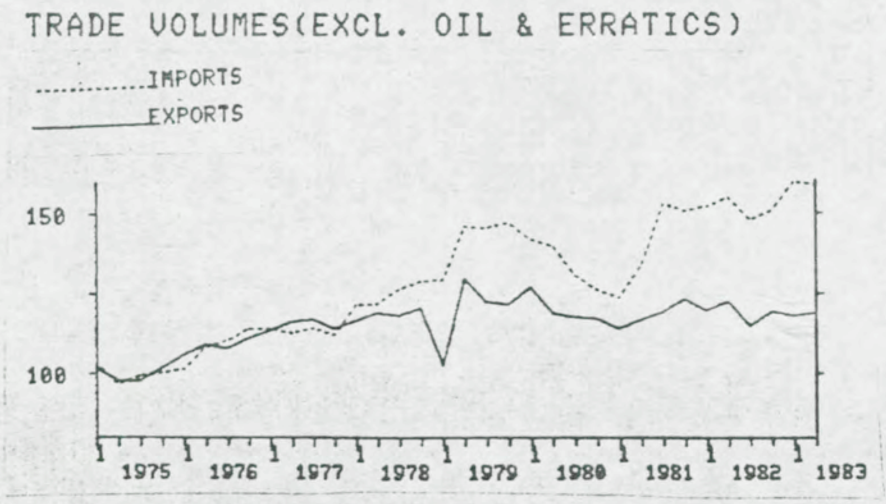
10. Total fixed investment has been broadly flat since mid-1982, with increases in distribution and services roughly offsetting a continued fall in manufacturing. Substantial destocking resumed in the second half of 1982 - partly because distributors initially responded to the upturn in consumers' spending by running down stocks. Far less destocking occured in the first quarter of this year - only some £42 million by manufacturers and distributors, compared with £900 million in the second half of 1982.

Competitiveness and Trade

11. Manufacturing trade competitiveness can be measured in a number of ways although the commonly used indices concentrate on "cost" or "price" rather than "non-price" factors. Cost competitiveness (on the basis of an effective exchange rate of 84) is estimated to have improved by some 20 per cent since early 1981 (partly reflecting the lower exchange rate, partly lower pay settlements and higher productivity) though remaining substantially worse than in the mid-1970s.

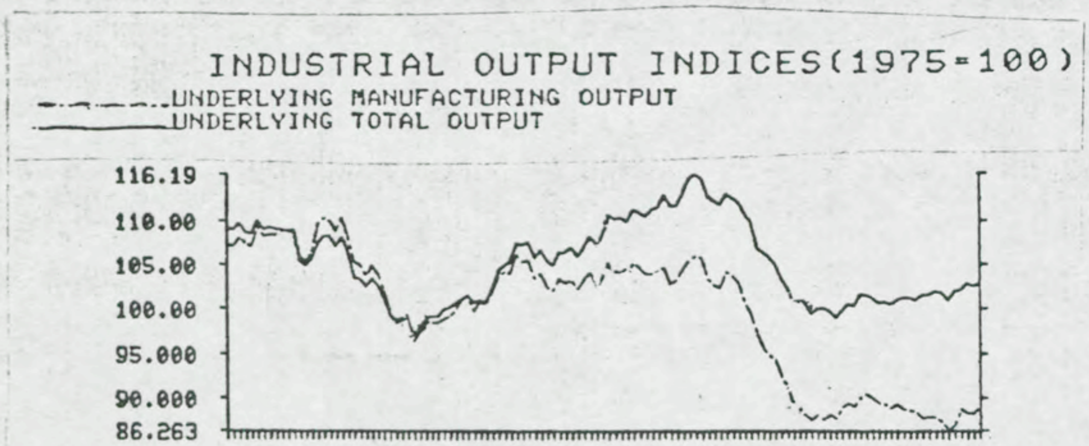


12. The current account of the balance of payments, though weakening, remained in small surplus in the first few months of 1983. Export volumes have continued to hold up well in relation to earlier substantial losses in competitiveness and weak world demand (though recently export strength has been coming from food and basic materials rather than manufactures). Import volumes were broadly flat in 1982 though, as expected, some rise has recently taken place associated with the slowdown in destocking and the recovery in domestic activity.

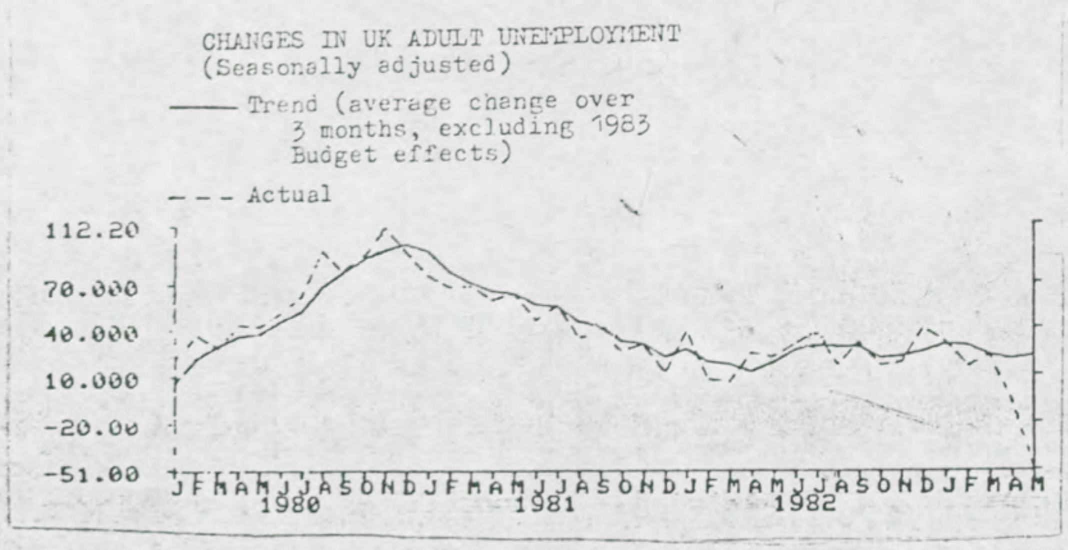


Demand, Output and Unemployment

13. In 1982 real domestic demand - using the expenditure components of GDP - was 2½ per cent higher than a year earlier. And partial information for the first quarter of this year suggests further growth largely resulting from the turnround in stockbuilding (full figures to be published on 21 June). There is also growing evidence that a modest recovery in domestic supply is underway. Total output (GDP) rose by ¾ per cent between 1982 Q4 and 1983 Q1 and is now 2½-3 per cent above its trough (reached in 1981 Q2). The underlying level of industrial output is some 3½ per cent above its spring 1981 trough, with about half this growth due to increased North Sea activity. Manufacturing output, which was on a declining trend during 1982, now also appears to be recovering.



14. However, the underlying level of unemployment is still rising. In May, the UK total (not seasonally adjusted) was 3.05 million (12.8 per cent). Adult unemployment (seasonally adjusted) was 2.97 million (12.4 per cent). These figures were substantially lower than those for April but this reflects the effects of the Budget provision of automatic national insurance credits for men over 60. Allowing for the latter, the adult total rose by 23,000, a slightly smaller rise than in March and April. Notified vacancies fell by 3,000 in May to 131,000 but their trend still appears to be upward. The trend in manufacturing employment continues downwards but the CBI's April Quarterly Trends Survey points to some slowdown in the rate of demanning in the near future.



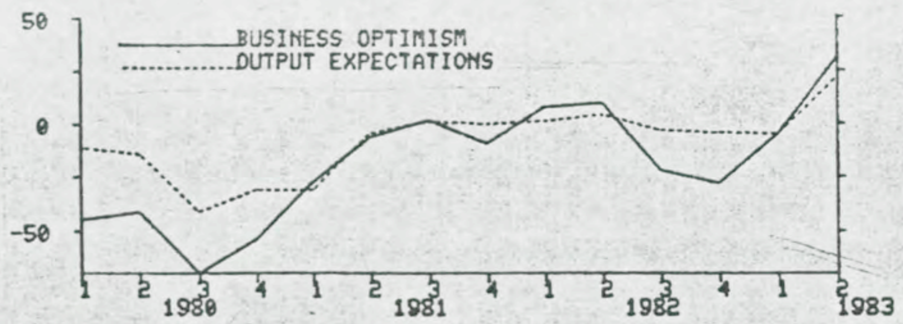
Recent forward indicators

15. The CSO's indices of cyclical indicators, taken together, point to a continued upswing in the business cycle. Other specific indicators show some generally encouraging signs. In the three months to May car production increased by 18 per cent compared to the previous three months. On the same comparison steel production was 20 per cent higher but remained 4½ per cent below the rate of production achieved in the same period a year earlier. Total engineering orders rose 3 per cent in the three months to February compared with the previous three months, and export orders rose by about 25 per cent on the same comparison. The volume of new construction orders continues to be quite buoyant as do total housing completions. Total housing starts have fallen since February but in the three months to April were 7 per cent higher than in the previous three months.

16. The CBI's April Industrial Trends Survey contained encouraging signs with improved business optimism (the highest net balance since 1976), order books and output expectations, and investment intentions. The results also pointed to a slowdown in destocking and job

shedding. This message was further confirmed in their May Enquiry which showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). The net balance of firms expecting an increase in output was positive for the fourth successive month and recently these balances have been the highest recorded since June 1979. The proportion of firms expecting an increase in average domestic selling prices is still higher than towards the end of 1982 but remains low by historical standards while the net balance of firms reporting excessive finished stocks is now at its lowest level since November 1979. The DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 although the underlying trend is expected to turn upwards later this year. Other components of investment (distribution and services) are more encouraging and overall the survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984.

CBI SURVEY INDICATORS(% BALANCES)



17. The Government forecast published with the Budget expects inflation to stabilise around the 6 per cent level by the end of 1983 (recent evidence suggests that progress on inflation has been better than expected). GDP is expected to rise by 2 per cent between 1982 and 1983 with a similar increase in manufacturing output. All demand components are expected to increase in 1983 with total domestic demand up by 3½ per cent. The current account surplus is anticipated to fall to £1½ billion in 1983 and the PSBR is expected to be £8 billion in 1983-84 (compared with £9¼ billion in 1982-83). World trade is expected to rise by 1 per cent this year but to grow more strongly in the first half of 1984. Recent outside forecasts expect slightly higher GDP growth of around 2-2½ per cent in 1983 with some recovery in the world economy and inflation around 6-7 per cent by the end of the year. Consumers' spending and stockbuilding are the main expansionary influences but overall the expected improvement in activity is insufficient to prevent further expected increases in unemployment. For 1984 the outlook is less clear but all groups expect continued GDP growth though possibly at a slower rate than in 1983.

Key indicators to be published in week ending 24 June

Mon	20 :	Cyclical Indicators (May)
Tues	21 :	GDP (1st quarter)
Wed	22 :	Construction - new orders (Apr)
Thurs	23 :	New Vehicle Registration (May)
Fri	24 :	Overseas Trade and BoP current account (May)

Copy 4 of 5

B.C. Nick Owen

10 DOWNING STREET

From the Private Secretary

15 June 1983

The Prime Minister has asked me to send you, for the personal attention of your Secretary of State only, the attached copy of a note prepared for her by the CPRS on Economic Prospects and Opportunities.

I am sending a copy of this letter, with the same request from the Prime Minister, to Alex Galloway (Office of the Chancellor of the Duchy of Lancaster).

I should be grateful if you and he could ensure that this paper is neither circulated outside the Private Office nor photocopied.

M. C. SCHOLAR

Jonathan Spencer, Esq.,
Department of Trade and Industry.

(1)

Prime Minister

There are a number of passages here which, if leaked, might cause embarrassment

Covering CONFIDENTIAL

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Qa 06391

To: PRIME MINISTER

From: JOHN SPARROW

14 June 1983

Economic Prospects and Opportunities

1. I attach a note which has been prepared within the CPRS and which you might like to have circulated to Cabinet colleagues.

2. I am sending a copy of this minute and the attachment to Nigel Lawson and Sir Robert Armstrong.

JS.

Told Mr Sparrow's office of PM's decision
MCS 15/6

The last sentence of para 3, for example:

Also the marked passages in paras 14, 19 21 and 22(a).

Att

Do you wish this circulated to Cabinet colleagues?

No. The Chancellor, Industry Sec + Chancellor of Duchy to have PERSONAL copies only [illegible]

MCS 14/6

ECONOMIC PROSPECTS AND OPPORTUNITIES

Note by the Central Policy Review Staff

Introduction

The Manifesto puts the Government's first "great task for the future" as the creation of "an economy which provides stable prices, lasting prosperity and employment".

2. The first term of office has achieved :-
- dramatic fall in inflation
- improved fiscal and monetary control
- strong balance of payments
- greater shop floor realism and hence less time squandered in strikes
- some progress but not nearly enough towards competitiveness
- reduction or abolition of controls across a wide range of activities

3. The emphasis in the Government's second term must be on creating conditions for sustained growth while not putting these achievements at risk. Without growth the chances of demonstrating within the next 5 years that the Government's economic policies can help bring down unemployment will be minimal.

4. There are 5 priority areas for attention :-
- world economy
- continued control of inflation with the main emphasis on pay
- public expenditure
- taxation and incentives
- measures to assist a faster fall in unemployment

World economy

5. The Williamsburg Summit produced agreement among the 7 upon the nature of current economic problems and upon the priorities for their solution :-

- reverse the drift to protectionism
- downward pressure on inflation and interest rates
- improved economic convergence

6. As host nation for the 1984 Economic Summit the UK has a special responsibility and opportunity for influencing the 7 nations to sustain their efforts to prevent the current economic recovery from petering out.

7. Crucial could be US success in reducing its large budget deficit. But with 1984 a Presidential Election Year the US might well not move far or fast enough. This means that the Government has not only to maintain its and others' pressure on the US but should also consider how to counter the adverse consequences of these not succeeding in getting adequate results fast enough. There are two main options :-

- accept depreciation against the dollar (ideally in the company of the rest of the world to minimise the risk to domestic inflation); or
- minimise the impact on growth of higher real interest rates by shifting the burden of taxation away from production towards consumption.

Inflation and Pay

8. Further reductions in UK money supply growth and public sector borrowing will be needed. The tighter the monetary target the more important it is that inflation is held in check; otherwise economic growth will be stifled. A revival of world activity will put upward pressure on oil and commodity prices - important external influences on inflation. Downward pressure on the key internal component of inflation - earnings - becomes crucial.

9. A reduction in the growth of real labour costs relative to productivity is also needed to promote a restoration of profitability from currently very low and inadequate levels. Provided productivity growth is fast enough this need not involve a fall in the level of real living standards.

10. At a time of rising demand a continued fall in earnings inflation and a relatively slow advance of real earnings cannot be easily achieved without a radical change in pay bargaining behaviour. Despite greater realism in pay bargaining those in work have since 1979 enjoyed an overall rise in real take home pay in excess of what has been earned through increased productivity. If this can happen during a period of deep recession there must be a real risk of excessive pay rises during a period of recovery. And comparability still plays too great a role as a justification for pay increases in both public and private sectors.

11. In the short term Government should :

- <u>in the public sector</u> :
  use cash limits to influence wage settlements and go slow on comparability

- <u>in the private sector</u> :
  exercise influence through exhortation and public sector example.

12. These measures are not enough for the long term. The aims for both sectors should be :-

- to ensure that the large number of unemployed is not ignored by those responsible for pay bargaining.
- to make output, performance and market forces rather than "fairness" the determining factors for wage settlements

13. To achieve these aims the Government needs to :-

a) Open up labour markets to more effective competition through Trade Union and Wage Council reforms.
b) Ensure that Special Employment Measures also encourage wage flexibility.
c) Promote employee share schemes as one method for getting employees to place greater weight on the success of their firms.
d) Encourage improved employer/employee communications and better industrial relations both by setting an example as manager of the public services and by exhortation.
e) Open up product markets by removing anti-competitive practices in industry and barriers against decentralisation and demerging. This requires a more effective policy on mergers and monopolies to discourage excessive concentration and collusive agreements. It requires the phasing out of protective measures and lax industrial subsidy arrangements. The more competitive the environment the more responsive employers will be to labour market conditions. Also employers would be more ready to resist any pressure from their employees to pass on to them in the form of higher earnings all the benefits of improved profits or higher output (especially when the improvement does not result from increased effort by employees).

Public Expenditure

14. Public expenditure grew by about 5% (real) in the first 3 years of the Government's term. Present plans are for no further growth in the next 3 years. If these plans are achieved and steady growth of GDP also occurs, the ratio of public expenditure to GDP will fall significantly. Economic growth will help to reduce cyclically sensitive expenditure e.g. unemployment benefits, special employment measures, nationalised industry deficits. It could also reduce the need for assistance to industry and agriculture, housing subsidies and earnings related social security benefits which have developed because of low income or low savings in the corporate and personal sectors.

15. The Manifesto contains few specific public expenditure commitments but many of the tasks and aims described in the Manifesto may be held to imply expansion of the relevant Government expenditure programmes.

16. Even with economic growth there will remain two important threats to the objective of reducing the size of public expenditure both in absolute terms and as a proportion of GDP :-

a) The PES system has become more an instrument of short term control and less an instrument for resource allocation and planning over the longer term. This carries the risk that later years will produce unpleasant surprises.

b) The emphasis on controlling quantity has its place but needs to be complemented by attention to quality - to the balance between programmes, the relationship between expenditure inputs and programme outputs, and the balance between expenditure on current consumption and expenditure on investment.

17. The beginning of a new Parliament provides a short-lived and unique opportunity to consider the path of public expenditure over the longer term period and to carry out in the context of the PES some effective medium term planning with more attention to strategic priorities and to the economic effects of different patterns of expenditure.

Taxation and Incentives

18. The objective of further reduction and simplification of taxes will be more easily achieved if there is sustained growth. Progress towards that objective can also contribute to the growth objective by improving incentives.

19. The computerisation of PAYE, which should be completed by the end of the new Parliament, would greatly facilitate the integration of the personal tax and benefit systems. The anomalies in the present system of taxing income (personal and corporate) justify fundamental reform.

If the opportunity for reform is to be taken, a strategy needs to be developed as soon as possible. This strategy should take into account "tax expenditures" (tax allowances, reliefs and exemptions, excluding personal allowances) which in the last three years have risen faster than mainstream public expenditure and which impact on incentives by reducing the scope for cuts in the basic rates.

20. The two initial targets in a strategy for reform should be :-

a) Lifting the personal tax threshold in real terms in order to reduce overlap with social security and supplementary benefit levels thus improving the incentive for those out of work to seek jobs and to mitigate "poverty trap" effects for the low paid in work.

b) Altering the relative burden of tax on capital and labour in order to encourage job generation and economic efficiency. Present tax arrangements which tend to subsidise capital and tax labour might have been appropriate at a time of labour shortage but now discourage the growth of labour intensive activities and encourage the use of excessive capital.

Unemployment

21. Significant economic growth is a necessary but not sufficient condition for reducing unemployment. If we assume economic growth and productivity improvement as fast as in the best 5 year period since the War radical changes in the labour market will still be necessary to prevent high unemployment from being a problem for at least the rest of this decade. Besides the new growth industries may not be labour-intensive whilst the need for further improvements in competitiveness means that still more jobs will have to be shaken out of companies in the public and the private sector.

22. Long term problems require long term solutions. There are two main options over and above the existing Special Employment Measures :-

a) Further actions to increase the efficiency of the labour market by reducing the barriers which discourage employers from recruiting staff or by increasing the incentives to people to take work (some possible steps were outlined in Chapters 6 and 7 of the 1982 CPRS Report on Unemployment). Progress in this direction would maximise the employment generated by whatever rate of GDP growth is achievable but it could also help raise the sustainable rate of growth. Employment in labour intensive services would help achieve faster growth rates; the main groups to benefit would probably be married women and young people.

b) A more radical approach to sharing out existing work. This could involve a concentrated campaign to shift employers and employees from bargaining over wages to bargaining over working time and retirement. Shorter working time requires concessions over wages and pensions if it is not to be inflationary - both the work and the income it produces have to be shared. By setting an example in the public sector and by developing selective incentives within public expenditure and taxation constraints the Government could accelerate a change of attitudes in the UK such as is already occurring in one or two other countries.

Conclusion/Summary

23. Only sustained growth with low inflation will enable the Government to meet its social and economic objectives. Fundamental factors influencing the objective of sustained growth include :

The World Economy. While continuing to press for international policy convergence the Government should consider the British response if the US deficit is not brought under control.

Inflation and Pay. To lower inflation further will require a radical change in pay bargaining behaviour. Government can directly contribute through a range of measures to open up the labour and product markets to more effective competition.

Public Expenditure. If firm control is to be maintained it is essential to take a longer-term view of public expenditure and to work out strategic priorities for all programmes.

Taxation. Improved incentives and simplification of the system require the development of a strategy for tax (and benefit) reform.

24. Given the importance of improving productivity, sustained economic growth cannot by itself be guaranteed to have a large impact on unemployment in the timescale of the new Parliament. To reduce unemployment significantly by 1988 it will be necessary for Government to :

(a) take further steps to increase the efficiency of the labour market; and

(b) encourage a much greater degree of work and income sharing.

14 June 1983

cc Mr. Scholar

2A

SECRET

8 June 1983

PRIME MINISTER

David Young

1

THE FIRST FIFTEEN MONTHS

I attach the paper which David Young promised you at your meeting with him and Keith on 16 May. He will be giving the only other copy to Keith.

The priorities he suggests seem very sensible, although, as he says, having been out at the MSC for more than a year, in one or two cases he has not taken full account of what we are already doing or planning to do. Here is a brief summary of his proposals.

1.1 The Civil Service. Little more to be gained from across-the-board cuts. We must cut functions.

1.2 Local Government. Restricting rate increases won't be enough. We ought to make some local authority fringe activities ultra vires. All direct labour work should be put out to tender.

1.3 The Nationalised Industries. We need an orderly programme to split up each industry by region or function and then sell them off piece by piece. We can turn many of these functions into Companies Act companies without legislation, as McGregor has done to British Steel. Legislation can come at the end, not the beginning, of the programme. David says that E(DL) at present acts as a rubber stamp for Ministerial agreement. It needs a small permanent secretariat to follow through the disposals programme and report to the Chairman. You should be that Chairman.

2.1 Taxation. We must stop the Inland Revenue frustrating the purposes of our tax allowances for business start-up, residential allowance and so on. The House of Lords has already effectively ended Rossminster-type cases in the Ramsay case. I think you need a Tax Effectiveness Group, consisting of the Small Business Minister, David Young himself, an experienced accountant in practice, as well as Treasury Ministers and Inland Revenue representatives to make sure in advance that our enterprise schemes really work. The Group should report jointly to you and the Chancellor.

SECRET

2. Investment Income Surcharge. In our first Budget last time, we took the radical steps on earned income that were needed. This time, we should use our first Budget to do the same on investment income.

3. Barriers to Mobility. We must have a radical change on regional policy, relating aid to jobs and not to capital investment. The official work being done for MISC 14 will never produce the right answer. You must take personal charge of a small Ministerial task force to produce the right answer.

3.1 Employment Restrictions. We must remove the barriers to employment set up by the Employment Protection Act.

3.2 Skills Training. David has always wanted to split the MSC into half, giving the Job Centres and the Community Programme back to the Department of Employment; with the rest being transformed into a National Training Commission (NTC) which would report to Education, as well as to Industry and Employment. This NTC could take charge of the funding of colleges of further education while leaving their ownership with the LEAs. I think this a brilliant way to make sure that FE does provide courses relevant to future needs.

David also wants to offer a training voucher scheme. This sounds rather promising and does not have the political difficulties posed by vouchers for schools, and should certainly be further examined.

3.3 Moving People. Like the rest of us, David is trying to find a way to encourage the building of housing for rent without abolishing rent control. He thinks liberalising the residential building allowance may well be the answer. I am sure that capital allowances are the key to many of the obstacles to a high rate of housebuilding. For example, Laurie Barratt has estimated that if capital allowances were extended to shared ownership in the private sector, then the industry would be building an extra 50,000 homes a year. Without capital allowances, it is simply not worth their while. When John Stanley brought this idea to the Family Policy Group, Geoffrey said the objection was one of tax philosophy. However, in talks with Nick Ridley later, the Treasury line had changed. They now say that giving capital allowances

SECRET

would simply cost too much. I am sure that this question needs to be tackled very early in order that private housebuilders should see at least 4 years ahead of them in which they will not be interrupted by political spite.

FM

FERDINAND MOUNT

SECRET

1/1

PPS/CHANCELLOR

file no TEB/CA/01

copied to:

Mr Salveson (for transmission to No.10)
PS/CST
PS/FST
PS/EST
PS/MST(C)
PS/MST(R)
PS/Home Secretary
PS/Lord Chancellor
PS/Foreign Secretary
PS/Secretary of State for Education and Science
PS/Lord President of the Council
PS/Secretary of State for Northern Ireland
PS/Secretary of State for Defence
PS/Minister of Agriculture, Fisheries and Food
PS/Secretary of State for Environment
PS/Secretary of State for Scotland
PS/Secretary of State for Wales
PS/Lord Privy Seal
PS/Secretary of State for Industry
PS/Secretary of State for Social Services
PS/Secretary of State for Trade
PS/Secretary of State for Energy
PS/Secretary of State for Transport
PS/Chancellor of the Duchy of Lancaster
PS/Secretary of State for Employment
PS/Paymaster General
and officials in HMT, Revenue Departments and other Departments in Whitehall

TREASURY BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 23 May, are sidelined. While we are in the run-up to a General Election, the contents are, as customary, confined to recapitulation of current Government policy and notes on latest developments, in particular new statistics. The next subsequent issue will be completed on 20 June.

M M Deyes

M M DEYES

RA

R I G ALLEN
6 June 1983

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

1/1

A GENERAL ECONOMIC STRATEGY

1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policies will continue to be applied to these ends.

2. 1983 Budget

Budget should not be seen as isolated event but as part of continuing programme being maintained over period of years. Wider context is intention to achieve enduring changes in attitudes and expectations. Framework for continuing responsible policies for money and borrowing was set out in MTFS. Within latter, Budget was designed to give relief to persons and business in order to improve incentives and help restore base for economic growth, higher output and increased employment.

3. Implications of Dissolution of Parliament on Budget proposals?

Selected provisions of Finance Bill - including those required to authorise continuation of power to collect 'annual' taxes - were expedited so as to secure Royal Assent before Dissolution. For fuller particulars see Section J and S5. For effect on social security uprating, see M1.

4. Economic situation?

Modest recovery is under way, not just in sectors like North Sea and construction but also in manufacturing. Figures for Q1 GDP (output) and end to major destocking confirm upward trend. Other indicators - including recent CBI reports (see B5), CSO cyclical indicators (see B10) - point in this direction; with inflation lower and growing evidence (eg from US and Germany) that world economy also picking up, good prospects that recovery will be sustained.

5. Latest unemployment figures?

See C1

6. Williamsburg Summit

See F4 67 and T1-2.

7. Outstanding Select Committee reports overtaken by Dissolution ?

Draft only of TCSC report on international monetary arrangements was published 24 May. Understand that report of TCSC subcommittee and Select Committee on Procedure will be published after new Parliament assembles.

B ECONOMIC ACTIVITY AND PROSPECTS

[NB Industrial production (Apr) figures to be published 15 June.]

1. Recent GDP figures

[GDP (0) the best short-term indicator of the three GDP measures - rose ¾ per cent in 1983 Q1, confirming a clear upward trend since 1982 Q1; level now 2½-3 per cent above 1981 Q2 trough. Evidence of declining trend in manufacturing output during 1982 but this now seems to have been reversed. Industrial production fell almost 1 per cent between February and March, but for 1983 Q1 as whole was 1½ per cent up on previous quarter; industrial output now around 3½ per cent above 1981 Q2 trough (largely due to oil and gas); manufacturing production 1½ per cent higher in 1983 Q1 than in previous quarter. Construction output recovering strongly: up 6 per cent in year to 1982 Q4 and preliminary indications suggest increase of around 1½ per cent in 1983 Q1 over previous quarter.]

GDP has recovered 2½-3 per cent since spring of 1981, and industrial output has recovered around 3½ per cent. Despite little change in manufacturing production in March, latest quarter has seen increase of 1½ per cent on previous quarter. Expectations (eg recent CBI Trends inquiries) are for further increases in manufacturing output, and indications for some other sectors (eg construction) also remain favourable.

2. UK experience compared other major industrialised countries since 1979

[Between 1979 and 1982 latest estimates suggest output in Germany rose slightly, in US was broadly constant, in Canada fell by over 1 per cent. This compares with UK GDP (output measure) fall of about 4 per cent.]

UK GDP grew relatively slowly throughout post-war period. True that UK entered recession earlier than competitors, but also emerging sooner. In 1982 our performance was better than most.

3. Prospect for UK economy

[March Industry Act Forecast published in FSBR summarised in Commentary - Z7.]

Total output forecast to grow significantly in 1983 (2 per cent) and to be growing slightly faster (2½ per cent) in 1984 H1, with inflation remaining moderate. Recent outside forecasts in broad agreement on outlook for this year, with output growth expected to be, if anything, slightly higher than in Industry Act forecast at Budget time.

4. Where will growth come from?

Economy <u>is</u> now growing. Total output 2½-3 per cent above 1981 trough; industrial output up 3½ per cent on same comparison; construction output recovering strongly and manufacturing production (particularly in food, chemicals and electrical engineering) has begun to increase. With inflation at lower level, and lower interest rates, conditions are favourable for further growth in demand and activity.

5. Latest (May) CBI Industrial Trends Enquiry

[See Commentary - Z7 - for details.]

Latest results seem to confirm previous CBI reports (in particular, the more detailed April Survey) in pointing to continued improvements in business climate and gradual economic recovery. However, as Sir James Cleminson has pointed out: 'The improvement is still uneven and is led by consumer and export demand'.

6. Construction industry indicators

In 12 months ended 1982 Q4, total construction output increased 6 per cent and early indications point to further rise in 1983 Q1 of around 1½ per cent on previous quarter. In 1983 Q1 total new orders increased 6 per cent on previous quarter; total housing starts in three months to April were up 7 per cent on previous three months.

7. Recent private investment performance?

[For latest available statistics see Commentary - Z3.]

Manufacturing investment has been disappointing (6 per cent fall, including leased assets, in 1983 Q1) but accounts for only small proportion of total investment. Fixed investment in other sectors has been stronger: total fixed investment rose 3-4 per cent in 1982 and in 1983 Q1 investment in distributive and service industries (including shipping) grew by 2 per cent. Housing starts and new construction orders are encouraging, and April CBI survey showed improvement in manufacturing investment intentions: for first time since July 1979, majority of firms intended authorisations for plant and machinery investment to increase over next 12 months.

8. Investment intentions?

Latest DOI investment intensions survey indicates 4 per cent fall in manufacturing investement between 1982 and 1983; survey also suggests underlying trend should start to turn upwards later this year and outlook for distribution and service industries investment more encouraging. April CBI Survey also forecast modest recovery in manufacturing investment by end of this year and continuing into 1984.

9. Continued destocking threat to recovery?

[For latest statistics see Commentary - Z3.]

Manufacturers' and distributors' destocking in 1983 Q1 was, as expected, much smaller than stock reductions in 1982 H2, and latest (May) CBI Enquiry shows further drop in net percentage balance of firms reporting excessive finished goods stocks - now at lowest level since November 1979.

10. Productivity growth falling off in manufacturing sector?

Slight drop in productivity growth last year. But output per head gains still impressive - up 5½ per cent in year to 1983 Q1; and overall improvement of around 17 per cent since end 1980. Some slowdown in 1982 against background of some fall in manufacturing output (after some recovery in 1981). But slowdown probably inevitable since best opportunities for plant closures and improved efficiency taken first. Overall performance since 1981 better than could have been expected on past experience.

11. CSO's indices of leading cyclical indicators

All four composite indices have risen over last few months. Taken together, indicators point to continuing upswing in business cycle.

12. Outside forecasts

[GDP profile in recent major assessments and in March IAF:

Per cent change

	IAF (Mar)	Phillips & Drew (June)	Simon & Coates (June)	NIESR (May)	Cambridge Econometrics (Apr)	CBI (Mar)	LBS* (Feb)**	OECD* (Feb)
1983 on 1982	+2	+2½	+2½	+2½	2	+2	+1¾	+1½
1984 on 1983	+2½	+2	1½	+1¼	2¼	+2½	+2	+1¾***

* Taking no account of Budget measures

** More recent LBS projections point to GDP growth around 2-3 per cent in 1983, 2½-4 per cent in 1984, depending on assumptions about General Election outcome.

*** 1984 H1 on 1983 H1]

Nearly all major outside forecasts see prospect of continued modest recovery (GDP up around 2-2½ per cent in 1983) and modest price inflation around 6-7 per cent range by end 1983.

C LABOUR MARKET

[NB For latest information on earnings/pay settlements see Section D.]

1. Unemployment figures (new basis)/ other labour market indicators?

[May fall in 'headline' total largely reflects favourable seasonal factors and impact of new provisions for over 60s to get automatic credits. Vacancies are on a slowly rising trend (though fell slightly in May). Overtime worked broadly flat and still around 5 per cent down on 1982 average. Hours lost through short time working remain well below peak levels reached in early 1981.

	June	Sep	Dec	Mar	Apr*	May*
'Total unemployment' (millions)	2.77	3.07	3.10	3.17	3.17	3.05 (12.8%)
Adult sa unemployment (millions)	2.77	2.87	2.95	3.03	3.02	2.97 (12.4%)
Average change over 3 months to June, Sept etc (thousands)	+28	+31	+28	+26	+13 [+23]	-10 [+24]
Vacancies (000s)**	105	107	118	126	135	131

* From Apr 1983 unemployment figures reflect effects of automatic credits for men over 60 - figures in square brackets allow for these effects.

** Only about one third of vacancies are officially notified]

The unemployment figures continue to be affected by special factors. Large fall in headline total masks underlying upward trend. Although there are indications that this upward trend has eased, the improvement is modest. Other labour market indicators are mixed.

2. UK Government forecast of unemployment?

[Paragraph 3.39 of FSBR says: 'Growth of total output in the range 2-2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.']

Government does not publish unemployment forecast. FSBR published with Budget says what might happen to unemployment over a period of years on certain assumptions, and under certain conditions. Whether it applies during the forecast period to mid-1984 depends on number of factors, including extent to which increase in wages and other costs moderate, and financial position of companies.

3. How has unemployment moved in relation to the 1983 PEWP assumption?

1983 PEWP assumed 2.74 million unemployment (GB excluding, school leavers) for 1982-83 and 3.02 million for 1983-84. February 1983 figure, seasonally adjusted, was 2.89 million. These unemployment assumptions have not been changed from those given Government Actuary last November, except insofar as they have been revised onto the new (claimants) basis.

4. Could the outturn for unemployment be better than assumed in Cmnd 8789?

Yes. This is made clear in Cmnd 8789 which says (para 9 of Part I, and page 65 of Part II): 'The unemployment level in the later years may turn out to be lower than has been conventionally assumed if developments in the world economy are favourable and if developments at home - notably by way of continued reduction in pay settlements - permit.'

5. Unemployment in UK compared with other countries

[On standardised definitions in March 1983 UK unemployment on new basis was 13.9 per cent (compared with 5.5per cent in 1979), Canada 12.6 per cent (compared 7.4 per cent), US 10.1 per cent (compared 5.7 per cent), Japan 2.6 per cent (compared 2.1 per cent), France 8 per cent (compared 5.9 per cent), Germany 7.7 per cent (compared 3.2 per cent.]

Unemployment has risen sharply in many industrialised countries - increase over year to latest available month in number unemployed (on national definitions - not strictly comparable) was more in Germany (32 per cent - rise of 2.3 points in unemployment rate - in April), Holland (29 per cent - up 3.4 points - in March), and Canada (28 per cent - 2.6 points-in March), than in UK (8 per cent - 0.9 points - in April).

6. Government's special employment measures

On full range of employment and training schemes Government planning to spend over £2 billion in 1983-84, bringing direct help to ¾ million people. Includes £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) new Job Splitting Subsidy to encourage extension of part time work. From 1 October Job Release Scheme will include new scheme for part-time job release for up to 40,000 more people and from 1 August Enterprise Allowances will be available throughout country within overall cash limit of £25 million in 1983-84.

D PRICES AND EARNINGS

[NB RPI and TPI (May) figures to be published 15 June.]

PRICES

1. Inflation rate

[12 monthly RPI increase 4.0 per cent in April, compared 4.6 per cent in March].

12 monthly rate of inflation again fell sharply in April to 4.0 per cent - lowest level for over 15 years (compared 3.4 per cent in March 1968).

2. Inflation increasing in second half of year

RPI scarely rose at all between June and September last year. As a matter of simple arithmetic there is likely to be an increase in the 12 month change over corresponding period in 1983. It was made clear at Budget time that after months of faster than expected progress, inflation was expected to be about 4 per cent in May with some slight rise later in the year perhaps to about 6 per cent; if anything progress since then has been better than expected.

3. Effect of fall in exchange rate

Budget forecast took into account, among other factors, depreciation of £ since the autumn. Since then fall has been partly reversed. But exchange rate only one factor amongst many that affect inflation. Offsetting factors include weak commodity prices (including oil), low increases in UK labour costs (rise in earnings slowed down further, productivity gains continuing, and cuts in NIS); likely cuts in profit margins by exporters to UK, and Government's commitment to sound financial policies.

4. Inflation in future years

Budget forecast of RPI inflation only extends to 1984 Q2. Beyond that policies will continue to be directed towards price stability. Underlying trend has been downward since 1980.

5. Effect of 1983 Budget on RPI

Increase in excise duties will add 0.4 per cent to RPI (mainly in April) but, since duties revised broadly in line with inflation, on an indexed comparison there will be little effect on the RPI (a 0.1 per cent reduction).

6. Effect of 1983 Budget on TPI

Increase in excise duties and allowances will reduce TPI by 2 per cent (or 1½ per cent including also effect of NIC increases). Since allowances were increased well ahead of inflation, Budget still gives TPI reduction of 1¼ per cent even on an indexed comparison.

7. TPI increase

12 monthly increase in TPI (3.5 per cent) over year to April 1983, now ½ per cent lower than for RPI (4.0 per cent) because of Budget increase in tax allowances.

8. Comparison with competitors

[April figures UK inflation 4.0 per cent compared 3.3 per cent in West Germany, 3.9 per cent (annual change on new index) in US, 9.2 per cent in France, 16.5 per cent in Italy, 6.6 per cent in Canada, and 2.0 per cent in Japan; 4.8 per cent weighted average 'major 6'.]

UK inflation now lower than average of major OECD 6 and well below France, Italy and Canada, but still some way to go to match West Germany and Japan.

PAY

[NB Average earnings (April) figures to be published 15 June.]

9. Current level of settlements

CBI data bank of manufacturing settlements shows average lower than last year at 5.8 per cent in pay round so far and 5.6 per cent so far in 1983 . Latest average earnings index (March) shows 8.2 per cent increase (underlying increase 7½ per cent) on year earlier; but this is still heavily influenced by settlements in the last round, and also includes effect of 'drift' as well as settlements.

10. Recommendations of Review Bodies

Government published on 12 May its decisions on Reports from the Armed Forces Pay Review Body and from the Doctors' and Dentists Review Body. The recommendations have been accepted. Two reports from the Top Salaries Review Body on the salaries of the higher civil service, senior officers in the Armed Forces and the judiciary, and on salaries of MPs and Ministers and other office holders, and Parliamentary allowances, will be for consideration after the Election.

E MONETARY AND FINANCIAL POLICY

[NB Provisional money aggregates (May) to be published Tuesday 7 June.]

1. Monetary policy

[8-12 per cent target range for 1982-83 growth of monetary aggregates set out in 1982 MTFS successfully met; target range of 7-11 per cent for 1983-84.]

Control of money supply is central part of medium term financial strategy, directed towards securing progressive reduction in underlying trend of inflation.

2. Is money supply out of control?

[M1, £M3 and PSL2 grew by 1.1 per cent, 1.9 percent and 1.9 per cent respectively in banking April (seasonally adjusted). Annualising the March and April figures produces rates of growth well over the top of the 7-11 per cent target range.]

We take a longer-term view of monetary growth than provided by just one month's figures (and annualising two months' changes is bound to produce exaggerated results). Growth rates of all three aggregates in 1982-83 (including banking April) were within 8-12 per cent target range. The 7-11 per cent range applies to 1983-84 as whole - rates of growth in any one month may be above or below the range without implying breach. Public sector borrowing was unusually high at end of 1982-83 (part of banking April).

3. Do high April money figures mean interest rates will now have to rise?

Does not follow: Government takes account of more than just one month's figures for monetary aggregates in making its assessment of monetary conditions. Other indicators - in particular, recent firming of exchange rate, progress on inflation - do not point to lax monetary conditions.

4. Does surge in US money supply mean UK interest rates will now rise?

Question assumes US interest rates will rise in response to growth in US money supply and that this will cause UK rates to follow. This need not necessarily be the case: UK rates are determined in the light of UK domestic conditions generally, of which the exchange rate is of course only one indicator.

5. Growth in bank lending

[Revised series shows that sterling bank lending increased by £1.4 billion in February, £0.6 billion in March and £0.2 billion in April (banking months).]

Recent figures show clear slackening in rate of growth.

6. Mortgage interest rates likely to go up again?

[No change BSA meeting 13 May. BSA secretary general stated it was unlikely societies would put up rates at next meeting 10 June.]

At current rates of interest, building societies will have either to cut back on the mortgage lending or raise their interest rates in the near future.

F EXCHANGE RATE AND THE RESERVES

1. Market developments

Compared last October, sterling has fallen 5 per cent in effective terms, 7 per cent against the dollar, 5 per cent against the D-Mark, 17 per cent against the yen. On 24 March, sterling touched 6-year low of 77.9 in effective terms and on 28 March reached record low against dollar of $1.4515. Sterling subsequently recovered with return of greater confidence about stability in oil markets.

	October average	6 June 10.15 am	% change Oct - 6 June
$/£	1.6977	1.5840	-6.7
DM/£	4.2932	4.0669	-5.3
Y/£	460.12	381.0	-17.2
£ effective	92.5	87.5	-5.4

2. Exchange rate policy

Government has no target for exchange rate and considers that recent events suggest that in current conditions pursuit of a target would not be viable policy. Bank of England do intervene to seek to moderate excessive fluctuations and maintain orderly markets so far as is feasible. Government's approach to exchange rate is symmetrical whether pound is rising or falling. It is one, but only one, of factors taken into account in interpreting domestic monetary conditions, in Government's attitude to interest rate movements. Similarly, market intervention has been provided in both directions in recent months, but intervention cannot hope to prevent movement in face of strong market pressures - or, by itself, influence the rate in other than the short term.

3. Intervention/underlying reserves change in May?

[Underlying increase in reserves in May was $233 million.]

Not practice to comment on Bank's intervention tactics. Underlying change in reserves result of variety of transactions, both debits and credits; should not be taken as indicator of market intervention during the month.

4. Williamsburg Summit 28-30 May

[See also T1-2]

Summit partners resolved to improve consultation, policy convergence and international co-operation to help stabilise exchange markets, bearing in mind their conclusions on the Jurgensen report (see F6).

5. Jurgensen Report - significance?

[Jurgensen report on exchange market intervention, commissioned at Versailles Summit, published 29 April.]

Report covers only narrow topic of intervention. It aims at giving better understanding of the methods, motives and effects of past intervention. Therefore did not make any policy recommendations. Does not herald an early return to fixed exchange rates. Although it notes importance of broader economic policies in determining the exchange rate it did not consider wider issues of greater policy convergence or IMF surveillance. These questions were considered at Williamsburg and will be taken further in IMF.

6. Jurgensen Report - verdict on UK policy?

Report's findings confirm approach taken by UK Government. Government have always felt that intervention could be useful at times to help steady and calm disturbed market conditions. But always considered that consistent pursuit of sound, counter-inflationary monetary and fiscal policies is only long-term solution to problem of exchange rate instability, and that trying to solve problem through intervention alone would be misguided and ineffective.

7. Join EMS exchange rate mechanism (ERM)?

Government considers that recent events scarcely suggest that conditions that have led successive Governments to delay sterling's full membership of the ERM are yet right for us to join. Sterling as a major internationally traded currency is still being affected by oil and other factors in a different way from the D mark. Membership of the ERM is a constraint, not a policy: it carries an obligation to take action to try to defend a particular rate.

8. Impact on inflation of fall in sterling before April?

See D3.

9. Level of overseas debt

Total official external foreign currency debt now stands at just under $12 billion, compared with $22 billion when Government took office. Remaining debt now smaller in relation to imports than at any time since Second World War.

G BALANCE OF PAYMENTS AND TRADE POLICY

BALANCE OF PAYMENTS

[1983 Q1 balance of payments figures - with information on invisibles and capital account - will be published 3.30 pm Tuesday 7 June.]

1. April trade figures

[Current account in deficit in April £180 million; current account in three months to April £400 million in surplus].

Trade figures erratic month to month. Underlying level of non-oil imports now seems to be increasing as activity picks up.

2. Trade in manufactures in deficit?

[Trade in manufactures £664 million in first quarter - on balance of payments basis. In 1982 trade in manufactures was £2½ billion in surplus.]

Exports of manufactures have held up well. Higher manufactured imports one way in which we have benefited from N Sea oil.

3. Export trends

Underlying level of non-oil exports has probably not changed significantly over recent years, despite world recession. Latest CBI quarterly Industrial Trends Survey shows sharp improvement in order books and expectations of rise in deliveries over next few months.

4. Import trends

Having shown little change during 1982, imports have risen in 1983. Largest increases in imports of basics and semi-manufactures.

5. Invisibles

Deterioration on invisibles in 1982 for private sector largely on interest, profits and dividends, which - at a surplus of £1.1 billion - were down £0.6 billion on 1981.

6. Current account 1983 forecasts

FSBR forecasts £1½ billion current account surplus in 1983 (down from £4 billion in 1982). Import volumes 1983 on 1982 expected to increase 5 per cent - reflecting resumption of growth in UK economy. Export volumes not expected increase significantly until second half of 1983, when world economy starts to pick up. Only 1 per cent growth in exports 1983 on 1982, but 5 per cent increase projected 1984 H1 on 1983 H1. As result, current account may improve slightly in 1984 - projected surplus for first half of year is £2 billion at annual rate.

TRADE POLICY

7. Protectionism

Government has been concerned at the extent of unfair trading practices and the damaging effect of very high tariffs and quotas in some other countries. Has been pressing for positive European Community action to remedy this. But will be continuing to defend the open trading system. [Buying British: see P5.] Leaders at Williamsburg summit committed themselves to 'halt protectionism and, as recovery proceeds, to reverse it by dismantling trade barriers' They emphasised importance of working through GATT.

8. What can UK do to safeguard our producers against dumping of subsidised imports?

UK has right to take selective action where British producers subjected to unfair competition. Under international agreements, EC and GATT can counter by imposing specific duties with aim of getting countries responsible to abandon such practices.

9. Japan

Japan recently agreed Community-wide export restraints in number of sensitive product areas, including tariff cuts and improvements to non-tariff barriers to trade. A helpful review of standard procedures has also been completed. These developments welcome, but we shall continue to press for measures to increase the level of our exports to Japan and for a more equal trading relationship.

H FISCAL POLICY AND THE PSBR

[NB CGBR (May) figure to be published Thursday 9 June.]

1. Government policy

Aim is to achieve trend reduction in PSBR as percentage of GDP over run of years, so as to achieve lower inflation and interest rates.

2. Reasons for 1982-83 PSBR overshoot

[Budget estimate £7.5 billion, provisional outturn £9.0 billion. CG own account borrowing higher by £1 billion, LABR by £0.5 billion, PCBR by £0.1 billion.]

Mainly higher than expected supply expenditure (£0.9 billion) and higher local authority borrowing (£0.5 billion). End year surge of expenditure greater than expected at time of Budget. Even so, still within £9.5 billion forecast in 1982 Budget. Downward path in ratio PSBR/GDP has been maintained. [GDP ratios in 1980-81 5¾ per cent, 1981-82 3½ per cent, 1982-83 3¼ per cent. MTFS ratio for 1983-84 is 2¾ per cent.]

3. So public expenditure plans exceeded at end of 1982-83?

No, simply less underspending then was assumed at Budget time. Only one very minor breach of cash limits, and ended year with large part of the Contingency Reserve unspent.

4. Implications for PSBR in 1983-84 given overshoot and high April 1983 CGBR?

[Budget forecast £8.2 billion, 2¾ per cent of GDP; CGBR in April £1.2 billion, compared £0.8 billion in April 1982.]

Too early to say. Next published new forecasts for CGBR and PSBR at time of Autumn Statement. [1982-83 outturns for full public sector accounts will not be published by the CSO until July *Financial Statistics*.]

J TAXATION

1. <u>What changes have been made in the Finance Act to proposals announced in the Budget?</u>

Main changes are that mortgage interest relief ceiling will remain at £25,000 and the higher rate bands for income tax will remain at their 1982-83 levels. In addition, the threshold and rate bands for capital transfer tax will be indexed - Government had proposed an increase in real terms - and the profits limit for the 'small companies' rate of corporation tax will remain unaltered. In addition, a variety of other proposals have had to be dropped in their entirety: these included proposals on the taxation of international business, on oil expenditure reliefs and receipts, and on capital transfer tax.

2. <u>Effect on taxpayers of changes made to earlier Finance Bill?</u>

Main change is that mortgage interest relief ceiling will remain at £25,000 and higher rate bands for income tax will remain at their 1982-83 levels. But the new income tax codes issued to employers based on the changes announced in the Budget, will continue to have effect <u>until August</u>. If a Conservative Government is elected it will introduce a short Bill to restore the omitted Budget proposals.

3. <u>Effect of Finance Act on family man</u>

There will be some 850,000 fewer tax 'units' (counting husband and wife as one) in 1983-84 than if personal allowances not increased. Of these, about 120,000 family heads with dependent children. But substantial increase in allowances over indexation will cut tax bills for all families paying tax at the basic rate. And families will also benefit from substantial increase in Child Benefit.

4. <u>Effect on lower paid</u>

Budget provides help for lowest paid by removing 1¼ million people from tax in 1983-84, compared with position if allowances had remained unchanged. Low paid therefore among greatest gainers from increase in thresholds in real terms for second successive year. Low paid with children also benefit from 11 per cent increase in Child Benefit - now at highest real level since its introduction, and from generous increases in FIS.

5. <u>Comparison with 1978-79 for families since 1978-79</u>

Necessary to measure changes in the tax burden in a way which avoids distortion because of the switch from child tax allowances to child benefit. A couple where the man is on average earnings and there are 2 children will pay a smaller proportion of their earnings in income tax <u>net of child benefit</u> in 1983-84 than they did in 1978-79.

6. Tax reductions in Budget wiped out by increases in national insurance contributions?

[NICs rise in April by 0.25 per cent of earnings for the contracted in, and 0.6 per cent for contracted out.]

Tax reductions will be greater than effect of increase in NICs for all but a minority. [BACKGROUND: Those who will lose are contracted out with above 1½ times average earnings and a very small number of contracted in.]

7. Effect on people with mortgages of MIRAS and recovery of excess tax relief?

Tax payments will go up as result of MIRAS but mortgage payments will go down. Borrowers entitled to ask building society to reduce their monthly payments in such a way that their net position is unchanged. When mortgage interest rates fell last year, PAYE codes were not altered and people received more relief than they were entitled to. Recovery of this excess relief, which increases tax payments, allows people to pay tax that should have been paid last year by easy instalments. In no sense an increase in tax burden.

8. Average worker with mortgage only 19p a week better off after Budget?

[Calculation for particular type of individual in Sheldon PQ as follows: £2.02 income tax cut, minus 40p NIC increase, minus £1.43 recovery of excess mortgage tax relief.]

Wrong to treat repayment of tax underpaid last year as a tax increase. Annex to Mr Sheldon's PQ also showed this individual over £6 a week better off than past August, as result of cut in income tax in last Budget and fall in mortgage interest rates. These interest rates falls are direct result of Government's economic policies.

9. Some people not getting mortgage interest relief as a result of switch to MIRAS?

No one entitled to the relief will be deprived of it. A number of people with bank mortgages have not been brought into the new scheme. A few of these have also lost the relief through their tax coding. Anyone in that position should contact their tax office, who will put matter right as quickly as possible.

10. What did Budget do for industry?

Budget contained substantial help for industry, worth about £¾ billion in a full year, on top of £½ billion benefit to industry of changes announced in Autumn Statement. Included further NIS cut. Number of measures in Budget precisely targeted to help particular sectors. For example, Business Expansion Scheme builds on highly successful Business Start up Scheme for small firms. Reintroduction of Small Engineering Firms Investment Scheme will be of benefit to engineering, particularly in places, such as West Midlands, most hit by recession.

11. NIS reduction

Further ½ per cent cut in NIS will benefit private industry by nearly £400 million in full year. Rate of NIS has been reduced by 2½ percentage points since April 1982 - worth nearly £2 billion to private sector in full year. Outright abolition would be very costly; another £1.2 billion in a full year.

12. Poverty and unemployment traps

Government is concerned about poverty and unemployment traps, in context of incentives as a whole. Substantial increase in allowances announced in Budget will help alleviate poverty trap, and will, together with the increase in child benefit, improve work incentives generally. Long-term solution to poverty and unemployment traps will be provided by maintaining public expenditure restraint, thus allowing tax thresholds to be increased, and by sustained improvement in economic performance, leading to higher real earnings.

13. Future of married man's personal allowance?

Government's 1980 Green Paper on Taxation of Husband and Wife set out number of different options; these being considered in light of very wide range of views received. Abolition, by itself, would affect many millions of taxpayers and leave a basic rate taxpayer nearly £6 a week worse off.

14. Keith Committee Report on Enforcement Powers of Revenue Departments

First part of report published 23 March. Second part should be ready later this year. Very substantial document deserves careful study and full consultation; inevitably lengthy process. Some aspects controversial: all the more need for careful consideration and consultation. Report draws attention to scale of 'black economy' -Government is concerned about tax evasion; numbers of investigation staff in Revenue Departments have been increased.

15. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39½ per cent in 1983-84. Corresponding figures excluding NIC are 28½ per cent and 32½ per cent].

Burden inevitably risen because of upward pressures on public expenditure caused by recession. Budget provided significant cut in income tax burden by increasing personal allowances by 14 per cent - 8½ percentage points over inflation. Those in work whose earnings have risen in line with national average have higher real take-home pay now than in 1978-79.

16. British tax burden compared other countries

Accurate comparisons difficult, but UK burden is about average for OECD countries [provisional 1981 data from OECD's Revenue Statistics 1965-81]. Similarly, UK taxes on personal income and UK employees' social security contributions are about average for EC countries and lower than USA [1980 provisional OECD data].

K PUBLIC EXPENDITURE AND FINANCE

PUBLIC EXPENDITURE PLANS

1. What effect has Dissolution of Parliament had on Government's public spending plans?

No effect on plans announced in PEWP 83 as revised by Budget (total for 1983-84 in FSBR given as £119.3 billion). Plans will be reviewed as part of the annual Survey after the Election.

2. Capital spending plans lower in 1983-84 than 1982-83

Immediate problem not making more funds available but getting local authorities and nationalised industries to spend capital provision available to them. Reduction in planned expenditure compared last year's plans, reflects fact that those plans were not realised.

3. Over-run on spending plans for 1982-83

No question of any failure of public expenditure control system. There has been only one very minor breach of cash limits and we ended the year with a large part of the Contingency Reserve unspent. On total plans there has simply been less underspending than was assumed in the FSBR.

4. Implications for 1983-84 and later years

[1983-84 planning total allows for net shortfall of £1.2 billion, or 1 per cent of total. Total shortfall for 1982-83 compared plans announced in 1982 Budget thought at Budget time likely to be £2.2 billion but now likely to be much smaller.]

Not clear that expenditure was accelerating in any underlying sense in last weeks of 1982-83. There are one or two items of expenditure that could have fallen either side of 31 March, but in the event fell inside 1982-83. Wrong therefore to draw conclusions either about likelihood of expenditure overshooting in 1982-83 or about appropriateness of figures for public expenditure shortfall and Contingency Reserve published with Budget.

5. Price assumptions in spending plans

With exception of social security and provision for pay in 1983-84, no explicit price assumptions underlying FSBR plans. Of course, in determining cash plans Ministers had in mind broad view, consistent with their general strategy, about future course of prices. Not in general necessary for these to be formulated in precisely quantified terms, nor has it been.

6. Policy on contracting out

Government encouraging further use of private sector contractors by public bodies where this will increase economy, efficiency and effectiveness.

LOCAL GOVERNMENT

7. Suggestions of local authority current overspending of £1 billion in 1983-84

This is the figure that emerges from local authority budgets for 1983-84. Local authorities in England and Wales were warned, at the time of the Rate Support Grant settlements, that they might lose grant as a consequence of overspending. Scottish Secretary of State has warned five of the overspending local authorities in Scotland they could lose grant.

8. LA capital underspending in 1982-83

Latest estimates suggest that local authorities underspent their capital cash limits by a little over £1 billion in 1982-83, following underspending of £¾ billion in 1981-82. Steps were taken last autumn to reduce the underspend: PM wrote to local authority associations; local authorities invited to apply for extra allocations (well over £¼ billion issued), and allowed to spend without limit on improvement grants. Extra £150 million made available to Housing Corporation.

9. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83. Steps taken to reduce further underspending: new rules on receipts (measures announced on Budget Day by Environment Secretary to ease transitional problems including supplementary allocations), LAs can spend above allocations on improvement grants and eligible expenditure limits raised in Budget by 20 percent, also new 'enveloping' provisions (where whole streets being renovated) announced in Budget.

10. Revenue implications of capital projects

Concern about revenue implications should not inhibit full use of allocations: plans for relevant LA current expenditure allow for financing costs of full planned capital programmes; many capital projects have no immediate running costs eg roads, reclamation of derelict land; others will reduce running costs by rationalisation. Government cannot guarantee there will be no underspending - LAs take the decisions. But Government will be monitoring closely, and will take further action, if needed, to encourage full use of provisions.

11. Green Paper on Domestic Rating System

Government has been carefully considering representations. Need scheme that will remedy shortcomings of present rating system and command widespread support. Taking account of pleas from industry, business, etc.

FALKLANDS EXPENDITURE

12. What defending Falklands has cost so far and foreseeable future cost

Latest assessment of costs of operation, of replacing equipment lost during conflict, and of garrison, in 1982-83 is about £750 million. Provision has been made for £624 million in 1983-84, £684 million in 1984-85 and £552 million in 1985-86 (total some £2.6 billion).

13. Costs of repairing damage and reconstructing the Islands' economy

Too soon to say. Work has begun on restoration of essential services. About £10 million now expected to be spent in 1982-83; further £5 million in 1983-84. Ministers have agreed on package of measures for long term development of the Islands, tentatively estimated to cost in all £31 million over next 6 years.

14. Cost of paying compensation for war damage

Too soon to say. Expected that bulk of claims for civilian compensation will be settled in 1982-83, and remainder in 1983-84, but no accurate figure as claims still being processed. Total expected to be in region of £3½-4 million.

PAC REPORT

[PAC Report including item on non-competitive contracts for MOD published 19 May. Another referring to non-competitive contracts for drugs out on 26 May.]

15. Government reply to PAC Report?

Reply will be made in usual way in due course to the PAC Reports. [Reply will take form of issue of Treasury Minute - it is hoped before Summer Recess - covering about 10 PAC Reports in all.]

L CIVIL SERVICE STAFFING AND PAY

1. Size of civil service

Since Government came to office, Civil Service has been reduced by 11½ per cent to 648,700 (at 1 April 1983). Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve the 630,000 target by April 1984. This is 102,000 fewer staff in post than in April 1979, and will mean smallest Civil Service since end of Second World war.

2. Manpower policy after 1984

Survey of manpower needs being collated centrally. Manpower planning now on same basis as expenditure planning. Departments exploring option cuts of 5 per cent and 10 per cent and stating needs for extra staff. No decisions have been taken.

3. Government measures to improve standard of financial management in civil service

In May 1982 launched financial management initiative aimed at promoting in each Department an organisational system in which managers at all levels have clear view of their objectives, and means to assess performance against them; well-defined responsibility for making best use of their resources; and the information, training and access to expert advice to exercise responsibilities effectively. Departments were required to submit programmes of work to Treasury and MPO by January 1983; these have been assessed by Treasury and MPO officials. Government is committed to publish a central report on the initiative by July 1983.

4. Civil service pay negotiations for 1983 - non-industrials

Council of Civil Service Unions representing the non-industrial civil service have signified their acceptance of the agreement reached with Treasury. The agreement will increase pay, London Weighting and pay related allowances by 4.86 per cent on average. The cost is to be met from within the provision already made for Civil Service administrative expenditure.

5. Claim for industrial civil servants

Claim for industrial grades has been received and acknowledged. [It seeks: (i) "substantial" increases in basic rates; (ii) restructuring of pay bands; (iii) increases in the special efficiency productivity bonus, and consolidation of other productivity bonuses into basic pay; and (iv) other improvements in hours, leave etc.] First meeting of the JCC pay sub-committee to discuss the claim held on 21 April.

6. Megaw Report

Unions have been told Government prepared to enter into negotiations with them with view to agreeing an ordered pay determination system based on recommendations of Megaw report. Discussions now in progress.

7. Top Salaries Review Body and the higher civil service

See D10.

M SOCIAL SECURITY

1. Effect of Dissolution on uprating proposals?

Bill enabling reversion to historic method of uprating has completed Parliamentary passage and received Royal Assent.

2. Change in uprating method - effect on beneficiaries?

[Government has decided to revert to 'historic' method for uprating: amounts to be paid from November will be announced in June, based on inflation in year to May, instead of announced at Budget time on basis of forecast RPI inflation in year to November. Inflation between May 1982 and May 1983 expected to be 'in region of 4 per cent' (Budget Speech).]

Beneficiaries will keep 2.7 per cent 'real' increase they received last November. But increase next November will be based not on forecast but on actual inflation over 12 months to May 1983. But cannot know exact uprating until May inflation figure published (in June). Chancellor said in Budget Speech this was likely to be 'in region of 4 per cent'.

3. Choice of May

In past years there has been criticism of lag between announcement of uprating and date for implementation. Government therefore sought latest operationally feasible date for determining uprating. This entails an announcement in June - using RPI figure for May.

4. Supplementary Benefit uprating?

[Last year, SB uprated by RPI broadly adjusted for housing costs rather than full RPI, giving uprating ½ per cent lower than other benefits.]

Supplementary benefit will be uprated by the historic method but factors taken into account will be unchanged. Chancellor also announced improvements in capital disregards for SB. (Main disregard up from £2,500 to £3,000); single payment disregard up from £300 to £500; new separate disregard for life assurance policies -of £1,500.)

5. Budget improvements in social security?

[Chancellor announced:

- (a) 11 per cent increase in child benefit to £6.50 in November;
- (b) restoration of 5 per cent abatement of unemployment benefit;
- (c) 'invalidity trap' being abolished (inability of invalidity pensioners to qualify for long term rate of supplementary benefit); pensioners under 60 will get long term rate after one year; those over 60 immediately. Helps 55,000 sick and disabled people;
- (d) higher scale (long term) rate of supplementary benefit to be available to unemployed men over 60 on supplementary benefit effective from June (in addition, men between 60 and 65 no longer need to 'sign on' in order to safeguard pension entitlement);

(e) therapeutic earnings limit (amount disabled and chronic sick can earn - with doctor's approval - before benefit withdrawn) up from £20 to £22.50; and

(f) new mobility supplement for war pensioners (broadly equivalent civilian mobility allowance but with £2.10 war pensioners preference premium).]

These changes will go ahead as announced.

N EUROPEAN COMMUNITY

[NB EC Finance Council meeting 13 June.]

1. UK budget settlement for 1982

UK's basic refund is £631 million gross (about £500 million net). Supplementary and special energy measures covering this refund were announced on 28 March. 90 per cent of total was paid over by 30 March, and balance will come later in year. Further refund entitlements under the risk-sharing arrangements will be determined later this year.

2. Refunds for 1983 and later

[European Council on 21-22 March reached agreement on timetable for reaching conclusions on both lasting and interim solution to the budget problem.]

Foreign Affairs Council is meeting on 13 June to agree conclusions on both interim and lasting solutions to be reported to the June European Council, and it has been agreed that provision for 1983 refund will be made in draft budget for 1984.

3. UK objectives for longer-term negotiations?

Government has made it clear that, in spite of our relative economic position, UK is prepared to remain a net contributor - but only on a very modest scale.

4. Will Government withhold contributions?

Government very much hope the issue of our Budget contributions can be satisfactorily settled without need for recourse to such a step.

5. Commission proposals for Community financing?

UK Government are studying these carefully. At first sight they appear not to take sufficient account of problem of budgetary imbalances, though proposals for 'modulated' VAT related to relative prosperity and agricultural production are of some interest. Our opposition to new 'own resources' is well known.

6. Commission cash crisis?

UK Government has repeatedly called for better control of CAP guarantee expenditure. Recent developments in CAP have served to emphasise need for action here.

7. UK Government response to Commission request for advance to meet cash crisis?

In the absence of Parliament, it is not possible to accede to this request.

8. 1984 Preliminary Draft Budget makes no provision for refund?

March European Council has agreed our refunds should be paid from 1984 Budget. This agreement will have to be respected.

9. Policy for CAP reform

Key measures are price restraint, curbs on surplus production and strict control of growth of guarantee expenditure.

10. Costs of CAP to UK consumers

Minister of Agriculture has dealt with a number of questions on this. Costs to consumers of CAP as such depend on nature of alternative support system that is envisaged. Arrangements leading to reduction in the cost of food to consumers could well involve increased costs to taxpayers.

11. European Monetary System exchange rate mechanism

See F7.

P INDUSTRY

1. Latest statistics of output and investment?

See Section B and Commentary at end of Brief.

2. Company Sector

(i) Company liquidity ratios

[D. Industry's survey of 200 large companies shows continued trends to improved liquidity between 1982 Q4 and 1983 Q1. Total current assets rose by over £½ billion; current liabilities fell by about £1 billion. For manufacturing companies in the survey, current liquidity ratios rose from 79 per cent to 104 per cent - highest figures since 1979 Q2.]

Latest D Industry figures show continued encouraging improvement in liquidity, particularly for manufacturing, between 1982 Q4 and 1983 Q1. Although liquidity ratio for manufacturing companies still low, it has improved very considerably since 1980. No widespread concern about liquidity.

(ii) Company profits/rate of return

[Gross trading profits of industrial and commercial companies (ICCs), net of stock appreciation and excluding oil, rose almost 15 per cent between 1981 and 1982; but increase was from a very low base. ICC's real pre-tax rate of return (excluding North Sea) estimated up from 3½ per cent in 1981 to 4 per cent in 1982. No 1982 estimate for manufacturing available, but 1981 figure of 2 per cent was half previous cyclical low figure in 1975.]

1982 seems to have been seen some welcome improvement in ICC's rates of return. But the recovery was from a very low base. Further progress depends on better performance by companies. Government can best help by getting inflation down and setting sound basis for sustained recovery. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

3. Company insolvencies

[Total bankruptcies in 1982: 5,700 - up 11 per cent on 1981. Provisional figure of liquidations in 1982: 12,000 - up 40 per cent on 1981.]

Figures to some extent reflect disappointing output performance in 1982. Need to remember that new company formation is also substantial. High company liquidations and large number of new companies formed partly a symptom of structural change.

4. Government help for small firms

Measures enacted in shortened Finance Act provided further measures to help enterprise and small businesses, increasing the number of measures taken so far from which small firms can benefit to over 100. Enterprise and small firms package included further reduction in weight of corporation tax; further increases in VAT registration limits; increases in global amount available for loans under Loan Guarantee Scheme (see below); introduced new Business Expansion Scheme to replace Business Start-Up Scheme. These measures designed to encourage start-ups and existing firms. In total, measures to assist enterprise and small firms introduced since 1979 have full year revenue cost of around £500 million.

5. Buying British

Many British products have always been competitive. New competitive ones coming onto market. When buying British must take account of price and quality - otherwise would only render firms incapable of competing effectively internationally. But should give British products - and ourselves - a full and fair chance.

6. Loan Guarantee Scheme?

[Nearly 9,400 guarantees already issued - about half to new businesses. Total lending under scheme over £310 million. 1982 Budget provided for lending ceiling in first year (to May 1982) to be raised to £150 million and for further £150 million to be available in second year (to May 1983). 1983 Budget raised ceiling by £300 million (to £600 million) for third year (to May 1984). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost. First year cost covered by premium income. Now clear that payments will exceed income in this financial year. By end-January 1983, payments under scheme in respect of 'called' guarantees exceeded premium income plus recoveries by £3.8 million.

7. New Enterprise Zones

Proposed sites for nine new zones in England were announced by Environment Secretary 15 November though one of these (NE Derbyshire) is not now going ahead; sites for two new zones for Scotland, one for Northern Ireland and two for Wales have also been announced. Meanwhile, the report from consultants published 26 April shows that the zones in general appear to be succeeding in their primary purpose of bringing new life and investment to some very run-down areas.

R PUBLIC OWNERSHIP AND PRIVATISATION

NATIONALISED INDUSTRIES - GENERAL

1. EFLs for 1982-83

Estimated outturn for external financing in 1982-83 published in PEWP 1983 is £2.3 billion - about £½ billion down from 1982 PEWP. Actual outturn now expected to be about £1.8 billion. British Telecom and British Gas undershot EFLs substantially. Indications are that no EFL exceeded.

2. EFLs for 1983-84?

EFLs for 1983-84 currently total £2.5 billion (including revisions to allow for Budget NIS reductions). Current outlook suggests the industries' requirements may fall below this limit; situation is being watched closely. Already substantial reduction has been made for British Telecom; if similar circumstances arise for other industries Government would consider reducing their EFLs.

3. What is Government doing to improve nationalised industries' efficiency?

Government seeking greater efficiency within NIs. Setting realistic financial targets and performance aims. Rolling programme of Monopolies and Mergers Commission investigations has been set up.

INVESTMENT

4. Step up nationalised industries' investment to/improve infrastructure/provide orders to private sector/ boost economy?

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. Not Government policy to provide funds for public sector projects with lower returns than those in private sector. Pre-tax rate of return on nationalised industries' capital (including subsidies) in 1981 (latest available figure) was minus ½ per cent, compared with 3 per cent for industrial and commercial companies.

5. Continuing undershoot on investment plans?

No Government can unconditionally guarantee a particular level of nationalised industries investment. Events outside industries' control may cause investment plans to be revised downwards. Industries substantially undershot investment plans in both 1981-82 and 1982-83. Even so, latest estimates suggest that actual investment in 1982-83 increased by 14 per cent over 1981-82 levels (allowing for privatisation, changes in BT's treatment of certain investment, and excluding BNOC and BTDB). PM has encouraged industries to fulfil their investment plans. If they do, investment in 1983-84 should increase by about 12 per cent over this year's estimated outturn (excluding BNOC).

PAY AND PRICES

6. Nationalised industries' prices

[Increase in NI prices water charges and London Transport fares over 12 months to April 1983 7.5 per cent, compared RPI increase of 4.0 per cent.]

NI prices expected to rise at slightly lower rate than RPI in 1983-84. This substantial improvement is sustainable only so long as the industries contain their current costs (particularly pay) in the way that private sector companies have to do.

7. UK industrial energy prices above those of European counterparts?

CBI's recent report on comparative energy prices confirms that vast majority of gas and electricity consumers pay comparable prices to their European competitors. Some disparities exist for limited number of intensive users of electricity. Cannot expect disparities to be closed entirely especially where due to different costs of supply. Sole way of reducing real electricity costs is by containing costs of generating electricity.

8. Prospects for gas and electricity prices in 1983?

Freeze on industrial gas prices extended to first nine months of this year. Domestic gas prices expected to rise by no more than rate of inflation. On average, industrial and domestic electricity prices will not be increased at all in 1983. These decisions taken by the industries themselves purely on commercial grounds.

PRIVATISATION

9. Special asset sales in 1982-83?

Estimated outturn for 1982-83 around £500 million. Full details of that year's receipts will be published shortly. Sale of Britoil completed; amounted to about £625 million, paid partly in 1982-83 and partly in 1983-84. ABP has been sold, producing net receipts of £46 million.

10. What further sales expected?

Wytch Farm sale to be completed early in 1983-84. Sale of British Gas Corporation's major offshore oil assets as soon as possible. Aim to sell shares in British Telecom after General Election and to transfer British Airways to the private sector as soon as possible.

11. <u>What sales included in special asset sale targets for future years</u>?

[PEWP 1983 has targets of £750 million (previously published target £600 million) in 1983-84, £1500 million (previously £600 million) in 1984-85 and £500 million in 1985-86, for proceeds from special sales of assets.]

Not practice to disclose details of composition of targets because timing of sales dependent on market conditions and price information commercially sensitive. Changes from 1982 PEWP reflect decisions on privatisation since last targets published, and make allowance for additional disposals likely to arise from continuing scrutiny of potential candidates for privatisation.

S NORTH SEA AND UK ECONOMY

1. Will OPEC agreement hold? BNOC prices?

Whether OPEC's agreement works will depend on OPEC. Price negotiations matter for BNOC's judgment. But North Sea prices will obviously be related to prices of closely-competing crudes. BNOC will continue to monitor market developments, and act accordingly.

2. Impact of lower oil prices on UK?

Large disruptive movements in any direction are in no one's interest. But modest and gradual fall we have seen should reduce inflation and boost growth - both in UK and rest of world. Trade balance effect relatively modest. Budget forecast assumed oil prices would remain on average at about current levels.

3. Latest published projections of North Sea revenues

[FSBR/MTFS projections of Government revenues from the North Sea (in money of the day): £7.8 billion in 1982-83; £8 billion in 1983-84 and 1984-85: £9½ billion in 1985-86. Higher than last year's FSBR and Autumn Statement projections, partly because of higher production in tax-paying fields, partly higher sterling oil prices. Other forecasters generally predict higher revenues.]

Oil revenue projections depend on uncertain cost, price and production assumptions. Prospects for North Sea revenues in 1983-84 better than in 1982 FSBR and Autumn Statement because of higher than previously assumed sterling oil prices and production in tax-paying fields. Latest projections generally consistent with recent BNOC announcement on North Sea prices. In general, higher forecasts by others based on combination of higher future production and prices and lower expected future capital expenditure.

4. Fall in North Sea output after 1985?

Hazardous to forecast so far ahead. But always known that oil output would peak in mid-1980's and then decline. Cannot be complacent about effects of falling North Sea output.

5. What remains of Budget proposals in truncated Finance Act?

Phasing out of Advanced Petroleum Revenue Tax, doubling of oil allowance, and immediate Petroleum Revenue Tax relief for exploration and appraisal drilling have all been included in the truncated Finance Act. Provisions for abolishing royalties on future fields and for PRT expenditure relief on shared assets have been dropped.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Williamsburg Summit 28-30 May

Summit partners sounded note of optimism reflecting confidence in prospects for recovery. They noted success in reducing inflation and interest rates, and agreed on need for prudent, balanced policies to ensure spread of recovery to all countries. Summit governments pledged themselves to pursue monetary and fiscal policies conducive to lower inflation and interest rates, more investment and greater employment. Also agreed to take forward the multilateral surveillance process initiated at (1982) Versailles Summit.

2. New 'Bretton Woods'?

Summit partners invited Ministers of Finance, in consultation with Managing Director of IMF, to define conditions for improving international monetary system and to consider part which might, in due course, be played in this process by a high level international monetary conference.

3. World recovery under way?

[According to FT 9 May OECD Secretariat has revised up forecast for growth in industrialised countries this year to 2 per cent (from 1½ per cent December 1982 forecast).]

Welcome signs of recovery particularly in those countries which have successfully reduced inflation (notably US, Germany and UK). The recovery is likely to accelerate during the course of this year and into early next year, with output rising by perhaps 1½ per cent in 1983.

4. Latest inflation figures

[Consumer price inflation down from a year ago in all major economies apart from Italy on latest available figures: US (from 6.6 to 3.9 per cent), UK (8.4 to 4.0 per cent), Japan (2.8 to 2.3 per cent), Canada (11.6 to 7.2 per cent) France (13.9 to 9.2 per cent), Germany (5.0 to 3.3 per cent), Italy risen slightly (from 15.6 to 16.5 per cent).]

UK performance in bringing down inflation in past year as good as any, and better than most of our major trading partners. Falls in inflation together with falls in interest rates offer better prospects for recovery both in UK and rest of world this year.

5. Prospects for US economy?

[Industrial production has risen for last 5 months, retail sales have picked up, and revised estimates show ~~s~~ GNP up by about ½ per cent in first quarter although this mainly due to slower destocking. As result, many forecasts for this year have been revised upwards.]

Welcome signs of modest (by historical standards) recovery in US although too early to be sure recovery firmly established.

6. US Budget

[Agreement over budget for FY 1984 still appears some way off. Senate and House of Representatives have passed (differing) budget resolutions which allow for lower defence spending, higher taxes and lower deficit than proposed by Administration.]

Share widely expressed concern over potential size of budget deficit. Important that firm measures to reduce deficit be agreed if US interest rates are not to rise again, as economy recovers.

7. US has relaxed monetary policy?

[M1 has grown rapidly recently and is well above its 4-7 per cent target range set out in February. M2 and M3 are within their target range.]

Federal Reserve following firm but flexible policies in face of distortions affecting monetary aggregates. Federal Reserve Chairman Volcker has stressed that Federal Reserve remains committed to reducing inflation.

8. IMF borrowing on international capital market?

UK support view of Interim Committee in Washington in September 1981 that possibility of borrowing by IMF in private markets should remain open in light of evolution of IMF's commitments and available resources. Question being kept under close review.

9. What about a fresh allocation of Special Drawing Rights? Why not allocate SDRs exclusively to LDC's?

IMF will be examining desirability of further SDR allocation, in light of current trends in growth, inflation, and international liquidity. We have an open mind about case for further allocation. The Fund's Articles require SDR allocations to be issued to all member pro rota with their quota.

10. International Debt

Many developing countries have faced considerable financing difficulties due to falls in commodity prices, high interest rates and strength of dollar. Although many of largest debtors now undertaking adjustment programmes, often with IMF assistance, some short term financing difficulties may remain.

2.19

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS
6 JUNE 1983

Summary comment

Clear upward trend in GDP(O) during 1982 and encouraging signs that output is gradually picking up both inside and outside manufacturing sector. Output forecast, published with Budget, expects continued recovery with 2 per cent growth in 1983. Outside forecasters in broad agreement. RPI inflation is low (4 per cent), and forecast to stabilise around 6 per cent by end-1983. The effective exchange rate now around 7 per cent below October level.

World Economy: World trade fell about 3½ per cent in 1982. A 1 per cent recovery in world trade is expected this year.

. US economy: encouraging signs of recovery; latest estimates show GNP rose by about ½ per cent in the first quarter of 1983; housing starts up substantially on a year ago and industrial production has risen in last 5 months; retail sales have also picked up. US authorities have now revised upwards their forecast of growth through 1983 from 3.1 to 4.7 per cent (Q4 on Q4);

. world commodity prices which were at their lowest level in real terms for thirty years at end of 1982 have moved upwards only slightly in the first quarter of 1983;

. oil prices are weak and likely to remain so for the near future; North Sea prices at \$30 per barrel from March; OPEC agreed price cut to \$29 per barrel;

. consumer price inflation (OECD major 7) under 5 per cent in April (on latest figures) ranging from 16½ per cent in Italy to 3¼ per cent in Germany and only 2 per cent in Japan;

. average world 3-month interest rates around 9 per cent at 23 May; about 6 points fall between 1981 Q3 and April 1983; US 3 month rate about 8¾ per cent on 23 May. Real interest rates remain clearly positive;

. EMS: following 1 day float (21 March) 8 participating currencies have been realigned;

. <u>total industrial production</u>: OECD Major 7 fell 2½ per cent in year to March; in the US it rose in April and is now 1¾ points higher than a year ago;

. <u>unemployment</u> (Major 7) 8.5 per cent in March 1983 compared with 6.5 per cent for average 1981 on standard definitions.

<u>UK Balance of Payments</u>: The UK current account has now been in substantial surplus for three years. In 1982 non-oil export volumes held up well and the current account should remain in surplus in 1983, though this will be reduced as imports respond to increasing activity in UK.

. <u>Export</u> volumes so far this year have continued the resilience shown in 1982 when world trade actually fell, with OPEC and third world countries in particular cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries;

. <u>import</u> volumes were flat in 1982 and, as expected, some rise has been taking place this year associated with the first signs of an end to destocking and the continued recovery in domestic activity;

. <u>effective exchange rate</u> at 85.7 on 3 June, having previously been as low as 77.9 (24 March); this compares with 87-93 range occupied in 1981 H2 and 1982 H1 and May 1979 level of 86.3.

<u>Financial Developments</u>

.<u>Monetary aggregates</u>: growth rates of the monetary aggregates (M1, £M3 and PSL2) were within the 8-12 per cent target range for 1982-83;

.Banks cut <u>base rates</u> by ½ point on 14 April (to 10 per cent) following similar fall in March (2 point increase November-January); short term <u>interest rates</u> down nearly 7 points since Autumn 1981; base-rates down about 6 points;

.<u>mortgage interest rates</u> down to 10 per cent, first time since 1978;

.<u>real interest rates</u> remain clearly positive (as elsewhere);

.<u>CGBR</u> (not seasonally adjusted) £1.2 billion in April, compared with £0.8 billion in April 1982;

.PSBR: estimated at £9.2 billion in 1982-83;

.underlying increase in the reserves during May was $233 million.

Inflation

.retail price inflation, 4.0 per cent in year to April;

.TPI increase in 12 months to April 3.5 per cent;

.Wholesale price inflation: input prices up 6.2 per cent in year to April compared with 9.2 per cent in March; 12 monthly movement in prices of products other than crude oil also fell to 6.6 per cent. Output prices up 7.3 per cent in year to April, compared with 7.2 per cent in the 12 months ending March.

GDP and industrial production

.GDP(O) rose ¾ per cent in Q1 1983 confirming clear upward trend apparent since Q1 1982. Increase of 2½-3 per cent since 1981 Q2 trough. Construction output in 1982 Q4 was 6 per cent up on year earlier and preliminary estimates suggest further increase of 1½ per cent in 1983 Q1. Industrial output is picking up and is around 3½ per cent above spring 1981 trough; manufacturing production in 1983 Q1 rose by 1½ per cent on previous quarter, despite little change in March, and was roughly at its 1981 Q1 trough level.

Demand Components

.consumer spending held up well during the recent recession and rose 3½ per cent during 1982. Some fall in RPDI (see below personal sector) offset by lower savings ratio. Retail sales remain buoyant, and in three months to April provisionally estimated to have increased ½ per cent to a level 5 per cent up on a year earlier. Consumers' expenditure, on preliminary estimates, little changed in 1983 Q1; but still around 3 per cent up on a year earlier. Car registrations in four months to April 1983 were 17 per cent up on same period in 1982. Import penetration, at 56¾ per cent (for Jan-April) below 1982 overall average of 57¼ per cent.

.total gross fixed investment broadly unchanged in 1982 H2 after a disappointing second quarter and in 1982 H2 was 5 per cent up on 1981 H1, but 7 per cent below its average 1979 level. Manufacturing investment (including leasing) in Q1 1983 almost

6 per cent down on Q4 1982 and 6 per cent down in latest 6 months on previous 6. Also, on latter comparison, total capital expenditure by manufacturing, distribution and service industries (including shipping) up 1 per cent.

.Total destocking of £400 million (1975 prices) occured in 1982 Q4 (£320 million in Q3); manufacturers' reduced stocks in Q1 1983 by £80 million on provisional estimate - compared to £385 million in 1982 Q4, £355 million in 1982 Q3;

.government consumption rose 2 per cent between 1981 and 1982. In 1982 Q4 it was a little below its third quarter level and 2 per cent up on its level in the same period last year.

Productivity and Competitiveness

.manufacturing productivity (output per head) continues to rise - at 5½ per cent in year to Q1 1983. Now 17 per cent up on end 1980;

.manufacturers' unit wage/salary costs up around 2½ per cent in Q1 1983 on a year earlier; compares very favourably with our major competitors;

.Cost competitiveness has improved about 15-20 per cent since early 1981, remains almost 20 per cent worse than in May 1979.

Company Sector

.ICCs (excluding North Sea) pre-tax real rates of return up from 3½ per cent in 1981 to 4 per cent in 1982 - but recovery from a very low base;

.gross trading profits (net of stock appreciation) of ICCs rose in the fourth quarter by over 6 per cent and in 1982 were almost 15 per cent up on their average 1981 level;

.non-North Sea profits recovered 4-5 per cent in 1982 Q4 from a disappointing third quarter and in 1982 as a whole were almost 15 per cent up on 1981;

.gross profits of North Sea oil companies in 1982 were 15 per cent up on their average 1981 level;

.DOI Survey of company liquidity showed marked improvement in 1983 Q1 in liquidity of companies (large) covered. Improv ement particularly notable in manufacturing. Liquidity ratios now at their best level since mid-1979;

.ICCs financial surplus was £1.8 billion in 1982 H2 following deficit of £1.2 billion in 1982 H1. Over same period net borrowing requirement fell from £6.1 billion to £2.5 billion;

.working days lost through industrial stoppages estimated at 335,000 in April. Total for whole of 1982 (5.3 million) well below average of 12 million for preceding ten years and latest international comparison of industrial disputes showed that, in 1981, UK occupied a middle ranking position compared with other countries;

.insolvencies: bankruptcies and company liquidations in 1982 totalled 5,700 and 12,100 respectively; increases of around 10 per cent and 40 per cent on 1981. Bankruptcies in the three months to April 1983 reached a new high point of 1686.

Personal Sector

.wage settlements in 1981-82 were on average around 7 per cent, 2 per cent lower than in the previous round;

.underlying rate of increase in average earnings down to 7½ per cent in year to March 1983;

.CBI says that pay settlements in manufacturing industry currently running at some 5.6 per cent. Bulk of settlements occur in 1983 H1;

.real earnings up over 3 per cent in 12 months to March.

Labour Market

.Total employees in employment (UK) fell 2.4 million (10 per cent) between 1979 Q2 and 1982 Q4 (heavily concentrated in manufacturing) but fell less in 1982 Q4 (160,000) than in the previous quarter (190,000); between 1981 Q4 and 1982 Q4 the fall was 635,000; manufacturing employment fell a further 89,000 (1½ per cent) between 1982 Q4 and 1983 Q1;

.total registered unemployment fell by 121,000 to 3.05 million (12.8 per cent) in May (fall reflects seasonal factors and effects of Budget provision of automatic credits for men over 60);

.UK adult unemployment (sa) fell by 51,000 to 2.97 million (12.4 per cent) in May. After allowing for effects of "automatic credits" provisions, there was a rise of 23,000, suggesting further signs of some easing in the underlying trend. Notified vacancies fell by 3,000 to 131,000 in May, but this is first monthly fall since September 1982, and underlying trend probably remains upwards;

.redundancies (reported as due to occur) provisionally estimated at 30,000 for March and April - compares with average monthly figures of 33,000 1982 and 44,000 in 1981;

.other labour market indicators hours lost through short time working at about 1.5m in March, were over 10 per cent below the 1982 average. Overtime worked is broadly flat and still around 5 per cent down on 1982 average.

Forward Indicators

.car production (sa) down in April (largely reflecting industrial disputes) but remains similar to monthly average for 1982; commercial vehicle production little changed in April but remains down on average 1982 H2 level;

.steel production (averge weekly rate) fell by 8½ per cent in April but in latest 3 months was 32 per cent up on previous three months;

.the volume of new construction orders continues buoyant and in 1983 Q1 was 6 per cent up on preceding quarter, with private housing orders 29 per cent up on same comparison. Total engineering orders (sa) rose 3 per cent in three months to February compared with previous three months (export orders up almost 25 per cent on same comparison). Working Party on short term trends in mechanical engineering forecasts 7 per cent increase in output from mid-1983 to end-1984;

.DOI's investment intentions survey (May) suggests a 4 per cent fall in manufacturing investment between 1982 and 1983 but other components of investment (distribution and services) are more encouraging: for manufacturing, distribution and services as a whole, survey indicates a rise of 3-4 per cent in investment in both 1983 and 1984;

.<u>total housing starts</u> in 3 months to April rose by 7 per cent on previous 3 (private starts up 8 per cent on same comparison) and 14 per cent up on a year earlier (private sector starts up 15 per cent on latter comparison). <u>Total completions</u>, compared with the previous three months, rose 5 per cent in 3 months to April;

.<u>CSO's index of cyclical indicators</u>, taken together, point to a continued upswing in the business cycle.

<u>CBI's latest Industrial Trends Enquiry</u> showed encouraging improvements in total and export order books (former now stronger than in any Survey since November 1979). Net balance of firms expecting increase in output was positive for fourth successive month. Proportion of firms expecting increase in average domestic selling prices still higher than towards end of 1982 but remains low by historical standards while net balance of firms reporting excessive finished stocks now at lowest level since November 1979.

<u>Government Forecast</u> published with Budget expects: inflation to stabilise around 6 per cent by end 1983. GDP to rise 2 per cent between 1982 and 1983 with a similar increase in manufacturing output. All demand components increase in 1983 with total domestic demand up 3½ per cent. Current account surplus to fall to £1½ billion in 1983, PSBR at £8 billion in 1983-84 (£7½ billion in 1982-83). World trade to rise 1 per cent this year but to grow much more strongly (6 per cent) in 1984 H1.

<u>Outside forecasting groups</u> - many recent forecasts expect GDP growth of around 2-2½ per cent in 1983, assuming some slight recovery in world economy, with inflation forecast around 6-7 per cent by the end of 1983.

<u>Key indicators to be published in 2 weeks ending 17 June</u>

Mon 6	:	Housing starts and completions (Apr)
Tues 7	:	Credit Business (Apr)
	:	Wholesale prices (May)
	:	Retail sales (Apr - final)
	:	Balance of payments (1st qtr)
	:	Monetary aggregates (May - provisional)
Thurs 9	:	Car production (May - provisional)
Fri 10	:	Steel production (May)
	:	Building societies figures (May)
Mon 13	:	Retail sales (May - provisional)
Wed 15	:	Industrial production (Apr)
	:	Average earnings (Apr) wage rates (May)

Thurs 16	:	Monetary aggregates (May - final)
	:	Capital expenditure by manufacturing, distributive and service industries (1st qtr - revised)
	:	Manufacturers' and distributors' stocks (1st qtr - revised)
Fri 17	:	Retail price index (May)
	:	Tax and price index (May)

PART 23 ~~31.5.83~~ ends:-

EC 83/11 31.5.83.

Note: Parts 22 and 23 destroyed at review

PART 24 begins:-

HMT Brief 6.6.83

~~John Sparrow to PM~~ ~~14 June 1983~~

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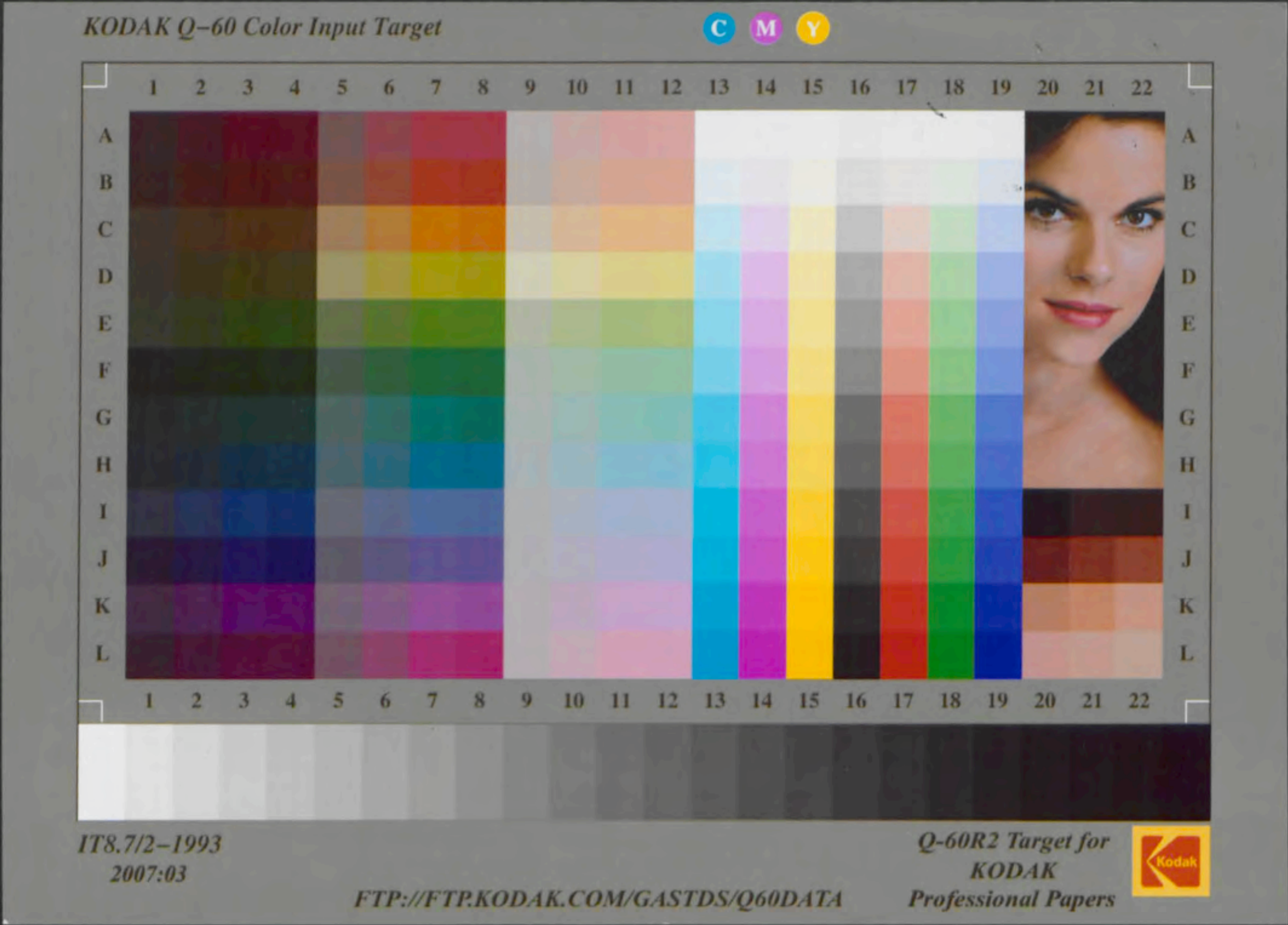
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