

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(L)
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 the 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 WEEKLY ECONOMIC BRIEF

I attach the latest version of this Brief. Changes from the previous Brief, of 23 November, are sidelined.

M M Deyes

M M DEYES

RA

R I G ALLEN

30 November 1981

EB Division
HM Treasury
01-233-3364

Note : Separate briefing being prepared for announcements being made this week and for forthcoming report of Treasury and Civil Service Committee -expected this week or next.

ECONOMIC BRIEF: CONTENTS

SOURCES:

A	GENERAL ECONOMIC STRATEGY	EB
B	ECONOMIC ACTIVITY AND PROSPECTS	EB
C	LABOUR MARKET	EB
D	TAXATION	FP1/2
E	PUBLIC EXPENDITURE AND FINANCE	GEP1/2
F	SOCIAL SECURITY	SS1
G	PUBLIC SECTOR BORROWING	GEA1
H	MONETARY AND FINANCIAL POLICY	HF3
J	PRICES AND EARNINGS	IP2
K	BALANCE OF PAYMENTS	EF1
L	FOREIGN EXCHANGE RESERVES AND IMF	EF1
M	EUROPEAN MATTERS	EC1
N	INDUSTRY	IP1
P	NATIONALISED INDUSTRIES	PE1/2
R	NORTH SEA AND UK ECONOMY	PE3/MP2
S	WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE	EF2
ANNEX	AIDE MEMOIRE: RECENT ECONOMIC INDICATORS	EB

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 and promotion of enterprise and initiative. Reduction of inflation requires strict adherence to firm monetary and fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Relative importance given to inflation and unemployment?

Government is equally concerned about both. These are complementary not competitive objectives; unemployment will not be reduced by relaxing struggle against inflation.

3. What has Government achieved during term of office so far?

Removed constraints on market forces: reduced Government regulation and bureaucracy; fostered a new mood of realism; improved incentives to enterprise and efficiency. Specific measures to help small businesses to start up and/or expand. Manufacturing output up 1½ per cent in third quarter. Inflation below 12 per cent - nearly halved since Spring 1980 peak. Unemployment in latest three months rising less than half as quickly as in last quarter of 1980.

4. When will upturn in economy come?

Latest figures (published 12 November) suggest that both GDP and industrial production are now rising. New CBI survey also suggests beginnings of a recovery. Manufacturing productivity (output per man) up 5 per cent since end-1980. Unit wage costs in manufacturing have shown little rise in first half 1981 [NB but rising more strongly again now]. Rate of de-stocking may now be slowing. Competitiveness improved. Prospects depend above all on further success in reducing inflation and improving industrial competitiveness and productivity. (See also B1 and 2.)

5. Statement on public expenditure?

A statement on public expenditure will be made on Wednesday 2 December.

6. When will Industry Act forecast be published?

We expect the Industry Act Forecast to be published on Wednesday 2 December.

7. British business in crisis? Manufacturing bearing the brunt?

Government has done a good deal to create right conditions for business to thrive but recession has obscured them. Best help Government can give is further progress in bringing down inflation. Glad to note leaders of industry (letter in The Times 26 November signed by among others, Chairman of Beechams, Cadbury, Schweppes, McAlpine's, Metal Box, Taylor-Woodrow, Whitbread and Wimpey), back us in our broad strategy against inflation and urge us not to be deflected. Many signs companies now tackling problems ignored for far too long. Unreasonable to expect problems of years to be solved overnight. Growing evidence of improvements in productivity and competitiveness.

8. Recent manufacturing productivity gains predictable consequence of recession?

[P Kellner in N. Statesman 13 and 20 November.]

During the downswing to this spring, manufacturing productivity fell less than would be expected, given fall in output. And rise in productivity this year has greatly outstripped increase in output. Output per man hour both in manufacturing and whole economy are higher than in first half 1979.

9. Productivity gains mean job losses?

No. Productivity a way of improving competitiveness and securing more growth in the economy.

10. Current unemployment levels intolerable? Going to get worse?

No immediate prospects for fall in unemployment but the rate of increase has slowed markedly since turn of year. Less short time working, overtime picking up. (See also C1) The prospects depend crucially on securing further reductions in pay settlements and increasing productivity so obtaining improved competitiveness. This is the way to get real sustainable jobs.

11. 10 per cent November inflation target now impossible? Inflation bound to get worse? Sacrifices have been for nothing?

Developments since the Budget (particularly fall in exchange rates) have certainly worsened short-term inflation outlook. But Government expect downward trend will continue, though precise timing is difficult to predict.

12. Government has failed to check public spending?

Public spending this year is expected to be somewhat higher than we had originally planned. An important reason for this is that we took the effect of the recession into account when we prepared our most recent plans. We remain committed to containing public spending.

13. Government has failed to allow accommodation to the recession?

Accusations that we are inflexible in our tactics are unfounded. Have been flexible within the limits of prudence over the levels of public spending and borrowing.

14. Government being flexible to point of laxity?

We must be flexible about particular policies while holding in place our policy framework. We cannot and will not allow the foundations to be destroyed.

15. Government has not taken fully into account effect of rising cost of unemployment on PSBR, and hence deflationary consequences?

[P Kellner in N Statesman 13 and 20 November; questioning at TCSC 16 November.]

Appropriate PSBR must be judged by taking account of all relevant factors including monetary conditions. It's the actual cash PSBR that has to be financed, not a notional 'constant employment' one. Limit on PSBR is extent to which it can be financed at tolerable levels of interest rates.

16. Why are high interest rates needed?

Current level of interest rates has reflected developments overseas and strength of bank lending. Although sterling has recently firmed, high level of bank lending continues. However it should be noted that bank base rates have come down by 1 per cent from the peak in September.

17. Rapid growth in £M3 shows slackening in monetary squeeze?

Not followed £M3 target slavishly to exclusion of all else. Allowed overshoot last year because judged could do so without endangering objectives for reducing inflation.

18. Is the MTFs still Government policy?

The MTFs sets out our broad strategy on fiscal and monetary policy. Objective is to provide assurance Government will continue to provide financial discipline. Judged by results, rather than precise numbers, we have done just this. (See also section H).

19. MTFS shot to pieces?

Completely untrue to say we have failed to achieve MTFS. Main objective is reduction in inflation, and progress here has been good. £M3 growth has been higher than we would have liked, though narrow measures of money have grown more slowly. But growth in nominal GDP (as discussed in November Economic Progress Report) seems to have been growing by about 10 per cent in first half 1981. The PSBR for this year is likely to be much as expected at the time of the 1981 Budget.

20. Government should change course?

(a) Moderate reflation the answer?

[Alternative reflationary packages continue to proliferate: eg NIESR suggested £5 billion in their November Review]

Government has shown willingness to adapt to recession and is allowing higher PSBR than envisaged last year. Fallacy that we could "spend our way out of recession" (i.e borrow much more) without seeing a resurgence of inflation, and as a consequence interest rates rising further and faster. Even large reflationary packages like those suggested by NIESR yield relatively small benefits in terms of higher output and lower unemployment.

(b) Reintroduce exchange controls and join EMS?

EMS is not a panacea. But Government does fully support EMS as an important step in monetary co-operation and closer integration in the European Community. Have stated that UK will participate in the EMS exchange rate mechanism when conditions appropriate both for the system and ourselves. Question is kept under constant review.

(c) More capital spending in public sector?

Projects must be economically sound. Not all capital spending virtuous nor all current spending bad. Cost of public sector investment in terms higher borrowing pushing up interest rates could outweigh immediate boost to jobs.

B ECONOMIC ACTIVITY AND PROSPECTS

1. Is recession over?

Ministers have been saying for many months that fall in output was ending. This now appears to be the case. Preliminary GDP output figures for Q3 up $\frac{1}{4}$ per cent on Q2. Manufacturing output increased by $1\frac{1}{2}$ per cent in same period. Preliminary Q3 figures for manufacturing, distribution and wholesalers stock show rate of destocking reduced by about two-thirds compared with H1 1981. Some improvement in financial position of company sector (see N3).

IF PRESSED: Evidence not conclusive

Recognise all usual uncertainties. Equally I see no virtue in ignoring what has occurred. There has been a substantial improvement since the end of last year. GDP output has stabilised, manufacturing output has picked up, labour market indicators have improved (see C1). This year has seen higher engineering and construction orders and increased private sector housing starts, compared with the second half of last year. CSO's cyclical indicator system suggests turning point in Q2. (See B3 for independent forecasts).

[IF ASKED about decline in CSO's longer leading indicator: Too early to judge significance; recall that temporary weakening occurred in last cycle.]

2. Government assessment of prospects

Budget forecast assessment suggested beginnings of recovery in H2 1981. This now appears to be emerging. New Industry Act forecast will be released by Treasury on Wednesday 2 December.

3. Outside forecasts

[GDP profile in major forecasts released since June:

	H2 1981 on H1 1981	H1 1982 on H1 1981	per cent
LBS (Nov)	$\frac{1}{3}$	1	
NIESR	1	$1\frac{1}{4}$	
CBI (Nov)	0	$\frac{2}{3}$	
Phillips & Drew (Nov)	0	$\frac{1}{2}$	
OECD (July)	$-\frac{1}{3}$	0	

November NIESR Review contains only annual data, but commentary suggests low point reached in H1 1981, with prospect of some recovery.

New P&D forecast to be published later this week.]

Recent major independent forecasts assess that low point in activity was reached in first half of year, with prospect of some recovery in the coming year.

4. New National Institute Review argues reflation needed?

[NIESR Review sees broadly flat medium-term profile, dismisses supply constraints and plays down danger of re-emergence of inflation. Consequently advocates £5 billion relation with 150-300,000 effect on unemployment.]

Note that NIESR adopt clearly what is usually implicit in their commentary ie substantial reflation. Also note that on their own calculations, such action would not be particularly successful in alleviating unemployment. Dismissal of supply side problems ignores our sorry experience of declining market shares.

5. CBI Economic Situation report gloomy?

Both the monthly enquiry and new forecast continue to show low point in output in H1 1981, with some modest recovery starting to show. Report assesses that "export volume will provide major contribution to growth in demand next year." Report stresses importance of further moderation in pay settlements, and need to improve productivity further.

6. Where will recovery come from?

Mainly from the reversal of the same factors that contributed to the downswing. There are signs that the rate of destocking is slowing, the savings ratio can be expected to decline further as inflation abates, and some recovery is expected in world trade. Additionally productivity and competitiveness are now improving [see second half of B7].

7. Recovery slow?

Never claimed it would be rapid [FSBR shows 1 per cent growth in GDP in year to H1 1982]. Economy has weakened cumulatively during the post war period. Have created the opportunities and foundations for improved economic performance.

8. Higher interest rates will abort recovery? Business confidence weakened?

Understand concern over higher interest rates, but it is absolutely essential to contain inflation. Inflation is inimical to sustainable recovery. Interest rates only one of factors affecting industry. Manufacturing productivity in second quarter some 5 per cent up on final quarter of last year. Together with last pay round's lower level of settlements, this has meant only a small rise in manufacturers' wage costs this year. This can be expected to contribute towards improved profitability and competitiveness.

9. Recession worse than in the 1930s?

Any such comparisons must of course be subject to a statistical health warning. It is true that the fall in output is comparable to the 1930s, but structure of the economy and society is much changed.

C LABOUR

1. Unemployment continues to rise?

[November total count was 2,954,000 (12.2 per cent) - second consecutive month showing slight decrease. Seasonally adjusted excluding school leavers figure was 2,764,000 (11.4 per cent)]

Unemployment rising much less rapidly. Increase in recent months less than half those at end of last year [44,000 per month in 3 months to November 1981 compared with 115,000 per month in Q4 1980]. Also should note within manufacturing short time working sharply cut -(down $\frac{1}{3}$ from January level), overtime showing signs of picking up and fall in employment much less. Result is that total hours worked have stabilised and now show signs of some pick up. Vacancies improving too.

2. Unemployment accelerating?

[Monthly increases in adult unemployment, seasonally adjusted, in 4 months July-October showed some acceleration, with successively 30,000; 44,000; 46,000; 56,000. November's 36,000 halts this.]

Recent months figures difficult to interpret [due to emergency procedures because of civil service dispute]. Reliability somewhat uncertain. November breaks any apparent trend. Remains the case that labour market indicators are much more favourable than at turn of year (see C1 above). IF PRESSED FURTHER: Unemployment forecasts and assessments always uncertain. What is essential is that all participants in the economy contribute to improved economic opportunities. Crucial to this is further moderation in pay settlements.

3. Employment continues to fall?

[Total employment fell further $\frac{1}{4}$ million in Q2 1981, much the same as in Q1. Total decline since mid-1979 1.7 million or 7 $\frac{1}{2}$ per cent.]

Decline in manufacturing employment showing signs of further marked slackening in August and September (25,000 compared with about 50,000 per month earlier in year), and 80,000 per month in H2 1980.

4. Government forecasts for unemployment

[Public Expenditure White Paper published Budget Day used working assumption of an average level of 2.5 million unemployed in Great Britain (excluding school leavers) in 1981-82 and 2.7 million in 1982-83. Government Actuary's Report published 3 July revised 1981-82 assumption to 2.6 million. NB new GAD report will shortly be published]

Like previous administrations Government does not publish forecasts of unemployment, though Government Actuary Reports etc contain working assumptions. Government is

concerned about unemployment. Scale of special employment measures (SEMs) adequate evidence of this. Prospects depend on further progress on productivity and competitiveness. [See 5 below for independent forecasts.]

5. Independent forecasts?

[Consensus is for medium term rise in "narrow definition" unemployment, reaching about 3 million in Q4 1982.]

History shows unemployment forecasts to be very uncertain (this is a major reason why Government does not publish one). This is reflected in range especially for beyond next year.

6. True level of unemployment is far higher than official figures?

[TUC now state it is above 4 million.]

Unemployment statistics are published on the same basis as under previous administration. MSC has wisely commented (in paper to NEDC) "the current definition provides a good and well understood series for discerning trends and once that firm ground is left, there is endless scope for statistical and semantic debate." We are concerned about unemployment however defined. But our policies are laying foundation for creation of secure employment.

7. Unemployment higher than in other countries?

[OECD standardised data show UK Q1 1981 at 10½ per cent compared with OECD average of 6½ per cent.]

Unemployment has been rising sharply in major industrialised countries, given weakness of world economy. In our case we are suffering the cumulative effects of lost competitiveness and low productivity and implications of inflationary pay settlements in 1978-79 and 1979-80 pay rounds. This is why the rise in UK unemployment has been higher than in most other countries, and points to the need to improve productivity and competitiveness.

8. Would work-sharing help reduce unemployment?

I doubt whether this is the answer. We prefer to leave the determination of hours and working schedules to the decision of employers and workers who know the local conditions. But unless people prepared to accept reduction in income commensurate with reduction in hours, effect on productivity and competitiveness likely to make worksharing counter productive.

9. What is the cost to the Exchequer of the unemployed?

[MSC estimate £438 million per 100,000 additional registered, private sector unemployment (similar figure estimated by Institute of Fiscal Studies); when "grossed up" gives £12½ billion

for total unemployment. This figure has received much attention eg FT front page 9 November.]

All such calculations depend critically on and are sensitive to exact assumptions adopted eg composition (especially whether public or private sector workers), previous earnings, and benefit entitlement of the additional unemployed.

As explained in detail in Treasury's Economic Progress Report for February 1981, cannot gross up estimates by naive arithmetic to give cost of total unemployed - or of resources available for costlessly reducing unemployment. [IF PRESSED: No economy has zero unemployment: Moreover, any major change in policy would have implications for inflation, thereby affecting estimates by changing earnings, prices, taxes and benefits.]

10. Spend money on new jobs rather than unemployment benefit?

Cannot switch employment on and off like a tap. But Government doing a great deal to help. Special employment and training measures currently cover almost 700,000 people at a cost of over £1,100 million this year. Not easy to assess just how many being kept off unemployment register by SEMs, but Department of Employment estimate at around 345,000.

11. Should spend more, especially for young people?

In July announced further provision for special measures of around (gross) £700 million in 1982-83. A large part of this was for young people, including the new Young Workers Scheme. For the future, I expect my rhF the Employment Secretary will soon announce substantial further measures in the form of a comprehensive training scheme for young unemployed.

12. Need to improve training at all levels?

Agree. Aim must be both to help individual and strengthen economy by having a better trained workforce. Government has fully endorsed objectives of MSC's New Training Initiative. We shall be making a statement before the turn of the year about role which Government and others can play.

13. Unemployment as bad as in the 1930s?

Comparisons extremely difficult to make. Maximum recorded unemployment in 1930s was just under 3 million; but the labour force has grown by about $\frac{1}{3}$ since, so unemployment rates in the 1930s almost certainly higher than now. One also needs to bear in mind changed social conditions and protection given by the welfare state.

D TAXATION

1. Burden of taxation

[Total taxation in 1978-79 was 35 per cent of GDP (at market prices), 36½ per cent in 1979-80, 38 per cent 1980-81. It is forecast to be 40 per cent in 1981-82.]

This has inevitably increased during a time when national production has not been growing. But, for the vast majority, real personal disposable income is still higher than for most of the period when the Labour Party was in Government. Recent OECD report showed that the Government's total 'take' (by way of taxation and national insurance contribution) as percentage of GDP is less than in many other industrial countries - UK eleventh in OECD rankings, behind most other EC countries, including France and W Germany. [NB: HMG's position is that national insurance contributions are not a tax - compare F5].

2. No increase in income tax allowances and thresholds in next Budget?

No decisions have yet been taken, and it is ridiculous to read any such implications into my rhF the Chief Secretary's recent speech [18 November at Westminster and City Programmes Conference on Tax Reform]. Of course, this is one area in which my rhF the Chancellor's room for manoeuvre will be determined by the extent of our success in limiting the growth of public expenditure.

3. Government policy regressive?

Largest percentage reductions in take-home pay, as a result of March Budget, were for those with very high incomes.

4. Government policy has harmed incentives?

Marginal rates of income tax for most taxpayers lower than when the Government came to power. Basic rate still 3p below rate inherited from Labour.

5. Indirect tax increases inflationary?

True that the indirect tax increases have added to the RPI. But by reducing public borrowing, they will help to bring inflation down in the longer run and ensure that it stays down.

6. Heavy fuel oil duty

Costs involved mean that it would not be in the national interest to go beyond the Budget decision not to increase the duty in heavy fuel oil. Terms of North Sea gas contracts a commercial matter for the British Gas Corporation.

7. Reduce petrol/derv duties?

Pump price also dependent on pricing policies of oil companies and world market conditions. Real value of derv duty now about 60 per cent of 1970 level, and of petrol duty no higher than in 1970.

8. Reduce National Insurance Surcharge?

[Chancellor reminded CBI on 1 November of key importance of wages in costs, and told them no prospect of NIS being abolished. Institute of Directors have called for precedence to be given to cuts in income tax over cuts in NIS.]

Fully aware of all representations and of strength of feeling in some quarters in favour of reductions. But important to remember that wages are major element in industrial labour costs. Remains one of possible candidates for reduction if resources available. Scope for any tax measures dependent on what decisions reached on public spending. NIS (like income tax) a major revenue raiser, producing £3.8 billion in current year, and very costly to reduce.

[NB. This briefing may require amendment during the week - HMT will provide amended version if necessary.]

9. Progress with examining corporation tax structure?

[Promise to re-examine corporation tax structure in 1980 Budget Speech]

It is hoped to produce the Green Paper on corporation tax this winter.

10. What about 'inflation tax' suggested by Roy Jenkins at SDP Conference and Professor Layard in recent Guardian article?

Such a tax would essentially be a form of income policy with all the well known defects of such. (See J11). In addition collecting such a tax would mean considerable extra work for the Inland Revenue. It would go against our policy of simplifying the tax system.

11. Progress so far on tax reform/simplification?

✓ As in CST's speech 18 November ✓

Substantial progress has already been made in improving incentives and simplifying the tax system, eg switch from direct to indirect taxes in 1979, correction of worst features of Capital Transfer Tax, improvement in Capital Gains Tax and Development Land Tax regimes, introduction of Business Start Up scheme etc. But reform of the tax system must be pursued within a financially responsible framework.

12. North Sea fiscal regime?

See R3.

E PUBLIC EXPENDITURE AND FINANCE

1. Announcement of spending plans?

Decisions for 1982-83 will be announced this week. More detail will be published in the White Paper at the time of the Budget.

2. 1981-82: Overspending?

[Outturn for the current year is expected to be in the region of £107 billion against £104½ billion in the last White Paper.]

Spending is expected to be higher in 1981-82 than was planned in the last White Paper. The major reason for this is the present level of spending by local authorities.

3. Failure to cut spending?

[Planning total for next year expected to be in the region of £115 billion against £110 billion in the last White Paper. Figures have been quoted in the press. The Chancellor will announce decisions for 1982-83 on Wednesday.]

Necessary to take account of changing circumstances and the needs of programmes. The discussions of public expenditure this autumn have been about the extent to which it would be appropriate to increase spending and about the extent to which the increases we have agreed upon should be offset by reductions elsewhere so as to limit the overall increase in spending.

4. Implications for tax and monetary policy

A matter for the Budget. But a high level of spending does mean taxation higher than it would otherwise be. The alternative would be more borrowing and higher inflation and interest rates.

5. When will this year's Winter Supplementary Estimates be published?

Winter Supplementaries will be presented to the House shortly.

[Note: Proposed date is 4 December but this has not been announced.]

6. Will, as in previous years, interim monitoring figures for 1981-82 Central Government cash limits and votes be published at the same time?

Yes

7. What about the cash limits 1980-81 provisional outturn White Paper?

The provisional outturn White Paper will be presented to the House shortly.

[Note: Proposed date is 4 December but this has not been announced.]

8. Cut current not capital/Cut current to allow more capital spending?

The Government's objective is, wherever practicable, to give priority to worthwhile capital projects providing this involves no overall increase in public expenditure. Must not oversimplify distinction between current and capital spending. Capital expenditure frequently necessitates additional current expenditure which it is difficult to accommodate at a time when our main objective is to contain the overall level of public expenditure.

9. Public spending overwhelmingly on administration?

[90 per cent figure quoted by some critics]

Not all current expenditure is on administration. One-third is current payments such as money paid out to old age pensioners, and the unemployed, child benefit and so on. One-fifth is for purchase of goods and services, for example for defence. One-tenth is grants such as overseas aid and subsidies. Only a third of current expenditure is on wages and salaries, and much of that is for nurses, teachers, policemen, soldiers and so on. We made it clear in the White Paper, Efficiency in the Civil Service, (published last July) that the Government is seeking ways of improving efficiency and cost consciousness in the Civil Service.

10. Cut staff numbers in public services?

Numbers in public service have already fallen since we took office. Civil Service has been reduced by over 7 per cent to 679,800. This is the smallest for over 14 years and we are well on target to achieve our aim of having by end of this Parliament the smallest Civil Service since the war. Local authority manpower has been reduced by nearly 70,000 (over 3 per cent).

11. Moves to cash planning announced in Budget mean that Plowden system is being abandoned?

Government does recognise case for medium term planning. But it must be planning in relation to the availability of finance as well as in relation to prospective resources. Illusion to suppose there can be unconditional commitment to forward plans for services.

12. Ratio of public spending to GDP is getting back to the peak levels of the mid 1970's?

The ratios in 1980-81 (44½ per cent) and 1981-82 (45 per cent forecast) remain below the level of 1974-75 and 1975-76 (46½ per cent in both years). The large rise from 41½ per cent in 1979-80 is partly because of the "relative price effect" and partly because the volume of expenditure rose at a time when real GDP has fallen.

LOCAL GOVERNMENT

13. England: Measures to combat overspending

Although most local authorities in England are planning expenditure in line with the Government's targets, a few have increased their budgets. As a result, the overall total for current expenditure remains about 5½ per cent (Nov '80 prices) above the Government's plans. In view of this my rhF the Environment Secretary will be obliged to seek Parliamentary approval to reduce the total of rate support grant. Individual authorities which meet their target or spend less than their Grant Related Expenditure assessment will not lose grant.

~~14.~~ Scotland: Measures to combat overspending

Scottish local authorities' original targets were 8.8 per cent (Nov '80 prices) above the Government's plans. In the light of this my rhF the Secretary of State for Scotland has withheld £31 million from three authorities which he considered were planning excessive and unreasonable expenditure. These authorities have now reduced their budgets. In view of the general high level of spending my rhF also intends to withhold a further £35 million from all authorities.

15. Rates: Powers to control

The Government is considering possible additional measures, including legislation, to bring home to individual high-spending authorities the consequences of their policies.

[Note: It is assumed the PM's Office will be in touch with Department of the Environment for latest developments.]

16. Rates: Alternatives

A Green Paper on alternatives to domestic rates will be published shortly.

F SOCIAL SECURITY

1. Government's forecast of 10 per cent inflation by November 1981 unlikely to be achieved; will it make good shortfall in November social security up-rating?

[Most social security benefits are due to be increased by 9 per cent this week (Child Benefit and Mobility Allowance by slightly more). 9 per cent increase based on Budget-time forecast of movement in prices November 1980 to November 1981 of 10 per cent, less 1 per cent to allow for over-payment in November 1980 increases.]

If we under-shoot this year, we can expect pensioners to catch up at the next uprating.

2. Government planning to cut real value of social security benefits?

Social Security Benefits, including Child Benefit, will be uprated in November by the amounts announced at Budget time and approved by Parliament. The level of upratings in November 1982 will be announced in due course. All public expenditure programmes are currently under examination; the social security programme cannot be excused from this process.

3. Announcement about National Insurance Fund contributions?

The level of contributions for 1982-83 will be announced later this week.

4. Will the Government ensure that the burden on employees/employers will not rise?

Whether or not we increase contribution rates, there is likely to be a cash increase in the amounts paid both by employers and employees because of increases in earnings, and, potentially, from changes to the earnings limits between which contributions are levied. Earnings limits or thresholds normally rise annually in line with prices.

[IF PRESSED: On employers: I am well aware of the need to limit the burden placed on employers. Members will recall that the increase in rates last year was confined to employees. But I cannot anticipate the decision we will be taking.

On employees: In deciding the level of contributions we shall ensure that we place no unjustifiable burden on employees.]

5. National Insurance Contributions are a tax?

National Insurance contributions are not a tax; they are paid into the National Insurance Fund specifically to meet the cost of national insurance benefits.

6. Statutory sick pay plans place new burden on employers?

[Social Security Bill, published on 6 November provides for reform of housing benefits and a statutory sick pay scheme (SSP). Most employers will gain from SSP, but some will lose]

Overall we expect employers to gain from the method of compensation we have adopted. The CBI have recognised this and welcome the proposals.

[IF PRESSED: Employers will be compensated for the statutory sickness payments themselves, but not for the national insurance contributions and surcharge levied on them. Those employers who have no existing occupational schemes will, therefore, lose. This is unfortunate, but it applies to a relatively small proportion of sickness payments; and we believe that the advantages of the scheme outweigh this disadvantage.]

G PUBLIC SECTOR BORROWING

1. PSBR in 1981-82

[Budget forecast PSBR in 1981-82 was £10.6 billion; PSBR in April - September, published 5 November, was £10 billion]

The Civil Service dispute has greatly affected the PSBR so far this year, but the underlying PSBR looks to be in line with the Budget forecast of £10½ billion.

2. Effect of civil service dispute on CGBR

[CGBR April-October was £9.2 billion]

The shortfall of net revenue outstanding at the end of October from the start of the dispute was around £5½-6 billion. £½-1 billion of this shortfall affected March; the remainder this financial year. Interest costs on the additional borrowing caused by the dispute are over £½ billion.

3. Will the Government be able to collect all delayed revenue this financial year?

It is not yet clear how soon all the delayed revenue will be collected. Since the dispute ended at the end of July, response has been quite good.

4. Public expenditure likely to overrun this year?

It is too early to say what the outturn for the current year will be.

[IF PRESSED: The local authorities are, admittedly, spending above the Government's plans. We are taking measures to deal with that but these measures cannot be effective this year. Expenditure which is under the Government's direct control is running broadly according to plan in total.]

5. Recession means that PSBR should be higher, not lower?

In my rhF's Budget statement earlier this year he explained that this year's PSBR would be larger on account of the recession. But experience shows that attempts to buy jobs with reflation simply fuel inflation and quickly have to be reversed. Our policies are designed to cut inflation and secure a sustainable improvement in output and employment.

6. What are implications for next year's PSBR of reported £5 billion overrun on public expenditure?

No decisions have yet been made on 1982-83 PSBR. Must await Budget. But is expected to decline as proportion of GDP - as outlined in MTFS in last FSBR (even before taking account of revenue delayed by civil service dispute).

H MONETARY AND FINANCIAL POLICY

1. Why has general level of interest rates risen?

[Clearing bank base rates rose by 4 percentage points to 16 per cent in September but have since fallen back 1 per cent.]

Immediate reason was pressure on sterling and rapid pace of bank lending. But important to note that rates overseas had been rising since the spring and while measures we took in the Budget enabled us for some months to keep our rates from being pulled up, we could not fly in face of developments abroad.

2. Sterling under less pressure: declining US rates; why is Bank of England appearing to brake the fall in UK rates?

Of course we want to see lower rates. But must proceed cautiously if we are not to let up in the fight against inflation. Clearing banks have already reduced base rates by 1 per cent. But wrong to think that rates could safely drop much further in near future without potentially dangerous consequences for inflation.

3. Why so much emphasis on cutting PSBR if efforts undermined so easily by high overseas rates and rapid pace of bank lending?

Interest rate decisions must take account of all potential risks of inflation, not just of PSBR. If we had not reined back the PSBR, interest rates would be still higher.

4. The death knell for the recovery?

Agree that higher interest rates will increase difficulties of industry. But no purpose served by allowing higher inflation, whether due to falling exchange rate or credit-financed consumer spending.

5. But increase in bank lending not inflationary: house prices stagnant, retail sales flat or falling?

Very hard to distinguish upward pressure on prices due to bank lending from downward pressure due to other factors, especially falling real personal disposable incomes. Effect of higher bank lending will not be felt on prices immediately, but only with a lag.

6. Two tier system of interest rates?

Not practicable in highly sophisticated financial market like UK's. Very difficult to prevent money borrowed at lower rate being on-lent at higher. A lower rate for specified borrowers would require extra Government subsidy which would push up borrowing or require cross-

subsidisation by the banks. In either case the level of interest rates to other borrowers would be increased.

7. Ceilings on non-priority bank lending?

In UK's complex financial system, ways would be found of by-passing credit controls. Any improvements to money figures would prove to be cosmetic. Would create distortions and inhibit competition between banks.

8. Chancellor told TCSC there were signs that £M3 has risen outside target?

[£M3 increased by 1.7 per cent in banking October, bringing recorded increase in first eight months of target period to 12½ per cent. But position remains seriously distorted by effect of civil service dispute and aftermath.]

Recorded growth is running above target range because of Civil Service dispute. But too early to say whether target will be overshoot over target period as a whole.

9. Where is underlying money supply in relation to target?

Cumulative distortion to £M3 is very large. Extremely difficult to say where we are in relation to target. Remain determined not to fuel inflation by excessive growth of money supply.

10. When will the strike distortions be eliminated?

Distortion will continue for some months yet. It increased again in banking October as Customs & Excise made VAT repayments more rapidly than they recovered outstanding VAT. Customs & Excise have been giving priority to refunding businesses affected by the strike. But from now on recoveries by Government are expected to exceed repayments.

11. Status of MTFS now?

[Press comment about a prospective Government announcement on revised MTFS is pure speculation. Have also been Press suggestions that £M3 target base will be rolled over this November; Prime Minister knows that we have made no commitment to such a rollover]

MTFS remains basic framework of Government's economic policy. But as Chancellor said in Budget speech, also take account of other monetary indicators, prospects for inflation, exchange rate, etc.

12. What will Government do about the Michael Grylls study group report?

This was produced independently for the Conservative Backbench Industry Committee but the Government are looking at its analysis and proposals with interest.

J PRICES AND EARNINGS

1. Inflation has increased under this Government?

Considerable progress has been made in bringing down inflation from a peak of 21.9 per cent in May 1980 to 11.7 per cent in October.

2. Inflation back on a rising trend?

[Year-on year rate of inflation rose to 11.7 per cent in October compared with 11.4 per cent in September and lowest recent level of 10.9 per cent in July. Effect of mortgage interest increases estimated at around $\frac{1}{2}$ per cent on RPI in November, some $\frac{2}{3}$ per cent in December.]

Progress on inflation has been affected by the fall in the exchange rate, and the rise in the mortgage interest rate will affect the RPI. We expect further progress in reducing inflation, but the timing is of necessity uncertain.

3. Budget time forecast achievable? (10 per cent by Q4 1981; 8 per cent Q2 1982)

[NOTE: Industry Act forecast due this autumn will include revised assessments for RPI and new forecast to Q4 1982.]

Now clear that increase in retail prices between November 1980 and November 1981 will be more than 10 per cent envisaged at Budget time, though precise figures impossible to predict at this stage. Over-run mainly due to fall in exchange rate, partly to higher mortgage interest rates. Government confident that downward trend in inflation will be resumed.

4. 9 per cent increase in prices in 1982-83?

The 9 per cent price factor for preparing public expenditure plans for next year represents what is considered a realistic provision for the prices to be paid by departments. It is not a precise forecast.

5. Nationalised industry prices

Nationalised industry price rises have been due in substantial part to the ending of the previous Government's policy of artificial and distortionary price restraint. The rate of nationalised industry price rises is now coming more closely into line with the RPI.

6. TPI

The fact that the TPI has been increasing faster than the RPI ($3\frac{1}{2}$ per cent faster over the year to October) reflects the measures which have been taken to restrain Government borrowing, which is essential if inflation is to be controlled.

7. A 4 per cent pay policy?

The 4 per cent factor announced on 15 September [for calculations in Public Expenditure Survey] is not a pay norm. It is a broad measure of what the Government thinks reasonable and can be afforded as a general allowance for increases in pay, at this stage of fixing the programme from which the public service wage bill has to be met.

8. Does the 4 per cent apply to the Civil Service?

The 4 per cent factor does not imply that all public service pay increases will or should be 4 per cent. Some may be more; some less. [IF PRESSED: In response to enquiries from the civil service unions, they have been told that the assurance they were given earlier in the year about next year's pay negotiations are unaffected by the announcement of the 4 per cent factor.]

9. Public sector ignoring 4 per cent policy?

[Firemen have now settled at 10.1 per cent; NUM have rejected revised offer worth 7.3 per cent on earnings; and water manuals have rejected 7.8 per cent on earnings]

Pay negotiations in local government and the nationalised industries are a matter for the parties concerned, as are the financial consequences of any settlements reached. There is no pay norm. What we need are settlements which are consistent with maintaining economic recovery and improving employment prospects. [NB Not enough settlements so far in private sector to comment on trend there.]

10. Government aiming to cut living standards?

Government seeking to create conditions for sustained improvements in living standards. This requires creation of more competitive and profitable industrial sector. Means that less of increase in nominal incomes should be absorbed by higher pay. The lower the level of settlements, the greater the headroom for output and employment to expand.

11. Average earnings index

[Drop in year on year growth from 12.8 per cent in August to 9.4 per cent in September may attract attention, though (unpublished) underlying increase unchanged at 11 per cent]

I very much welcome the sharp reduction in pay settlements which has been achieved over the past year. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

12. Comparison of TPI and earnings index shows that real take-home pay has fallen over the past year

Yes. But follows growth of 17½ per cent in personal living standards in three years 1977-80.

13. Tax-based incomes policy?

[As in Mr Jenkin's proposals at SDP conference]

Like any other attempt to rely on incomes policy, a tax-based incomes policy would entail all the familiar problems of setting norms and interfering with market forces. Experience gives no encouragement to the idea that incomes policies can be made to work on a permanent basis. They always succumb to the distortions they create.

14. Index-linked pensions and the Scott Report

[Sunday Express 15 November gave examples of large impending increases for some recipients when pensions uprated next week; Sir William Clark asking for debate soon on Report (Hansard 12 November col 669).]

We hope to reach initial conclusions on the issues in next few months. General objective is to ensure that public service pensions should be fair, fairly paid for, and seen to be so. This principle will determine future decisions.

K BALANCE OF PAYMENTS

1. Trade figures for October

The October figures show that the current account continues in surplus. Exports have performed much better than many people expected and are well up on last year. Imports have recovered from the depressed level at the start of 1981. This is consistent with the apparent slowdown in destocking.

2. Exports

Export volumes in September/October were about the same as in 1979 and 1980. Despite the downturn in the world economy and the loss of competitiveness export volumes have not dropped as many people expected. Indeed export orders for British engineering industries show a 40 per cent increase since the summer.

3. Imports

The increase in import volumes confirms recent evidence of slowdown in destocking. Import volumes are 16 per cent higher than in the first four months of 1981 but are only 1 per cent higher than in 1980.

4. Invisibles

Invisible earnings continue in substantial surplus and are likely to rise to about £200 million a month in the fourth quarter of 1981 due to budget refunds from the EC.

5. Capital flows

The net capital outflows in 1981 Q2 was about £1.9 billion compared to over £3 billion in 1981 Q1. These capital flows represent overseas investments which will provide a valuable source of overseas income in future years. There is no evidence that outflows deprive UK firms of capital to invest.

L FOREIGN EXCHANGE, RESERVES AND IMF

1. Sterling still too high?

[Since July sterling has remained broadly stable against the dollar but has depreciated against the Deutschemark due to a slacker oil market and improved German current account. Recent "lows" have been \$1.77 on 14 September, DM4.07 on 20 October. Rates at noon on 27 November were \$1.9480; DM4.33 and an effective rate of 91.8. Reserves at end October stood at \$23.2 billion, compared with \$23.7 billion at end September]

Our policy is to allow the rate to be determined primarily by the balance of market forces. The effective exchange rate is only slightly higher than when the Government took office. Manipulating the rate is no answer to problems in the real economy.

2. Has the Bank intervened to support the rate?

The Bank intervene to smooth excessive fluctuations and preserve orderly markets. They do not seek to maintain any particular rate.

3. Does the Government have an exchange rate target?

No. As my rhF the Chancellor told the TCSC in July 1980, it is very difficult to make judgments about the 'right' level for the exchange rate or to resist strong market trends That continues to be the Governments' view. However, the Government is not indifferent to exchange market developments: account is taken of the level and movement in the exchange rate when taking decisions on interest rates.

4. Sterling should join the EMS?

[See M13]

5. Exchange rate and competitiveness?

I welcome the improvement in UK cost competitiveness of perhaps 10 per cent so far this year. This is partly due to a decline in the exchange rate; more importantly because there are signs that our domestic unit labour costs are now growing more slowly than those of our major competitors.

6. Debt repayments

We have made substantial progress with our plans to reduce the burden of external debt substantially during this Parliament. We have now pre-paid the \$2.5 billion Eurodollar loan and are continuing with other scheduled repayments. By end of 1981, total official external debt will be reduced to around \$14 billion, compared with over \$22 billion when the Government took office.

M EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. Outcome of European Council meeting 26-27 November?

Broad agreement on development of policies other than agriculture. Further work to be done on four issues - problems arising from Community milk surplus; support measures for Mediterranean agriculture; limiting spending on agriculture; and the Budget problem. Foreign Ministers to meet and report back to Heads of Government. Reaching agreement will not be easy, because fundamental issues at stake. But European Council made considerable progress.

2. Cost to UK of community membership too high?

Costs and benefits of UK membership of the Community must be viewed as a whole. We realise the need for reform of the Community financing as well as my hon Friend/the hon Member. We have already achieved a major reduction in our net contribution through the agreement reached on 30 May 1980. We shall continue to press for reform of the common agricultural policy (CAP) and restructuring of the Community Budget.

3. Net contribution too high?

A lot lower than it would have been without the agreement of 30 May last year. Important to build on that as soon as possible.

4. Lower Commission estimates of net contributions in respect of 1980 and 1981?

We shall need to examine the new Commission estimates with care. If it is true that our adjusted net contribution in respect of 1980 and 1981 will turn out to be lower than expected, that is very satisfactory, because the 30 May Agreement left us paying a large net contribution even though we are one of the poorer Member States. The problem of 1982 and later years remains to be solved.

5. Budget refunds reduced if net contribution less than originally estimated?

Have seen press reports that other member states take the view that our refunds should be reduced in those circumstances. The UK, however, is clear that the minimum net refunds payable under the 30 May agreement are 1175 million ecus (European Currency Units) for 1980 and 1410 million ecus for 1981.

6. Does recent vote of European Parliament's Budgets Committee to freeze part of 1982 budget provision for UK refunds mean UK will not receive its full entitlement to budget refunds?

No. The draft amendments supported by the Budgets Committee was not supported by the Parliament when it voted in plenary session on 5 November.

7. Do supplementary measures grants lead to additionality?

There is additionality in important sense that refunds are making possible a higher level of public expenditure in the regions and elsewhere than would otherwise have been possible. Both the participating authorities and other spending authorities are gaining the advantage of a higher level of expenditure than country could otherwise have afforded. Scheme does not, however, open way to increases in expenditure by participating authorities beyond levels already planned. In that sense there is no additionality.

8. Policy for CAP reform

Greater attention must be paid to the needs of the market, and action taken to curb surplus production and contain the growth of guarantee expenditure. Will continue to press for price restraint and other measures appropriate to surplus sectors.

9. Costs of CAP to UK consumers

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

10. What if we hit the 1 per cent VAT ceiling before 1982?

Our position is that there will not be an increase in the 1 per cent VAT ceiling, and discussions on the restructuring of the budget and other matters are within that firm context.

EUROPEAN MONETARY SYSTEM

11. What is the current attitude of the UK Government?

We fully support the EMS, and acknowledge the contribution which it has made to stability in the exchange markets. However, we do not yet feel able to join the exchange rate mechanism. We must wait until conditions are right for the system and for ourselves.

N INDUSTRY

[NB. NEDC meeting on Wednesday 2 December]

1. Recent increases in interest rates - damaging for industry and investment?

(Each 1 per cent in interest rates raises interest payments on industry's borrowing by around £250 million.)

Government believes best way it can help industry and promote investment is to create a climate in which business can flourish. Essential to get rate of inflation down so as to create a stable environment for business decision-taking. Recent rise in interest rates must be seen in context of priority attached to reducing inflation and need to control growth in money supply underlying the MTFs. (See brief H).

2. Prospects for industry - recovery?

Encouraging evidence that fall in output has now come to an end. Too early to talk about recovery: but index of manufacturing output rose 1½ per cent in the third quarter with chemicals and engineering performing particularly well.

3. Company sector finances improved?

[Gross Trading Profits of industrial and commercial companies (ICCs) other than North Sea activities net of stock appreciation were around £3½ billion in Q2 1981 for third successive quarter. Borrowing requirement of ICCs has improved over last year, and financial deficit turned into surplus. Company liquidity has also improved markedly this year; company sector's liquidity position better in second quarter this year than at any time since third quarter of 1979].

Figures mildly encouraging (but not wildly so). Company financial position is in any case confused by effects of civil service dispute. After adjustment for stock appreciation and excluding North Sea, ICC profits have stabilised since mid-1980. Improvement in financial position partly reflects destocking and action to reduce overmanning.

SMALL FIRMS

4. Government help for small firms

Over 70 measures taken which help important small firms sector: in particular the Business Start-Up Scheme, the pilot Loan Guarantee Scheme, the Venture Capital Scheme, and reduction in the burden of small firms' corporation tax.

5. Response to Loan Guarantee Scheme?

Scheme has got off to very good start. We have already issued close on 1200 guarantees - well over half to new businesses. Total lending under scheme is already over £41 million. Substantial demand for loans has led the Government to double this year's lending limit under the scheme. Ten new banks were admitted to the Scheme in November: a total of twenty-seven financial institutions are now participating.

ENTERPRISE ZONES

6. Progress with setting up Enterprise Zones?

Excellent progress being made. Ten of the eleven zones are already in operation. We expect the final zone - Isle of Dogs - to come into operation early next year.

7. Response from private sector?

Initial response has been very encouraging. Many new firms are setting up in the zones, existing firms are expanding their activities and vacant land has been brought into use. Too early to assess success of zones.

P NATIONALISED INDUSTRIES

1. Government policy on nationalised industries

To reduce State ownership and improve efficiency of publicly owned enterprises. Market forces are to be brought to bear, and private capital is being introduced - where appropriate. Competition Act has been used to refer selected nationalised industry operations to the Monopolies and Mergers Commission.

INVESTMENT

2. Government just not allowing for enough nationalised industry investment?

No. Last Public Expenditure White Paper showed nationalised industry planned investment 15 per cent higher in real terms this year than a year ago. Quantity of investment frustrated by tight EFL's is less than implied. TSSC report published last August estimated in range of £250-500 million this year.

3. Increased NI investment would boost private industry and add to productive potential?

Depends on whether or not extra investment is accommodated within existing public sector totals. If it were allowed to add to borrowing requirement, it would tend to raise interest rates and discourage other expenditure, including some private sector investment. Except in short term, net effect on private sector might not be beneficial and effect on future growth of productive potential is uncertain. Report from all-party TCSC accepted that there could be such financial "crowding-out".

4. Take nationalised industry investment out of the PSBR?

Since nationalised industries are part of the public sector, their borrowing - for whatever purpose - must by definition form part of the public sector borrowing requirement. The real problem of pressure on resources cannot be solved by changing statistical definitions.

5. Private finance for NI investment?

(The NEDC Working Party's study of nationalised industry investment was discussed at the Council's 5 October meeting; agreed that there should be a review of progress to be completed by June 1982]

We have indicated our willingness to consider new financing proposals, most recently in the context of the review carried out by the NEDC Working Party. But direct market finance can only be justified if there is a genuine element of performance-related risk for the investor, in order to improve incentives to management efficiency, and if new forms of saving are tapped, so as to avoid adverse monetary consequences. Market financing does not of itself reduce the PSBR, nor does it lessen the burden on financial markets.

6. Status of proposed British Telecom bond. If agreed, will this bond be outside PSBR and relevant EFL?

No. This is borrowing by a public sector body, thus public sector borrowing. The Government, with its overall responsibility for BT's finance, must continue to place limits on its external finance. But EFL might be somewhat larger on account of bond than it otherwise would be.

7. What problems have delayed the expected announcement? Does proposal meet criteria set out in the NEDC Working Party Report?

[Two criteria:- extra cost must be justified by pressure for greater efficiency; terms of investment won't involve unfair competition with private sector].

An intensive effort has been made to conclude this question, in the context of the public expenditure exercise and the decision on BT's EFL for 1982-83. Certain problems remain to be resolved before a decision can be taken.

[IF PRESSED: They are:-

(a) Cost to BT of the borrowing - will be greater than gilts, but the Government and BT must be sure that this will be justified by the contribution the bond makes to pressures for improved efficiency and profit.

(b) BT's pricing policy - some arrangement is needed to assure investors that BT's profits would not be constrained by the Government's holding prices down. But Government must protect consumers as well as investors. This is an industry where prices ought to fall in real terms, because of technological advance, ie to rise by less than the RPI. We have not so far been able to agree on a formula to deal with this]

8. Finance more nationalised industry investment by cutting current spending?

Yes. In particular, moderate pay settlements are essential. The ability to finance new investment in the nationalised industries is bound to diminish if excessive pay settlements are agreed.

9. But you cannot finance much investment by cutting current costs alone?

Not true. Each 1 per cent off wage costs would save about £125 million per annum; and each 1 per cent off total costs saves £300 million.

NATIONALISED INDUSTRY PAY AND PRICES

10. Pay assumption for next year's external financing limits?

The Government has made clear the need for significantly lower pay settlements across the economy. It is in the industries' own interests to secure their future by leaving enough room for investment. The Government has not set any norms for the industries, but it is bound to take a close interest in settlements in reaching its decisions on investment and finance.

11. Nationalised industries' prices have risen more rapidly than RPI?

True over last year or so, while adjustments from artificial and distortionary price restraints introduced by the Labour Government were working through the system. Unwelcome but inevitable: the only alternative is an increased burden on the taxpayer and a distortion of market forces.

12. What is happening now?

Nationalised industry price increases are falling relative to the RPI (14 per cent above in year to January, 3 per cent above in year to October). Fully expect them to come closer to RPI in next few months.

13. And the future?

Better price performance depends on improvements in efficiency and control of current costs, particularly pay. We are determined to see those improvements brought about. Privatisation and increasing competition have an especially important role here.

PRIVATISATION

[Announcements in week ending 24 October referred to Cable and Wireless, National Freight Corporation Ltd, BNOC's oil-producing business and BGC's monopoly of purchase of oil and its sale to industry; BR Hovercraft.]

14. The Government simply selling valuable national assets to achieve PSBR target?

Of course, the cash is welcome, but the benefits run wider than that. Not only will the main financial benefit be that future borrowing of these undertakings will be outside the PSBR and no longer burden the taxpayer, but the organisations concerned will be made responsive to market forces and thus have greater incentives to improve efficiency.

15. Why is disposal of BGC's gas showrooms to be delayed?

HMG has made it clear that safety standards must be fully maintained - this will require complex legislation, for which there is unlikely to be time during this Session.

16. Does the Government have more privatisation plans to announce?

Legislation already passed to enable public to hold equity stake in British Airways, British Transport Dock Board, subsidiaries of British Rail; and to dispose of some of British Telecom's peripheral activities. We shall be announcing further measures in due course.

17. Will these include British Leyland?

The 1982-83 Corporate Plan for BL being submitted shortly will doubtless refer to the prospects for disposals.

R NORTH SEA AND UK ECONOMY

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

[Direct contribution of North Sea oil and gas to GNP is estimated to rise from 3 per cent in 1980 to about 5 per cent in 1984; expected contribution to Government revenues estimated at £3½ billion in 1980-81 and £6 billion in 1981-82 (at current prices). Less susceptible of measurement is boost given by North Sea to local employment and to industry in offshore equipment].

Yes. Government's strategy derives greatest possible long-term benefit from North Sea. Revenues ease task of controlling public borrowing. This will help to achieve a lower level of interest rates to the benefit of industry and the economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Only one-twentieth of total general government receipts in 1981-82.

2. North Sea oil price rises following OPEC price reunification?

Price of North Sea oil is a matter of commercial negotiation between BNOG and the oil companies.

3. Will HMG change North Sea fiscal régime in line with oil industry's proposals?

[Memoranda lodged with Treasury and D/Energy 22 October].

I commend UKOOA (UK Offshore Operations Association) and BRINDEX for the hard work which they have put in. Obviously full study of their proposals is required. We shall look at their suggestions with an open mind, in close liaison with UKOOA and BRINDEX.

4. North Sea oil depletion policy?

Secretary of State for Energy announced in June that the Government would review in the Autumn the possibility of oil production cuts in 1982. We shall give the industry proper notice of our intentions.

5. Gas gathering pipeline - why did HMG not proceed?

The project has always been envisaged as a private sector utility. The vast bulk of economically recoverable gas will be brought ashore and this can and should be left to private enterprise as in the past. Note that oil companies are already planning a series of North Sea gas pipelines.

6. Government revenues from the North Sea should be used to finance cheap energy for industry?

It would be inequitable and inefficient to use the benefits of North Sea oil to subsidise some users. The age of cheap energy is past. Energy prices should recognise the cost of marginal supply and reflect the competitive position of industrial fuels. Only then can consumers receive reliable signals on which to base their energy consumption and investment decisions.

7. North Sea revenues should be channelled into a special fund to finance new investment, particularly in energy?

North Sea revenues are already committed. Setting up a special fund would make no difference. More money would not magically become available. So the money for this special fund would have to come from somewhere else - lower public expenditure, higher taxes or higher public borrowing.

8. North Sea oil bond?

Our present plan is to issue a North Sea oil bond, an entirely new kind of National Savings certificate, in the Spring of next year.

S WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Governments' policies pushing world economy into recession?

[Output in OECD area grew modestly in first half 1981. Little information on Q3; but small rise in US and French GNP. Industrial production picture in Q3 mixed. Average unemployment rate rising.] [OECD believe output of member countries will have stayed flat in second half of this year, and will recover gradually in 1982. CONFIDENTIAL: NOT FOR USE This OECD forecast not yet published.]

No. Healthy growth only possible if anti-inflation policies persevered with. Some recovery of output expected next year. And unemployment should level off during the year.

2. OECD gloomier about world economic prospects?

[Draft report referred to in Sunday Times 15 November]

Latest OECD forecast is still being prepared. Most major forecasts, including the IMF's, expect modest growth next year. OECD forecasts unlikely to be markedly different.

3. Comment on latest NIESR Review forecast for industrial countries?

[Report published 26 November forecasts 'slow' economic growth and 'gradual' decline in inflation in industrial countries in 1982 and 1983.]

Interested to note that NIESR forecasts lower inflation and rising output in the industrial countries in next few years.

4. Anti-inflation policies not working?

[Year on year consumer price inflation in major countries around 10 per cent in September. Underlying rates increasing in US and France. OECD and IMF expect some decline next year.]

Takes time to squeeze inflation out of system. Year-on-year consumer price inflation in major economies down from peak of 13 per cent in April 1980 to around 10 per cent in September 1981. Further decline expected next year.

5. Governments' policies have failed or worsened situation?

No. Adjustment to second oil shock better than to first. Investment has performed better, impact on wages better contained and dependence on oil reduced. But these gains must be reinforced by continued firm policies.

6. Countries disagree over direction of policy?

No. Both Ottawa Summit and IMF Interim Committee agreed that a clear priority had to be given to firm policies to reduce inflation. They stressed importance of steady and careful

restraint on growth of monetary aggregates and emphasised need, in many countries, for reductions in size of budget deficits.

7. Other countries giving priority to unemployment rather than inflation?

No. All major countries agree that lasting reduction in unemployment can only be achieved when inflation brought down. France, an exception till October, is now acting to curb inflation. This best way to secure lower interest rates, encourage productive investment and achieve better rates of economic growth and employment.

8. Other governments not following such stern policies as UK?

[US, Canada and Germany have announced lower monetary targets for this year compared with last. Most major countries (US, Japan, Germany, Italy, Netherlands, Australia, Sweden) have recently announced measures to cut planned public spending. France has announced the deferral of FF15 billion (£1½ billion) of capital investment. Recent Canadian Budget will reduce deficit.]

Most governments persevering with firm policies to lay foundations of renewed non-inflationary growth. In particular, continuing with their efforts to control monetary growth, offset effects of recession on budget balances, and keep public spending in check.

9. US are pursuing mad policies and care nothing for their impact on rest of world?

US authorities have widespread international support in their battle against inflation. Sound \$ is in everyone's best interests. Concern is over monetary/fiscal mix - a problem all countries familiar with.

10. Deeper than expected US recession will kill recovery in other countries?

Some fall of output in the US may be inevitable before inflationary expectations are reduced. In everyone's interests that US inflation should come down. A sustainable recovery will then be possible.

11. Recent comments by US Budget Director have undermined confidence?

[Press reports of Dr Stockman's description of Budget spending cuts as "hastily prepared and enacted" and tax cuts "Trojan horse" favouring the rich, while casting doubt on "Supply side" policies].

I note that Dr Stockman has apologised for his "careless ramblings to a reporter".

12. Recent international interest rate developments?

True that international interest rates have been high over last year, but glad to see some easing of US prime rates - down to 16 per cent from peak of 21½ per cent; also German rates declining.

13. Prospects for international interest rates?

Always difficult to forecast interest rates with certainty, but firm policies should over a period bring lasting reduction in both inflation and interest rates.

PRESENT SITUATION

Most recent major outside forecasts (NIESR, P&D, CBI, LBS, ST JAMES) assess recession's trough was reached in H1 1981, with some recovery in year to H2 1982 (in range $\frac{1}{2}$ - $2\frac{1}{2}$ per cent). Item are more pessimistic, seeing output fall a further 2 per cent in 1982, recovery thereafter. Unemployment (UK adult sa) forecast to increase to around 3 million by end 1982. Most major forecasters see year-on-year inflation in range 11-12 $\frac{1}{2}$ per cent for Q4 1981, falling to 9 $\frac{1}{2}$ -11 $\frac{1}{2}$ per cent in Q4 1982. Item and St James are more pessimistic; forecasting range of 13-15 per cent. Item see a sharp drop, well into single figures in 1983.

GDP output estimate rose $\frac{1}{2}$ per cent in Q3 1981 the first rise for 7 quarters. In Q3 1981 industrial output rose $\frac{1}{2}$ per cent and manufacturing output rose $1\frac{1}{2}$ per cent.

Consumers' expenditure fell by $\frac{1}{2}$ per cent in Q3 1981 returning to the level of Q3 1980. Retail sales rose 1 per cent in October 1981. In September and October the Volume of visible exports was 4 per cent above the average in January and February. Volume of visible imports rose 21 per cent on the same comparison. Manufacturing investment (excluding assets leased from the service sector) fell $4\frac{1}{2}$ per cent in Q3 1981. Distributive and service industry investment (including shipping and leasing) was virtually unchanged in Q3 1981. DI investment intentions survey (conducted in April/May) suggests a fall in manufacturing investment after allowing for leasing of 11 to 14 per cent in 1981 with some recovery in 1982; distributive and service industries investment (including shipping) expected to rise by less than 5 per cent in both 1981 and 1982. Manufacturers', wholesalers' and retail stocks dropped by £0.2 bn (at 1975 prices) in Q3 1981 compared with destocking of £1.0 bn in H1 1981 and £1.9 bn in 1980 as a whole.

Unemployment (UK, seasonally adjusted excl. school-leavers) was 2,764,000 (11.4 per cent) at November count, up 36,000 on October. Vacancies rose slightly to 104,000 in November.

Wholesale input prices (fuel and materials) were unchanged in October but stand 18 per cent higher than a year earlier; wholesale output prices rose 1 per cent and are 11 per cent above a year ago. Year-on-year RPI increase was 11.7 per cent in October. Year-on-year increase in average earnings was 9.4 per cent in September. RPDI fell by $2\frac{1}{2}$ per cent in Q2 1981 after a $1\frac{1}{2}$ per cent fall in the previous quarter and a 17.5 per cent rise over the 3 years 1977 to 1980. The savings ratio fell 2 per cent to $12\frac{1}{2}$ per cent in Q2 1981.

PSBR £9.5 bn in the first half of 1981/82 and CGBR in April to October - £9.2 bn; but both distorted upwards by the civil service dispute. Underlying PSBR believed in line with Budget forecast (£10 $\frac{1}{2}$ bn).

Sterling M3 increased by $1\frac{1}{2}$ - $1\frac{1}{4}$ per cent in banking October but distorted by the consequences of the civil service dispute.

Visible trade showed an estimated surplus of £13 million in September and £116 million in October compared with an average monthly surplus of £368 million over the period July 1980 to February 1981. Invisibles surplus in first ten months of 1981 estimated at £2.3 billion. Reserves at end-October \$23.3 bn. At the close on 30 November the sterling exchange rate was \$1.96 and the effective rate was 91.76.