1/1

Econ Pol

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 8 November, are sidelined.) This incorporates general coverage of the Autumn Statement made on 8 November. More detailed briefing has been supplied as well to No.10, Treasury Ministers and others with specific needs.

M M Deyes

M M DEYES

RGA

R I G ALLEN

15 November 1982

EB Division
H M Treasury
01-233-5503

ECONOMIC BRIEF: CONTENTS

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 maintaining steady but not excessive downward pressure on monetary variables, and complementary fiscal policies. Improvement of supply side depends on restoration of flexible and competitive market economy and better incentives.

2. Significance of Autumn Statement?

This first Autumn Statement. It explains autumn announcements in more complete and accessible way than in earlier years. Can expect the publication to evolve.

3. A S represents shift in policy?

No. Autumn Statement not a mini-Budget; brings together number of annoucements about decisions - on public expenditure, NIC and Industry Act Forecast - which have to be made at this time of year. Though announcements affect scope for fiscal action in next Budget, they are fully consistent with MTFS.

4. AS reflationary/deflationary?

There is no change of policy compared with 1982 MTFS. PSBR as percentage of GDP in 1983-84 unchanged; as is public expenditure planning total.

5. What help for indsutry?

Measures announced in AS themselves have benefits for industry-NIS (see P1-3), NIC (see P1-3), public expenditure decisions. Other announcements made around time of AS - energy (see R2-3), ending of RDG deferment (Industry Secretary 9 November), local authority capital spending initiative (see E13-14) - all helpful. Also keep in mind wider benefits of lower inflation and interest rates.

6. Effect on employees?

N.I contributions go to fund benefits which command wide support e.g retirement pensions. Increase less than full amount required to balance Fund. Decisions must not be seen in isolation from decisions on taxation to be taken at Budget time.

7. Clobbering pensioners in 1983?

No. See G4-8.

8. Recovery over/Activity flat?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Pause this year partly reflects external developments. Expected recovery in world trade and output expected at Budget time has not materialised. Progress on inflation and interest rates more rapid than expected and, together with continued rapid improvements in productivity argues well for future.

9. Recovery next year?

Although recovery has been hesitant this year renewed modest recovery expected in 1983. Expectation supported by upturn in cyclical indicators and by most outside forecasts. [For Industry Act forecast See B7.]

10. Where will growth come from?

Sources of growth are expected to be: some modest recovery in world activity; improved confidence as inflation comes down, encouraging more investment and risk-taking; lower interest rates improving companies' financial position and encouraging more fixed investment and stockbuilding; increased consumers' expenditure, partly reflecting lower inflation. But prospects depend critically on containing costs.

11. Policy far too tight, given world recession? Below FSBR forecast growth in output, prices and money GDP clear sign of deficient demand?

Government cannot fine-tune either money or real GDP. Domestic demand is recovering - much as expected. Problem is external demand and UK's falling share of home and foreign markets (reflecting weak competitiveness). Need improvements to supply as much as demand. Without better supply performance, a boost to demand may be largely wasted, even in the short term.

12. PSBR undershooting/fiscal policy too tight?

See H7.

13. Room for tax cuts in 1983 Budget?

Chancellor has effectively 'spent' nearly £1 billion by reducing NIS and holding down NIC increases. Scope for further worthwhile tax cuts for 1983-4 - the so-called fiscal adjustment - now estimated at about £1 billion. But figures very uncertain at this stage. Decisions taken in next Budget will depend on prospects as then seen for PSBR and economy. These factors will also affect choices of taxes to be modified.

14. Public spending decisions?

Planning total for 1983-84 held at level envisaged in the 1982 Budget - some £120 billion. Most welcome achievement - first time has happened since 1977. Unlike in 1977, Government not forced to hold to plans by outside intervention of IMF.

15. Monetary framework?

As Chancellor again made clear in Statement 8 November, Government's role is to maintain firm, consistent, financial framework, in line with major economic objectives (see 1 above) as set out in Government will continue to interpret monthly developments flexibly. With inflation coming down, should be ample scope within target ranges for rising activity.

16. To increase competitiveness, cannot rely on pay settlements alone; should devalue?

See M 2-3.

13. Unemployment prospect?

See C10.

2.29

BULL POINTS As at 15.11.82

(i) Activity. Underlying level of output broadly flat since last Autumn but industrial and manufacturing output above levels spring 1981. Most recent major independent forecasts see prospect of modest recovery later this year and next.

(ii) Interest rates. Bank base rates have fallen 7 points since last autumn (now 9 per cent). Lowest level for almost four years. Recent falls reflect several factors:- singel figure inflation M1, £M3 and PSL2 developing favourably in relation to 8-12 per cent target, Government borrowing under control, exchange rate firm.

(iii) Inflation. The increase in the RPI over the 12 months to October was 6.8 per cent. For the first time in 10 years the rate is below 7 per cent and is the lowest since August 1972. Forecast of annual rate RPI inflation 6½ per cent by end of 1982 and prospect of 5 per cent by Spring of 1983. Manufacturers' output prices up 7½ per cent in year to October.

(v) Costs.

- Increase in average earnings halved in 1980-81 pay round. Public sector pay in line. Further moderation in average level of settlements in 1981-82 round. CBI pay databank for manufacturing settlements suggests average around 7 per cent compared with 9 per cent in 1980-81 round.

- Manufacturers' unit wae and salary costs up less than 6 per cent in 3 months to August over a year earlier-below average of major competitors.

- Manufacturers' input prices up almost 3½ per cent in year to October.

- CBI October survey still shows lowest degree of unit cost pressures for 15 years.

(v) Manufacturing productivity. Output per head has risen about 13 per cent since end 1980. Output per head and output per hour now about 6 and 9 per cent higher than previous peak in 1H 1979.

(vi) Competitiveness. Cost competitiveness improved by about 15 per cent during 1091 reflecting pay moderation, higher productivity and exchange rate fall, but less than 1½ per cent improvement during 1982 H1 and position remains $\frac{1}{3}$ worse than in 1975.

(vii) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, exluding North Sea) risen 16 per cent in 1H 1982 compared with 1H 1981. Recovery in profits from very low base: pre-tax real rate of return of ICC's (excluding North Sea) only 3 per cent in 1981.

(viii) Housing starts (total) - up over a quarter in first nine months of 1982 compared with same period 1981.

(ix) Exports (non oil, exluding erratics) only 2 per cent lower in 12 months to Septembr 1982 than in 1980, despite earlier substantial loss of competitiveness.

(x) Special employment measures. Total provision for special employment schemes planned to reach £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983).

(xi) Overseas investment in UK: US direct investment in Britain amounted to stock of over $14 billion in 1980. Nearly 60 per cent of all US outward non-oil direct investment now takes place in EC - over half of that in UK. Half of all Japanese investment in the EC also comes to Britain. Investment intentions survey of 231 German owned companies in the UK shows great majority intend to expand here in the near future.

(xii) Overseas debt repayments. Officials external debt reduced from over $22 billion in May 1979 to around $12½ billion at end-September 1982.

Economic Briefing Division, HM Treasury, 01-233 5514/5503

Retail sales

B ECONOMIC ACTIVITY AND PROSPECTS

Housing
Restaurants
Theatres
consumer incl service not retail sales

1. Prospects for UK economy

[Industry Act Forecast Tables reproduced in Commentary at end of Brief.]

- Although recovery has been hesitant this year, partly reflecting depressed world activity it should gather pace in 1983: about 1½ per cent growth of GDP 1983 on 1982. All outside forecasts (some rather dated) expect recovery to continue in 1983; consensus has been for year-on-year growth around 2 per cent.

- Inflation has come down much faster than expected. Now forecast to be 6 per cent in 1982 Q4 (9 per cent in Budget forecast) and 5 per cent next year (7½ per cent in 1983 Q2 in Budget).

- Wage settlements are expected to decline further over next 12 months. [No forecast ~~given in IAF~~ but GAD Report assumes 6½ per cent earnings growth between 1982-83 and 1983-84, against 9 per cent in previous year.] Productivity growth still fast (level of output per head in manufacturing now 13 per cent above end-1980).

- Consumers' expenditure (particularly retail sales) now increasing again after three flat years - up 1½ per cent in 1982 Q3, compared Q2, and forecast to rise 2½ per cent 1983 on 1982.

- Current account of balance of payments expected to decline to zero in 1983.

2. Recent output figures

[Latest GDP figures (all three measures) suggest any growth in economic activity in 1982 H1 over 1981 H2 was slight, but output about 1 per cent higher than in 1981 Q2. Industrial production in 1982 Q3 unchanged from previous quarter, though underlying level of industrial output 1½-2 per cent above 1981 Q2 trough - largely attributable to North Sea oil. Trend in manufacturing activity at best flat, though IAF expects 1 per cent increase in year to 1983 H2.]

Output remains disappointingly flat - partly due to depressed world economic activity. But expected higher world output should encourage some modest recovery in 1983, while lower interest rates and inflation, coupled with improved productivity and competitiveness, provide a sounder base for expansion in the medium term.

3. Other evidence of improvement in economy?

See Bull Points (following Section A).

4. Latest CBI assessments/Business confidence collapsed?

[CBI October Trends Enquiry shows less optimism on general business outlook and export prospects over next 12 months (optimism net balance fell from minus 22 in July to minus 28 in October). Orders and output have fallen and most (94 per cent of participants) see orders constraining future output. Stock reductions continue and investment intentions have weakened again. Most exporters expect prices to limit new orders. Cost and price pressure remain low, and company liquidity may inprove slightly in next six months. CBI August forecast suggested GDP growth next year of 1-1½ per cent; more recently, CBI emphasising lower end of range.]

Results of October Survey certainly disappointing. But deterioration in optimism, and immediate outlook (next four months), not unexpected and probably reflect in part very depressed level of activity, at home and overseas, this year. Survey not entirely gloomy - favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. As witnessed by surveys from Times Business Forum in October and November, great majority of businessmen support Government's basic economic strategy and are optimistic about prospects for company growth/profits over next two years. Decisions announced 8 November aimed to reduce business and industry's costs and should boost confidence.

5. New orders figures depressing?

[New construction orders in August fell by 22 per cent from around £450 million to £350 million (at 1975 prices) compared previous month. In three months to August, orders fell 6 per cent compared previous three. Volume of new orders in engineering industries fell 9 per cent in three months to July compared previous three.]

Figures manifest depressed economic activity which itself partly reflects flatness in world trade.

6. Fall in investment and reduction in stocks?

[Capital expenditure by the manufacturing, distributive and service industries in Q2 1982 4 per cent lower than level in previous quarter. Investment in manufacturing in H1 1982 was 3 per cent lower than in Q4 1981. Stocks fell by £30 million ('75 prices) in Q2; but in the first half of 1982 stocks increased by £100 million compared with destocking of £520 million in second half of 1981. CBI October survey shows for second successive survey, decline in investment intentions. IAF projects 3 per cent growth in fixed investment in 1982, 5 per cent in 1983.]

Figures another manifestation of hesitation in economic activity. Despite this, some categories of investment, notably plant and machinery, have held up quite well. [IF PRESSED: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

7. Stock levels a threat to recovery?

Falling interest rates (nominal rates lowest for four years) have eased cash pressures and should assist recovery in stock cycle.

8. Competitiveness not improved this year?

Cost competitiveness has improved about 15 per cent since 1981 Q1 [but virtually no change during 1982 H1: position remains about one quarter worse than when Government took office]. Further improvements, which are essential to regain markets and create new ones, depend above all on substantially lower wage settlements in this pay round than in the last one. Lower exchange rate not the answer (see M2-3).

9. Productivity growth falling off?

No; productivity growth in manufacturing up 4½ per cent over last year, and 13 per cent up on end-1980, is well above UK historical average.

10. CSO's index of leading cyclical indicators?

[NB October cyclical indices to be published Friday 19 November: longer leading index expected to show further rise.]

Longer leading index rose again in September reflecting further falls in interest rates and an increase in share prices. Shorter leading index also rose in July and August. Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

11. Outside forecasts

[GDP profile in recent major assessments:

Per cent change

	LBS (Nov)	Phillips & Drew (Nov)	Simon & Coates (Oct)	CBI (Aug)	St James (Aug)	OECD (July)	NIESR (May)	IAF (Nov)
1982 on 1981	+¼	+½	+½	+½	+1¼	+1¼	+1	+½
1983 on 1982	+3	+¾	+2½	+1½	+2½	+1¾	+1	+1½]

Nearly all see prospect of continued recovery and lower inflation.

C LABOUR MARKET

1. Government concerned over unemployment?

Of course Government concerned; so pursuing balanced fiscal and monetary policies to curb inflation and creating conditions for enterprise - only measures that will ensure sustainable increase in employment. Nevertheless has substantially increased spending on schemes to alleviate impact on especially vulnerable groups. Most crucial factor in influencing unemployment is level of pay settlements (See also Section K).

2. Extent of help?

Government plan to spend £1½ billion in cash in 1982-83 (40 per cent more than in 1981-82) on special employment and training measures (including new Youth Training Scheme costing £1 billion a year from 1982-83); new community programme, designed to provide up to 130,000 places for long term unemployed; and new Job Splitting Subsidy (open on 1 January next year) to encourage extension of part time work and provide additional opportunities for productive jobs for unemployed people.

3. Recent unemployment figures and other labour market indicators?

[Underlying trend in unemployment has deteriorated since Q2, but October figures a little more favourable than of late. Because of seasonal factors, no further sharp rise in 'headline total' expected till January. Recent unemployment/vacancy figures shown below:

	1980 Q4	1981 Q1	Q2	Q3	Q4	1982 Q1	Q2	Q3	Oct
'Total' unemployment	2.16	2.46	2.59	2.93	2.96	3.04	3.01	3.28	3.30 (13.8% rate)
UK adult sa unemployment (millions)	2.02	2.28	2.48	2.64	2.75	2.82	2.88	2.98	3.06 (12.8% rate)
increase in period (000's)	+105	+77	+62	+51	+33*	+21*	+30*	+42	+23*
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

*After allowing for over 60's transferring to supplementary benefit.

Other labour market indicators (e.g overtime, short-time) roughly flat for last 6 months.]

October figures cannot provide indication of future trends but are nonetheless welcome. Level of unemployment still tragic but problems took a long time to build up will also take a long time to check or reverse. Recent figures reflect levelling out in activity since last autumn. Looking further ahead, lower inflation and interest rates, and lower pay settlements and hence improved industrial competitiveness should help promote economic recovery and create climate for sustainable jobs.

4. CBI's ideas for reducing unemployment?

[Report of Cave Committee presented to CBI Conference proposes strategy based on increasing economic growth; encouraging efficient labour-intensive sectors e.g. construction, tourism; increasing work opportunities e.g. by job splitting, phased retirement, short-time; reducing size of labour force e.g. voluntary early retirement, youth training. Claims to reduce unemployment by 1-1½ million.]

Interesting contribution - will stimulate public debate. Group has more work to demonstrate how this package relates to CBI's other policy recommendations. 1-1½ million reduction in unemployed very optimistic; almost half estimated effect attributable to measures already announced.

5. Unemployment in UK higher than in other countries?

[On standardised definitions in Q2 1982 UK unemployment was 12.7 per cent compared with 8.1 per cent OECD rate; little over doubling for UK compared with OECD rise of over one half since 1979.]

Unemployment now rising sharply in many industrialised countries - in last three months number unemployed (on national definitions - not strictly comparable) rose much more in Canada (up by over 20 per cent), Holland (9 per cent), Ireland (8 per cent), Germany (7 per cent) than in UK (4 per cent).

6. UK's true unemployment figures really much higher?

[TUC say 'true' figure just under 4½ million The Times 11 November.]

No one seeks to deny there are unregistered unemployed but reliable estimates of their numbers are difficult to obtain. Available estimates vary quite widely. Figures of registered unemployed are based on accurate counts, have been accepted by successive administrations and provide reasonable estimates of trend.

7. Cost of unemployment/Effect on PSBR?

There can be no single estimate of 'the cost of unemployment'. Only costs that can be at all readily identified are additional expenditure on unemployment benefit, supplementary benefit, rent and rate rebates and administration. (Even these dependent on characteristics of those becoming unemployed - family status, resources etc). These could average £1800 in 1982-83 for each additional registered unemployed person. (NB This cannot be multiplied out by the total number unemployed.)

[IF PRESSED: Estimates of effect of other influences on PSBR directly or indirectly associated with unemployment vary widely depending on large number of highly debatable assumptions. And a major change in the level of unemployment would have impact on other economic indicators effective in the calculation of PSBR.]

8. Fiddling the statistics?

[Rayner cost-saving exercise means that from November onwards method of measuring unemployed will change. November count will be some 100,000 lower than on traditional measure. Even further reduced in summer when school leavers register. NB October figures on revised basis to be published 18 November; November figures 2 December.]

No question of a fiddle. Detailed and considered study revealed substantial savings on collecting statistics for registered non-claimants. D.Employment will be providing estimates of effect on past statistics, and will provide similar information for up to a year from the change.

9. What is Government's own forecast of unemployment?

[Government Actuary was instructed to assume that number of unemployed in Great Britain, excluding school leavers etc, would average 2.9 million in 1982-83 and 3.2 million in 1983-84, (or just under 3.4 million including school leavers). Assumption for 1982-83 same as in 1982 PEWP but for 1983-84 3000,000 higher than in 1982 PEWP.]

GA's ~~assumptions~~ are not predictions or forecasts. [IF PRESSED they provide reasonable assessment of prospect but any forecast of unemployment must be highly conditional.]

10. Employment continuing to fall?

[Total employment declined 2.4 million (10½ per cent) between mid 1979 and Q2 1982. Decline of 94,000 in 1982 Q1 increased to 189,000 in 1982 Q2. Manufacturing employment in August fell 35,000 to 5,531,000 (compared 5,871,000 in August 1981).]

Only way to achieve permanent jobs is sustainable recovery, based on improved industrial competitiveness lower inflation and lower interest rates. Substantial provision (£1½ billion) being made to help most vulnerable groups (see C1 above).

11. Recent productivity gains inimical to higher employment/lower unemployment?

[Output per head in manufacturing up 12 per cent since end-1980.]

This may be true in the short run. But in the longer term, as experience in UK, Japan and many other countries clearly demonstrates, higher productivity essential for growth and employment opportunities.

D TAXATION

1. Burden of taxation

[Total taxation (including NIC) as proportion of GDP was 34½ per cent in 1978-79 and is forecast to be 39¾ per cent in 1982-83. Corresponding figures excluding NIC are 28½ per cent and 33 per cent].

Burden has inevitably risen because of upward pressures on public expenditure caused by the recession. Increases in taxation are better - and more honest - means of financing this than borrowing, because of adverse effects borrowing has on interest rates and inflation.

2. British tax burden high by international standards?

Not so. Accurate comparisons difficult, but UK burden about average for OECD countries [1981 data from Lloyds Bank Economic Bulletin, October 1982]. Similarly, UK taxes on household income and employees' social security contributions about average for EC countries and lower than Japan and USA [1980 provisional OECD data].

3. Autumn Statement

Chancellor on 8 November announced proposals for further reductions in NIS which should be welcomed by industry: another ½ per cent for 1982-83 and 1 per cent for 1983-84 to bring the rate down to 1½ per cent. Less than half the 3½ percent level inherited from Labour. Each 1 per cent reduction worth some £800 million pa (full year) to private sector.

4. NIC announcement

NICs not taxation but contributions giving entitlement to specific benefits. Holding down the increase below what would have been required fully to balance the National Insurance Fund.

5. Combined effect on taxpayer/contributors?

Effect on living standards and tax burden will also depend on income tax decisions to be taken in 1983 Budget.

6. Prospects for cuts in taxation in 1983 Budget?

NIS and NIC decisions do, of course, reduce scope for tax reductions in next Budget though sticking to public expenditure totals helps. Decisions for 1983 Budget, both in PSBR and particular tax changes, will not be made for several months yet.

7. Future of married man's personal allowance?

[Labour party commitment to phase out in favour of increased child benefit etc; SDP proposals to abolish as part of new scheme to assist lower paid.]

Government launched debate with December 1980 Green Paper on Taxation of Husband and Wife. Very wide range of views received, which government is considering. Abolition of married man's allowance advocated in some quarters would affect many millions of taxpayers and by itself leave a basic rate taxpayer £5 a week worse off. Abolition makes the poverty and unemployment traps worse for some people. (See also G11 on Labour's proposals.)

8. SDP plan to abolish poverty trap?

['Attacking Poverty', published 11 November.]

Their scheme costs £4½ billion and still leaves marginal tax rates, for people in the poverty trap, of 80-85 per cent. What is more, they extend the trap both up and down the income scale. Claims to have eliminated the trap are based on artificially restricted definitions.

9. SDP re-distributing to the poor?

SDP plan involves massive re-distribution. But it is not redistribution from rich to poor in any accepted sense. On SDP's own figures single people worse off on anything over half average earnings; married couple without children worse off if have income of more than ¾ average earnings; married couple with children worse off if have average earnings or even a bit less unless they have 3 children or more.

10. Government unconcerned about poverty and unemployment traps

[Incidence of 40-50 per cent marginal tax rates given in reply to PQ 25 October to 315. IEA document reported in Press 1 November 'The Moral Hazards of Social Benefit' claims 5½ million adults at risk from the traps.]

Government concerned about poverty and unemployment traps, in context of incentives as a whole. Traps caused by attempts of successive Governments to alleviate poverty and hardship while keeping costs in bounds. Alternatives are to give less support for the poor and unemployed or to let costs rip. SDP proposals far from a complete solution (see D8). [IF PRESSED: IEA paper exaggerates numbers affected and offers few concrete proposals.] A necessary step in the right direction is to reduce burden of income tax by restraining public expenditure - which is Government policy. Long-term solution is increased wages resulting from sustained improvement in productivity and economic performance: this too a goal of Government policy.

11. Burden of taxation risen most for the poor?

Proportion of income paid in income tax and NICs has fallen in 1982-83 for lowest paid taxpayers. Low paid with children are also entitled to benefits such as FIS.

12. Previous reductions in personal taxation favour the rich?

1979 Budget cut absurdly high top rates of income tax to European levels, as part of package which also involved substantial increase in thresholds. Such action was essential to restore incentives. No 'pot of gold' in higher rate tax; restoration of 83 per cent top rate would finance a cut of under $\frac{1}{2}$p in the basic rate.

E PUBLIC EXPENDITURE AND FINANCE

[Total spending of £120.1 billion in revised plans for 1983-84 announced 8 November. Compares with total of £120.7 billion in 1983-84 in Cmnd 8494 published 9 March, adjusted for Budget (and other minor changes). Revised plans for 1984-85 and 1985-86 will be published in next Public Expenditure White Paper in late January/early February 1983. Plans now announced are firm. Precise figures may change slightly between now and White Paper in light of more detailed calculations. Contingency Reserve will also be reviewed before White Paper finalised.]

PUBLIC EXPENDITURE 1982-83 AND AUTUMN STATEMENT

1. How do revised plans for 1983-84 compare with those previously announced?

[PM on 3 November referred to "holding to the total of £120.5 billion announced of time of last Budget].

Outcome of annual review of public expenditure plans has been to hold planning total within previously ~~announced~~ plans. First time this has happened since 1977. Unlike 1977, Government not forced to hold to plans by outside intervention of IMF.

2. What is change in real terms?

Small fall in expenditure in 'real' (cost) terms now planned for 1983-84 compared with 1982-83 plans. [NB cost terms means cash adjusted for general level of inflation as measured by GDP deflator]. No 'volume' (constant price) figures available.

3. Cuts in services?

Decision to contain expenditure has inevitably meant reductions in some programmes to compensate for increases in others. But Government's success in reducing inflation and interest rates has made it possible to accommodate such changes without major cuts in services.

4. Hasn't Government gone too far in reducing public expenditure?

Still planning for an increase (£5½ billion) between plans for 1982-83 and 1983-84. Reduction below Budget-time plans largely accounted for by two factors: £400 million benefit from NIS clawback: revised forecasts of receipts from special sales of assets. When effect of these discounted, Government has held closely to its previous plans.

PUBLIC EXPENDITURE - GENERAL

5. Ratio of public spending to GDP

Ratios in 1980-81 (43 per cent) and 1981-82 (44½ per cent estimated) remain below level of 1974-75 and 1975-76 (46 per cent in both years). Rise in ratio in 1981-82 compared 1980-81 mainly reflected higher expenditure on social security at a time when real GDP falling. Ratio expected to fall in next few years. Autumn Statement gives figures of 45 per cent in 1982-83 and 44 per cent in 1983-84.

6. Figures quoted in Weekend World programme 10 October?

[Ratio of public expenditure planned for 1982-83 to GDP in that year given in Weekend World programme was 46.8 per cent. Apparently derived (incorrectly) by someone at ITV taking from the FSBR the wrong numerator for the ratio. They took it from Table 8. The correct figures were given in the FSBR at para 2.21, and a reconciliation set out in Table 6.]

Figure of 46.8 per cent shown on Weekend World for 1982-83 based by them on incorrect calculation. At Budget time, the estimated ratio of public expenditure to GDP in 1982-83 was 44.5 per cent.

7. Increase spending in recession?

No good trying to spend way out of recession. Any benefits would be short-term. If increased spending not financed responsibly, would soon lead to more inflation. If financed prudently, would lead to higher interest rates and/or higher taxes. We are responding, within limits of prudence, to needs of current circumstances.

8. Capital spending in public sector?

Government's policy is that provision made for capital expenditure both in central government and local authorities, should be fully spent, subject to the normal prudential margin. (Of course always necessary to take account of implications for future current running costs - and interest). In nationalised industries, criterion is that capital expenditure should show an adequate return. (See also E13-14 and R9).

9. Cut public sector pay bill/administrative costs of central government?

Only one third of current expenditure is on wages and salaries and much of that is for nurses, teachers, members of armed forces, police and so on. Provision for public service pay increases 1982-83 limited to 4 per cent. Administrative costs are not far short of 10 per cent of total public expenditure. We are determined to reduce that proportion, and to maintain drive for more efficient management throughout public sector.

10. Cost of pay rises for public servants - equivalents in public spending programmes?

Every 1 per cent extra on pay for public servants (excluding Nationalised Industries) costs £335 million - the approximate equivalent of two frigates, 50 Harriers or about 70 miles of motorway.

11. What allowance will Government make for pay increase in public services next year?

Government attaches great importance to realistic wage settlements next year, in both public and private sectors. Provision for public service pay will be made from within cash plans.

12. 3½ per cent pay assumption for 1983-84

Assumption is not a 'norm'. Nor is it a decision on the offer to be made in any particular case. Each will be considered on its merits. It concerns the provision in public expenditure plans for next year for those groups for which Government is directly responsible, other than NHS. It does not directly cover local authorities, or nationalised industries, which are not within Government's direct control. But they will be controlled by the rate support grant and the external financing limits.

LOCAL GOVERNMENT

13. LA capital underspending and measures to prevent recurrence in 1983-84

Following underspend of £¾ billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1½ billion (GB figures). Some steps in hand to reduce the underspend: Prime Minister has written to local authority associations, and extra allocations will be given to authorities who can use them, especially for improvement grants.

14. LAs cannot increase capital spend because of revenue consequences?

Plans for relevant LA current expenditure allow for financing costs of full planned capital programme. Many capital projects have no immediate running costs eg roads, reclamation of derelict land. Others will reduce running costs by rationalisation. LAs would be able to afford running costs of worthwhile investments if curbed wasteful expenditure and held down pay settlements.

15. LA current overspending in 1982-83

Budget returns from LAs indicate overspend of over £1 billion on current expenditure is under way. Secretaries of State have announced intentions to abate rate support grant to overspenders in response. (For details, refer to statements in Parliament 27/28 July by Secretaries of State.)

16. Local government finance 1983-84?

[Announcements in Autumn Statement.]

Plans for LA current spending have been increased by over £1 billion to ensure that they are realistic. Only some £270 million of this increase will be allocated to service programmes the rest will be included in expenditure targets as it represents an extra provision which the Government does not consider desirable, but which has been included to make plans realistic in relation to this year's overspend.

17. Rate increases implied by plans?

What happens next year depends on what LAs decide to spend. If LAs comply with their expenditure targets, rate increases need only be very modest overall, and in some areas will be no need for any increase. Of course, if LAs decide to overspend, the rate burden they have to impose will be higher, and they may lose rate support grant if they exceed targets.

18. Holdback of RSG in 1983-84?

Refer Written Answer from Environment Secretary (Hansard 4 November) announcing options for holdbacks in England. Consultation with LAs underway (also in Scotland and Wales). Schemes adopted will depend on outcome of consultations.

19 Higher council house rents?

[85p assumption referred to in Autumn Statement].

In Government's view, LAs should not need to increase rents in real terms in 1983-84. For them to decide. Government decision is about provision for housing subsidy - Environment Secretary will be consulting LA associations on basis of figure of 85p per week per dwelling. ~~per week~~. If that figure confirmed, will be possible to provide for real increase in capital investment in housing next year.

20. Green Paper on Domestic Rating System: Government response?

Carefully considering representations. Need scheme to run that will remedy shortcomings of present rating system which will command widespread support. Taking account of pleas from industry, business, etc. (See also P 9.)

FALKLANDS EXPENDITURE

21. Falklands defence costs?

[Answers given by PM 26 October OR cols 885-6; Defence Secretary 28 October OR cols W 453-4.]

Latest assessment of costs of operation, and of replacing equipment lost during the conflict, is about £700 million in current year; over next three years the cost will be £200 million, £350 million and £320 million respectively. Decisions have yet to be taken on size (and thus cost) of garrison.

22. Equipment replacement costs

Defence budget will be compensated in full for Falklands costs. This will include full replacement costs of new - and usually better - ships, aircraft and other equipment. In some cases (eg the four new frigates) Ministry of Defence are considering detailed design requirements before going out to tender.

23. How will the various costs be met?

Extra costs in current year will be met from Contingency Reserve. The block defence cash limit for 1982-83 has been increased by £371 million on account of operations in the South Atlantic. (Hansard col W 108 9 November 1982) For 1983-84, an increase to the Defence Budget of just over £620 million has been announced. Future years' provision will be announced in the 1983 Public Expenditure White Paper. Extra defence costs will be met out of monies additional to path of annual real growth of 3 per cent.

24. What will be costs of repairing damage and reconstructing the Islands' economy?

Too soon to say what these costs will be. Work has begun on restoration of essential services and on implementing Civil Commissioner's recommendations for priority action (accommodation, inter-Islands air service, education). Up to £10 million is being made available for this. Not yet able to say whether these costs will require additions to existing FCO and ODA funds and how far additional sums will be needed. Ministers studying Shackleton Report proposals for long term development of Islands; in advance of decisions, impossible to say what costs will be.

[BACKGROUND WHICH CAN BE DRAWN UPON: Estimates of cost given in the Report are £31-36 million for new development aid; £40 million for offshore fishing; up to £12 million for additional housing/infrastructure. Total estimate of £83-89 million (at 1982 prices) excludes aid for rehabilitation and compensation for war damage already being made available.]

25. Cost of paying compensation for war damage?

Too soon to say what total will be. Claims are being processed, and further claims may be received. About £1 million has so far been paid out, but this is no guide to what the final total might be. Not yet clear whether the compensation scheme will require an addition to existing FCO programme.

F CIVIL SERVICE STAFFING AND PAY

1. Civil service too big/does too much/is over staffed?

Since Government came to office, Civil Service has been reduced by 10 per cent to 659,300. Results from reduction in functions, privatisation and improvements in efficiency. On course to achieve aim of having Civil Service of 630,000 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. Civil service efficiency?

[Government reply to TCSC was published 28 September entitled 'Efficiency and Effectiveness in the Civil Service Government Observations on TCSC Report Cmnd 8616].

Measures to increase efficiency in civil service set out in Government's recent White Paper welcoming Report from TSCS, and accepting (totally or with reservations) no less than 20 of the Committee's 26 recommendations. White Paper gives details of new financial management initiative, and responds to Committee recommendations on management information systems, training in management and financial management, and the filling of senior posts.

3. Civil service pay in 1983?

Unions have asked Government, in light of 3½ per cent planning assumption announced 1 October ~~(see~~ E 12), whether Government intend to have genuine negotiations, and whether arbitration will be available. They believe arbitration should be unconditionally binding ie not subject to Parliamentary over-ride.

4. Megaw Report

Report of Megaw Inquiry into arrangements for deciding civil service pay in future (Cmnd 8590) contained number of important recommendations which are now being considered. Government pleased with widespread support that has emerged for the general approaches which the Inquiry endorsed. Preliminary 'ground-clearing' discussions with unions have commenced. A new system will not be agreed in time for 1983 pay.

5. Scott Report/Public sector pensions?

See K 20.

G SOCIAL SECURITY

NATIONAL INSURANCE CONTRIBUTIONS

[National Insurance contribution rates for employees and employers to be increased by 0.25 per cent from next April, giving contracted-in rates for Class 1 of 9 per cent (employees) and 10.45 per cent (employers). (Because of reduction in rebate on contracted-out rates - announced last March and not part of the annual contributions review - of 0.35 per cent for employees and 0.4 per cent for employers, Class 1 rates for contracted-out rise by 0.6 per cent (employees) and 0.65 per cent (employers); giving rates of 6.85 per cent (employees) and 6.35 per cent (employers).) Lower Earnings Limit rises from £29.50 to £32.50 and Upper Earnings Limit from £220 to £235. Change in the rate of National Insurance Surcharge also affects employers' total payments, see P1-3 for burden on employers.]

1. Why increase employees' contributions?

Recognise that employees have been hard hit recently (increase of 2.5 per cent overall since Government came to power). Some increase necessary because of the rise in the cost of benefits paid from the Fund. But in order to protect contributors the increase is less than is needed to balance the Fund, and in consequence, Fund will be in deficit in 1983-84 by £262 million.

2. Very large increase for contracted-out?

The change in contracting-out terms was announced last March, following a report by the Government Actuary, and is not part of this review. This reduction in the rebate reflects the Government Actuary's assessment of the fall in the cost to contracted-out schemes of providing guaranteed minimum pensions.

3. Effects of 8 November decisions on employers?

See P1-3.

BENEFITS

[Benefits being uprated by 11 per cent later this month (22 November 1982). Includes 9 per cent to take account of inflation. 9 per cent clearly too high hence announcement in Autumn Statement that uprating in November 1983 will be adjusted to have regard to this fact].

4. Government reneging on pledge to maintain value of pensions?

On the contrary, pensioners will be better off during the next year by the extent of the overshoot. Only question is how much of this real increase will continue beyond November 1983. Maintaining real value bound to mean adjustments from year to year; nothing extraordinary about this.

5. Level of overshoot?

Cannot say exactly until December, when November RPI available. Industry Act forecast is 6 per cent inflation for fourth quarter 1982. So overshoot of 2½-3 per cent reasonable estimate. Reflects Government success in reducing inflation.

6. Public expenditure saving?

Recovery of a 2½ per cent overshoot would save £250 million in 1983-84; more in a full year. But social security programme has been reduced by £180 million in 1983-84. This reflects Government's judgement of appropriate level of expenditure. Exact level of November 1983 uprating will be settled at Budget time, when Government will, as usual, take wide range of factors into account.

7. Improvements in benefits?

[ie, using difference between reduction of £180 million and full saving of £250 million if overshoot is £250 million.]

There is constant pressure from both sides of House for whole variety of improvements. Government will have to determine priorities, eg between change in individual benefits and adjustment to next year's uprating. Decisions will, as usual, be taken at Budget time.

8. Uprate pension by pensioners' price index?

[Two PPI's for one and two person households; both exclude housing costs. Both indices have moved less than both RPI (all items), and RPI excluding housing costs, between fourth quarter 1978 Q4 and third quarter 1982 Q3. The gap has, however been narrowing in recent times. Moreover, comparison with the full RPI, ie including housing costs, shows that over time they produce very similar results.]

Pensioner's price index is not necessarily representative of pattern of pensioners' spending, and is constructed on limited information on a very small sample of pensioners. We consider RPI to be best measure of general level of prices, and appropriate for uprating of pensions. In any case, pensioners would not have done any better had we used the PPI to uprate pensions since we came into office.

9. Occupational pensions - increase supervision?

[Recent report by Occupational Pensions Board recommending, inter alia, disclosure of information to pension fund members; end to 'franking' (whereby schemes implement requirement to maintain value of guaranteed minimum pension only by eroding accumulated pension rights above that minimum).]

Government welcome recommendations of OPB. Accept in principle need for legislation on disclosure of information to members of pension funds. Social Services Secretary will be consulting interested parties about content. He also hopes to bring forward in first half of next year regulations to prohibit practice of 'franking'.

10. Death grant - increase to realistic level?

[Consultative document about death grant published 3 March, deadline for comments 30 July.]

Social Services Secretary grateful for comments received on consultative document on death grant published in spring and is considering them carefully.

ALTERNATIVE PROPOSALS BY OTHER PARTIES

11. Cost of social security proposals in 'Labour's Programme 1982'?

[Proposals include raising single/married pension to one-third/half of average earnings; reducing pension age to 60; increasing Child Benefit to £7.75; paying unemployment benefit for men, without limiting duration, at rate equal to RP.]

Cost of implementing Labour's proposals in full probably over £20 billion in full year - an increase of over 60 per cent in social security programme. Labour proposes revenue increases to finance changes of less than £4 billion (abolition of married man's tax allowance and of upper earnings limit of contributions). To raise remainder would require, for example, rise in employee's NIC from 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

12. SDP proposals?

See D8-9.

H FISCAL POLICY AND THE PSBR

1. Progress on fiscal policy?

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

Have made progress; Government has succeeded in reducing PSBR as percentage of GDP, and further reduction is projected. Inflation has fallen fast and is expected to fall further (see K2-3). Long term interest rates now lower than at any time in last 9 years. Benefits seen in recovery of debenture market. [IF PRESSED: Government would like to see rates lower still, so long as further reductions not likely to endanger progress or inflation.]

2. How does UK fiscal stance compare with other countries?

[IMF Annual Report noted that among major industrial countries by far the largest 'restrictive shift' over past two years, equivalent to more than 3½ per cent, was that of UK.]

Many countries reducing borrowing; UK budget deficit now well below average of OECD countries. France demonstrates problems with reflation option and US experience shows that fiscal and monetary policy must be broadly consistent.

3. CGBR in October?

[CGBR in October published 9 November, was £0.9 billion: CGBR April - October £6.5 billion].

CGBR outturn to end-October consistent with IAF PSBR for 1982-83 of £9 billion.

4. Why 1982-83 PSBR now expected to be lower than FSBR forecast?

[1982-83 FSBR forecast £9.5 billion. Industry Act Forecast (IAF) published 8 November £9.0 billion.]

It is only slightly lower, particularly in context of plus or minus £2 billion forecasting errors at this time of year. North Sea tax receipts are now higher and local authorities' capital expenditure lower than thought at time of FSBR. Some factors went other way: e.g. local authorities' over-spend on current expenditure.

5. How can Industry Act forecast of £9 billion PSBR in 1982-83 be reconciled with seasonally adjusted outturn for first half of year?

[Seasonally adjusted, PSBR April-September £3.0 billion. Commentators may multiply this by two to get £6 billion as PSBR figure for year as whole.]

It would be wrong to multiply seasonally adjusted half-yearly outturn by two as there are many erratic and irregular influences in the underlying data which seasonal adjustment does not pick up (nor is it meant to).

[IF PRESSED: what factors will increase PSBR in rest of year?

Public corporations expected to borrow more in second half of year than their £0.4 billion to end-September; there are a number of outstanding public sector pay awards which have not been implemented (eg nurses); National Insurance up-rating of 11 per cent, higher than present rate of inflation, will affect second half of year.]

6. Why treat PSBR as crucial statistic when prone to very substantial forecasting error?

[Margins of error are wide: plus or minus £4 billion.]

Although forecasting PSBR is hazardous, this in no way diminishes importance of achieving better balance between Government spending and income. Recognised by all Governments, whatever the difficulties of forecasting.

[CONFIDENTIAL NOT FOR USE: recently-decided measures on revenue and expenditure are intended to make PSBR £1¼ billion higher than it would have been otherwise. IAF allows for this.]

7. PSBR seriously undershooting and Government has been forced to inflate the economy?

Government does not control the PSBR out of a wish to wear a hair shirt. Chancellor said in Mansion House speech [22 October] that PSBR seemed to be undershooting; in light of this Government has decided to take further worthwhile measures to help industry and in other ways, e.g recent housing announcements by Environment Secretary.

8. Why then hasn't Government acted to get PSBR back to £9½ billion?

PSBR forecasts not precise targets - would not make practical sense to fine tune in that way. Must also remember margins of error in forecasting PSBR (see Q6).

9. Why has Government cut PSBR for 1983-84?

[IAF figure of £8 billion for 1983-84 compares with £8½ billion in this year's MTFS.]

PSBR figures in IAF and MTFS for 1983-84 are not targets. The actual plan will depend on judgement taken in next Budget. Both PSBR figures are same percentage (2¾ per cent) of money GDP. Reduction in money GDP forecast since March merely means that this implies £8 billion rather than £8½ billion.

10. More than £1 billion available for tax cuts next year?

[IAF showed fiscal adjustment of £1 billion for 1983-84, subsequent Press speculation has suggested more scope for tax cuts].

PSBR figures in Industry Act forecast illustrative, not targets. Final decisions about PSBR and tax cuts planned for 1983-84 will be made at Budget time, not before.

11. Cyclically adjusted PSBR better guide to policy?

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

12. Inflation-adjusted or 'real' PSBR in surplus - isn't fiscal policy too tight?

['Real' PSBR subtracts from actual PSBR erosion by inflation of real value of Government debt. Calculations by Bank of England and others produce a surplus 'real' PSBR in most years since the 60's].

No. Fall in inflation has raised the 'real' PSBR (because the 'inflation tax' is reduced). Real PSBR is interesting indicator but poor guide to setting policy e.g. suggests raising PSBR when inflation accelerates.

J MONETARY AND FINANCIAL POLICY

1. Monetary growth in 1982-83 on target

[Provisional money figures for October published 9 November heavily distorted upwards by oversubscription for STC. Bank gave more prominence to their estimates of underlying increases. Target aggregates M1 £M3 and PSL 2, adjusted for STC distortion, grew by ½ - 1¼, ¾- 1¼ and ¾ - 1¼ per cent respectively in banking October. Implied rates of growth in 1982-83 target period were 9-10½, 11¼ and 8¾-9¾ per cent per annum respectively, compared with target range of 8-12 per cent (all figures seasonally adjusted).]

Estimated rates of growth in target period are within Government's 8-12 per cent range for M1 and PSL 2 and at top end of range for £M 3. But looking also at behaviour of exchange rate and progress in reducing inflation, overall picture is of sound domestic monetary conditions.

2. Adjustment for STC attempts to cover up large October increases?

Distortion to recorded October money figures by STC effect was widely anticipated in the City. The clearing banks' own statement consistent with that of Bank of England. Nothing to be gained by covering up as distortion will correct itself in figures for later months.

3. Prospects for further reductions in interest rates?

[Last reduction in bank base rates made on 4 November - to 9 per cent. Have come down by 7 points since peak in October 1981. Long term interest rates also reduced significantly -by one point in October alone - 6 points since peak last year.]

Substantial interest rate reductions this year reflect sound monetary conditions, and good inflation prospects. Impulse also from US developments. Government would like to see rates lower still, so long as further reductions do not seem likely to endanger progress on inflation.

4. Benefit of interest rate falls to home buyers

[Mortgage rates have fallen 5 percentage points since this year's peak in March. Latest cut to 10 per cent comes into effect for all home buyers on 1 December.]

Mortgage rate falls including latest cut mean for average couple buying first home net saving of over £50 a month since March.

5. Effect of US interest rates on ours?

[US rates fell substantially during July/August, and again in October.]

The falls in US rates were helpful and facilitated reductions in our own. But of course US rates are not sole determinant of UK's, and this spring progress was made in reducing ours at a time when US rates were rising. UK rates are determined in the light of domestic monetary conditions generally, including the behaviour of the exchange rate.

6. Monetary conditions too tight - stifling recovery?

No. Behaviour of exchange rate and money supply suggest financial conditions moderately restrictive, as intended. Interest rates reductions have cut companies' costs and should promote climate for investment. Have given boost to corporate bond market - reducing companies' dependence on banks and easing pressure on monetary growth.

6. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by £1.3 billion in banking August and £2 billion in September (seasonally adjusted).]

Reasons for growth of bank lending to companies not entirely clear. Companies may be trying to build up gross liquidity levels which fell back in spring. Strong growth in personal lending is partly result of structural changes, such as move by banks into home loans market, replacing lending by building societies; ending of HP controls in July does not appear to have had a large effect. To the extent that increases in bank lending are additional, ie not just in substitution for lending by eg building societies, do represent potential cause for concern, as add to monetary growth. To be taken into account in interest rate policy.

7. Prospects for reactivation of corporate bond market?

[Tax treatment of 'zero coupon' and 'deep discount' stocks and removal of embargo on company issues of this type of stock announced 25 June. BOC announced issue of £100 million conventional bond 10 September, followed by other companies.]

Zeros broaden options available to companies, though not expected to transform capital market. Best hopes for resurgence of market provided by lower interest rates and inflation, for which we are on course.

8. Why has Bank of England been providing such large-scale money market assistance?

The rapid growth of bank lending has caused problems for conduct of monetary policy. By selling long-term Government debt on a larger scale outside the banking system, it has been possible to contain the rapid growth in money which could otherwise have taken place. This in turn has created shortages of liquidity in money markets. If Bank had not intervened, short-term interest rates would have been forced up to unnecessarily high levels.

9. <u>What is significance of National Loans Funds surplus with Banking Department in week ended 29 October? Result of over-funding?</u>

[A balance is accumulated at the Banking Department of the Bank of England when flows into NLF exceed flows out and there are no further Ways and Means Advances borrowed from the Issue Department to be repaid]

Need for a balance reflects many factors. Major ones have been low Government borrowing requirements earlier in year together with continuing sales of Government debt, and underlying decline in the reserves (recently reversed in part). Flow of debt sales of all kinds have been high in recent months but by no means exceptional, having regard to level of bank lending..

K PRICES AND EARNINGS

PRICES

1. October RPI

[Year on year increase in RPI 6.8 per cent in October, compared with 7.3 per cent in September].

Annual rate of inflation again fell sharply in October to 6.8 per cent, its lowest level for 10 years (compared 6.6 per cent in October 1972).

2. How low inflation by end 1982?

We expect inflation to be at or below 6½ per cent by end 1982.

3. Further falls likely in 1983?

We expect inflation to be down to 5 per cent by next spring.

4. Inflation turning up again next year?

We have forecast a figure of 5 per cent for price increase over the year to next autumn (fourth quarter 1983). Further falls in wage settlements this pay round and continued productivity growth should enable low rates of price increase to be maintained during 1983, even with some rebuilding of profit margins.

5. No decline in inflation between spring and autumn 1983?

[Mansion House speech: 5 per cent by spring. Industry Act forecast: 5 per cent in fourth quarter 1983.]

Obviously we cannot expect to maintain the very rapid progress on inflation which is now being made. What we will maintain are the policies which have given us this success; confident that they will keep inflation down.

6. Inflation lower than under previous Government?

[Average year-on-year rate of inflation between February 1974 and May 1979 was 15.4 per cent; average level of inflation since May 1979 has been 12.7 per cent.]

Year-on-year rate of inflation was 10.3 per cent and rising when previous Government left office in May 1979. Now (October 1982) 6.8 per cent and falling. We will be first Government for quarter of a century to achieve a lower average rate of inflation during its term of office than the previous Administration.

7. Inflation still not as low as competitors?

[September figures UK inflation 7.3 per cent compared with 5.0 per cent in US, 4.9 per cent in West Germany, and 3.2 per cent in Japan.]

UK inflation now lower than Western European (OECD Europe) average, and well below many countries - such as France and Italy. Still some way to go to match US, West Germany and Japan, but good progress being made in right direction.

8. Long term inflation objective?

Recent developments encouraging. But inflation rate still higher than some competitors e.g Germany. Must not let up. Have always made it clear that price stability not unattainable.

9. TPI now shows pay increases need to be ½ per cent higher than RPI to maintain living standards?

[Increase in TPI over 12 months to October 7.4 per cent, compared with RPI increase of 6.8 per cent].

The gap between the RPI and the TPI (now 0.6 percentage points) widened in July when benefits paid to the unemployed became taxable. Pay increases go to people in work, who will not pay any more tax as result of the change - except for the minority who have a spell of unemployment during the year.

10. Nationalised industry prices

[Increase over 12 months to October 15.1 per cent, compared RPI increase of 6.8 per cent].

Increases regrettable, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position has been improving steadily for past year or so. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also Section R).

PAY

[NB: GAD Report published 8 November includes assumption that average earnings in 1983-84 6½ per cent higher than in 1982-83.]

11. What pay settlements does Government now want?

Low enough to be consistent with improved job prospects in the industry concerned. The lower the better. Certainly lower than in the past year.

12. What has been average over past year/pay round?

[CBI Databank suggests 7 per cent average for manufacturing in last (1981-82) pay round.]

Average has been in single figures, and moving downwards, in each of past two years. We need a substantial further reduction, with really low settlements, and thus a better outlook for jobs, in the year ahead.

13. Pay settlements failing to come down?

[FT article (1 November) and November Incomes Data Services Report suggest pay settlements still averaging 7% in spite of falling inflation.]

Too early to say. Few settlements so far this autumn. But in everyone's interest that pay settlements should come down, and come down sharply.

14. A 3½ per cent pay policy?

The 3½ per cent pay assumption [announced 1 October for calculating the pay element in cash expenditure plans for 1983-84] does not represent a 'norm', still less an 'incomes policy'. Nor is it a decision on the offer to be made in any individual case. Settlements higher or lower than the assumption are not ruled out. Each case will be considered on merits.

15. Government exhortations on pay imply aiming to cut living standards?

[Real earnings show little variation over past two years; August 1982 broadly similar to August 1981 and about 1 per cent higher than August 1980.]

Low pay increases do not necessarily mean a reduction in living standards. But whether they do or not, they are essential if we are to create a competitive and profitable productive sector, and thus secure the conditions for sustained improvement in living standards.

16. 1982 New Earnings Survey shows public services falling behind?

Taking account of the effect of overtime on those working in the private sector, and public service settlements which were delayed beyond the Survey date, difference shown between public services and private sector pay movements over period covered by April 1981 and 1982 Surveys no more than 2 per cent.

17. Average earnings index

[Year on year growth 7.8 per cent in August compared with 10.9 per cent in July, but August index artificially low because of large amount of civil service back pay paid in August 1981. Underlying increase about 9 per cent in both July and August.]

Encouraging that underlying rate of growth continues to fall. Further moderation in settlements can only be helpful in maintaining jobs and getting inflation down.

18. Incomes Policy

Proposals for incomes policies, including recent refinements, do not avoid many of the familiar problems of norms, administrative costs, and interference with market forces. Experience gives no encouragement to the idea that incomes policy can be made to work on a permanent basis. They always succumb to the distortions they create.

19. Top Salaries Review Body increases too large?

[Government announced on 12 May increases of 14.3 per cent for senior civil servants and senior members of armed forces, and 18.6 per cent for judiciary.]

Government believes these increases are fully justified. Essential to ensure adequate supply of candidates of sufficient calibre for the Bench, and to provide adequate career structure and differentials in higher levels of civil service and armed forces. Before the increases, TSRB were the only group whose salaries were below those recommended for April 1980.

20. Performance-related pay for nationalised industry board members?

This is an attractive concept. Practicalities and implications of it are being studied jointly with representatives of the Nationalised Industries' Chairmen's Group, at Government's initiative. Individual boards are free to make proposals of this kind for their own circumstances.

21. Pay increase for nationalised industries' boards this year?

No general level of increases for board members this year. Proposals for each board are being considered individually on their merits, in light of circumstances of the board.

22. Index-linked pensions and Scott report?

Question debated in House of Commons 22 October, when Government announced they favoured Megaw Committee suggestion that civil service pension scheme be made contributory. Reduction in inflation has greatly eased disparity between private and public sector pensions; Government's main aim at present is to ensure appropriate contributions are paid for index-linked benefits.

L BALANCE OF PAYMENTS

1. Trade figures and current account

[September trade figures show trade account in broad balance though non-oil trade remains in deficit; invisibles surplus of £260 million a month in Q2 and projected £200 million a month in Q3. Cumulative current account surplus of £2.6 billion in nine months to September. IAF shows zero current account balance in 1983.]

Current account remains in substantial surplus, albeit reduced from last year's levels - current account surplus for 1981 was £6 billion.

2. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports in September from the erratically low August level but underlying level of non-oil exports has probably fallen since the spring. To a large extent this appears due to world recession; world trade in manufactures has probably fallen in 1982-83 - first year-on-year fall since 1975.

3. Export trends last few years?

Growth in UK exports of manufactures significantly below world trade growth over 1977 to early 1981, when competitiveness worsening, but with improvement in competitiveness since then, our share appears to have stabilised.

4. Import trends

Manufactured imports increased in September but there has been little, if any, growth in underlying level of manufacturing imports since end-1981. Manufacturing output has fallen back a little this year, so there has probably been some continued growth in import penetration, although not at anything like same rate as in 1981.

5. New import controls on way?

[Continuing Press speculation].

We are concerned at the extent of unfair trading practices and the damaging effect of very high tarriffs and quotas in some other countries. But wish to make clear, as Chancellor said recently [Caterham 22 October] that 'we will be continuing to defend the open trading system'. A free and fair trading system is in the interest of all trading nations.

6. Overseas investment takes jobs away from UK?

30 per cent of UK exports are bought by overseas firms connected with UK companies. By increasing links between UK and overseas companies, overseas investment helps UK exports

and production, so producing more jobs. If UK does not take profitable opportunities to invest overseas, others will.

M EXCHANGE RATE AND THE RESERVES

1. Policy towards the exchange rate/falling £?

[The average £ effective rate in Q3 1982 was nearly 10 per cent lower than in Q1 1981. In last few months £ has remained broadly stable. Lately £ has been strong in effective terms although it has lost ground against the stronger dollar. Rates at noon on 12 November were $1.6530 DM 4.786 and an effective of 91.3. Previous lows were $1.6476 on 29 November 1976, DM 4.098 on 21 May 1982. Highs were $1.97 on 30 November 1981, DM 4.407 on 9 February 1982. Reserves at end October stood at $18.5 billion, compared with $18.3 billion at end September.]

Government has no target for exchange rate. The exchange rate is only one of the factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. Sterling's effective exchange rate has continued to show the broadly stable pattern of recent months. This stability reflects the continuing international confidence in this Government's economic policies.

2. Why not improve UK competitiveness directly by bringing exchange rate down?

First of all, Government's ability to influence exchange rate very limited; developments in other countries critically important; domestic rate decisions must reflect overall judgement about monetary conditions, in which exchange rate only one element. Industry itself has mixed views about desirability of bringing the rate down (Illustrated at CBI Conference in October). Moreover, exchange rate depreciation only offers at best a breathing space. UK's problems caused by failure to contain costs (effective rate only 5-6 per cent above level in May 1979 but cost competitiveness some 26 per cent worse). Only long term solution is lower costs (via lower wages/higher productivity).

3. Influence rate differentially as against DM/yen and dollar?

Could only do so by depressing value of dollar against DM/yen. Over recent months both German and Japanese authorities have indicated that a desirable end but one which they are powerless to achieve. Dollar/DM and dollar/yen exchange rates are even less within power of UK authorities to influence.

4. Bank of England intervention?

Policy is unchanged. Bank do intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But, as Chancellor has already stated, we have no target - undisclosed, secret or otherwise - for the exchange rate. Most recent reserves figures confirm that policy is unchanged.

5. Debt repayments

We have made excellent progress with our plans to reduce the burden of external debt substantially during this Parliament. We aimed to reduce official external debt to $14 billion by end of 1981. This has been more than achieved - external debt is now around $13 billion, compared with over $22 billion when the Government took office.

N EUROPEAN MATTERS

MEMBERSHIP OF EUROPEAN COMMUNITY

1. UK budget settlement

Foreign Ministers agreed on 25 May to a settlement for the UK budget contribution for 1982. The settlement provides for a basic refund of about £470 million in respect of 1982, with provision for changes to this figure if our unadjusted net contribution varies from the Commission estimate of £880 million. It was also agreed that the problem for the longer term would be settled by the end of November.

2. Implementation of budget settlement

Final agreement was reached by Foreign Ministers on 25/26 October. Although the UK will not now be fully compensated for our contribution to German refunds, we shall receive our 1982 refunds of 1,092 millionecus, about £600 million gross, much earlier than originally envisaged. Payment will now be made before the end of December this year rather than in March next year or later - a significant improvement for the UK.

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?

We hope very much that the issue of our Budget contributions can be satisfactorily settled without the need for recourse to such a step.

5. Commission's ideas for changes to 'own resources' system

Understand that Commission are considering measures to diversify Community's revenue sources. If they put forward proposals we will consider them. Our opposition to any increase in the 1 per cent VAT ceiling is well known.

6. Policy for CAP reform

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

7. Costs of CAP to UK consumers

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.

EUROPEAN MONETARY SYSTEM

8. 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.

9. Join the EMS for exchange rate stability?

There is no reason to suppose that by the simple act of joining the EMS exchange rate mechanism we would guarantee exchange rate stability. This has not been the experience of the current participants. Genuine stability requires a return to low inflation rates throughout the Community.

P INDUSTRY

1. Effect of NIC and NIS changes on private sector employers?

[Chancellor announced further reduction of 1 percentage point in National Insurance surcharge for 1983-84, cutting the rate to 1½ per cent; also half of the 1 percentage point reduction in the rate next year will be brought forward into the current financial year. Effect will be as if private sector had paid at 2 per cent rather than 2½ per cent (rate announced in 1982 Budget) during 1982-83. Small increase in employer's NIC as from April 1983 also announced on 8 November (see G: NI contributions.]

The special reduction in NIS is worth about £350 million to private sector employers this year, and the announced NIC and NIS changes taken together will benefit them by over £400 million next year. Constitute a substantial reduction in the costs faced by private sector commerce and industry.

2. How does this compare with burden as at May 1979?

Private employers will pay around £1 billion less next year than they would have done under the rate of NIS and employers' NIC inherited from the previous Administration.

3. Won't contracted-out employers be worse off?

No; their combined rate of NIC and NIS falls by 0.35 per cent next year. [Reduction of contracted-out rebate was announced last March, so not part of Autumn Statement, but included in this calculation.]

4. Prospects for industry-recovery?

See A2-4 and Section B.

5. Companies' financial position?

[

£bn

	1979	1980	1981 Year	H1	H2	1982 H1
Net borrowing requirement (+)/repayments (-)	+6.3	+6.5	+5.1	-1.5	+6.6	+5.6
Financial surplus (+)/deficit (-)	-2.9	-1.4	+1.8	+1.0	+0.8	-1.3]

Financial position of industrial and commercial companies (excluding North Sea) improved last year, relative to 1979 and 1980. Improvement in part reflected companies' efforts to cut costs, for example by de-stocking. Some apparent deterioration in second half 1981 financial position due to slowdown in de-stocking and unwinding of delays in tax payments because of the civil service dispute. Figures for H1 1982 suggest reduction in companies' borrowing requirements relative to H2 1981; but borrowing needs still high.

6. Profits rate of return still too low?

[Gross trading profits of industrial and commercial companies (ICCs) (net of stock appreciation) rose 18 per cent to 1982 H1; but increase was from a very low base ICC's real pre-tax rate of return (except North Sea was just over 3 per cent in 1981, and only 2 per cent in manufacturing - half previous cyclical low figure in 1975.]

Government can help best by getting inflation down and setting sound basis for sustained recovery. Fundamental improvement in ICC's rates of return depend on better performance by companies. Some encouragement from recent productivity gains and trend towards moderate pay settlements.

7. Real rates of return on capital lower in UK than elsewhere?

[OECD statistics comparing UK, Japan, France and UK show net rates of return to fixed capital in non-financial corporations in 195-80 lowest in UK - though all on a downward trend. 1980 figures: US 13 per cent, Japan 15 per cent, France 9 per cent, UK 5 per cent.]

Figures show how policies of earlier administrations have allowed profitability to slide in UK. Sound basis for sustained recovery rests on reducing inflation, increased productivity gains, and moderation in pay settlements which creates conditions for better performance by companies.

8. High interest rates damaging for industry and investment?

Banks' base rates have fallen 7½ percentage points since last October, and 3½ points over last three months. Outside analysis suggests that a 1 per cent reduction in interest rates improves the net financial position of the company sector by about £250 million over a full year. Lower interest rates reflect Government's firm fiscal and monetary stance and will help industry and investment.

9. Lower rates for industry?

De-rating one of a number of possible ways of assisting industry and business, but in last Budget preference given to other forms of relief, notably reductions in NIS. De-rating would be expensive, though less so if applied to industry alone - even so, 10 per cent de-rating would cost about £140 million per annum. Legislation would be required.

10. Lower energy prices

See R2-3.

11. Government help for small firms

Budget provided further help for small businesses, increasing the number of measures taken so far to over 100. Enterprise package included further reduction in weight of corporation tax; further increases in VAT registration limits; increase in global amount available for loans under Loan Guarantee Scheme (see below); and doubling of investment limit under Business Start-Up Scheme to £20,000 a year. New measures will encourage start-ups and existing firms.

12. How many new firms starting up?

[Correspondence in progress between Treasury and D Industry about value of giving 'net' figures of 'birth' of minus 'deaths' of companies based on VAT registrations.]

On a very rough average some 10,000 new companies come into being every month.

13. Response to Loan Guarantee Scheme?

[Over 6,400 guarantees already issued - about half to new businesses. Total lending under scheme around £215 million. Budget provided for lending ceiling in first year (to May 1982) to be raised from £100 million to £150 million and for further £150 million to be available in second year (to May 1983). Thirty financial institutions now participating.]

Scheme operating successfully. Too early to assess overall cost . After first year, out of over 6000 guarantees issued, only 150 have so far been 'called'. Cost has been covered by the premium income received over the period. Scheme is kept under continuous review.

14. New enterprise zones

Chancellor announced Tuesday 27 July eleven new Enterprise Zones to be created: 7 in England; two in Scotland; one each in Wales and Northern Ireland. Applications from local authorities in all four countries for sites in their areas to be designated now being considered. (53 applications in England).

15. First group of enterprise zones

All first eleven zones now in operation. 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.

16. Is is true that a committee has been set up to consider changing basis of regional assistance?

[Report in FT 25 October.]

Regional policy is, like other Government policies, continually open to scrutiny in case improvements can be made. [IF PRESSED: But cannot comment on precise details of official committees.]

R NATIONALISED INDUSTRIES

NATIONALISED INDUSTRY PAY AND PRICES

1. Nationalised industries' prices

[Having risen approximately in line with retail prices for several months, the latest figures show bigger 12 months increase in nationalised industry prices, water charges and London Transport fares than all items RPI (15.1 per cent in October compared 6.8 per cent). This differential reflects March increase in LT fares. Removal of these temporary distortions confirms that nationalised industry prices are still increasing somewhat faster than RPI, largely because of increases in energy sector.]

Gap between nationalised industry price increases and RPI has been due in large measure to cumulative effect of years of artificial price restraint. World oil price rises of 1979 and 1980 have also played an important part. We greatly regret the need for these increases, but holding prices down artificially would distort market forces and add to burden on taxpayer. Underlying position better than it was. The differential between RPI (all items) and NI prices (including water charges and London Transport fares) is now currently about 8 per cent compared with 14 per cent in January 1982. But sustained improvement will only be possible if the industries succeed in holding down their current costs, particularly pay.

2. Freeze on industrial gas prices?

[BGC announced 8 Nomvember that freeze on renewal prices for contract gas due to expire at end of year would be extended for further nine months].

Government welcomes BGC's decision to freeze industrial gas prices for a further nine months from the end of this year. Decision was taken on purely commercial grounds - BGC judge that they can accommodate the freeze within their present EFL.

3. Electricity prices?

As announced by the Secretary of State (for Energy and for Scotland) on 12 November, electricity prices will not, on average, be increased at all in 1983. This is consistent with the EFLs announced 8 November. The standstill follows the recent review of the bulk supply tariffs.

4. What is Government doing to improve nationalised industries' efficiency?

We continue to press for greater efficiency within NIs. We are setting realistic financial targets and performance aims. A rolling programme of Monopolies and Mergers Commission investigations has been set up. The introduction of market forces provides greatest incentive to efficiency.

5. Nationalised industry boards' pay?

See K 20-21.

INVESTMENT

6. Nationalised industries' investment should be stepped up to/improve infrastructure/provide orders to private sector/as boost to economy

Government has not prevented the industries from carrying forward a large number of profitable investment programmes. It would be wasteful to provide funds for public sector projects with lower returns than those in the private sector. Unfortunately, the pre-tax rate of return on nationalised industries' capital (including subsidies) in 1980 (latest available figures) was minus one per cent, compared with 3 per cent for industrial and commercial companies.

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

As in private sector, moderate pay settlements and control of other costs are essential. Ability to finance new investment in nationalised industries bound to diminish if excessive pay ~~settlements~~ agreed. Each 1 per cent off wages saves about £140 million this year; and each 1 per cent off total costs saves £330 million this year.

8. Take nationalised industry investment out of PSBR?

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

9. Private finance for NI investment?

In discussions in NEDC and elsewhere, we have indicated our willingness to consider new financing proposals, provided they can be structured so as to induce improvements in efficiency at least sufficient to offset the extra cost, and provided the finance is raised in fair competition with the private sector.

10. Investment plans unlikely to be attained?

[Letter has been sent by PM to chairman of Nationalised Industries' Chairman's Group stressing importance of maintaining NI investment programme: £900 million underspend 1981-82, £500 million expected underspend 1982-83.]

No Government can unconditionally guarantee a particular level of investment by the nationalised industries. NI planned investment for 1982-83 26 per cent higher than estimated outturn 1981-82. Some signs plans may not be fulfilled. Events outside industries' control may cause investment plans to be revised downwards. PM has made it clear that industries should make full and proper use of their allocation.

EXTERNAL FINANCING LIMITS

11. EFLs for 1982-83

Nationalised industries' total external finance increased by £1.3 billion in 1982-83 (£1.2 billion after allowing for NIS cut and other changes). Increase in 1982-83 was roughly half what the industries bid for. Government has given full recognition to problems faced by the industries in a period of recession.

12. EFLs for 1983-84?

Nationalised industries EFLs for 1983-84 announced in Autumn Statement. Overall, external finance in line with previous plans. £2.7 billion being made available to nationalised industries in 1983-84.

PRIVATISATION

13. Special asset sales in 1981-82

Gross sales in 1981-82 totalled £481 million, so target published in 1981 Public Expenditure White Paper of £500 million nearly met. Pleasing result - included two large sales - Cable and Wireless (£182 million) and Amersham International (£64 million). True that delivery of BNOC oil in 1981-82 paid for in 1980-81 and taken into account in special disposals figure for that year reduced 1981-82 receipts by £573 million to total of -£92 million. But it is gross figure which is true measure of success of Government's privatisation programme. As Chancellor said in Cambridge 3 July, 'Public utilities and the so-called "natural monopolies" cannot be allowed permanently and without challenge to remain within State ownership'.

14. What further sales expected?

Special sales of assets in 1982-83 forecast at around £600 million and expected to increase in subsequent years. This year's and next year's involve primarily very large sales of energy assets - Britoil and the British Gas Corporation's major offshore oil assets - made possible by Oil and Gas (Enterprise) Act (which received Royal Assent in June). Industry Secretary announced 19 July plans to sell 51 per cent of British Telecom - but not before next Election.

15. Why sell Britoil?

[In 10 November statement Energy Secretary announced offer for sale by tender of 51 per cent of Britoil shares. Special arrangements made to encourage small investors and employees to apply. Shares underwritten at minimum tender prices of 215p per share. Payment in two instalments: first instalment of £1, with balance next April].

Sale will create an independent British oil company free to seize opportunities. Will substantially reduce size of public sector in area where State ownership has no justification whatever. Will allow public to take direct personal stake in North Sea.

16. Wrong time to sell Britoil?

[Slump in Shell profits and cut in prices by Indonesia reported 12 November].

Absolutely no reason to believe that could have obtained a better price by delaying sale. FT actuaries oil share index 17 per cent higher at time offer announced than when decision to sell announced last year.

17. Why a tender?

Choice between tender and fixed price offer considered carefully. Right in these particular circumstances for price to be tested by market. And a tender allows price to take into account movements in market during period of offer for sale. A novel approach for sale of this size. But objective is to get fair price for taxpayer.

18. Government has sold assets too cheap?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded.]

Not in Government's interest to see shares underpriced, given the loss to the PSBR, but also risks in pitching price too high. Getting balance right not easy - especially when company's shares have not previously been traded. Government will continue to consider alternative forms of sale eg tender, but critics should note that sale by tender could make it harder for small investor to buy shares.

19. Contribution to giving people satisfaction of property ownership?

Exercise of returning enterprises from State ownership to ownership by the public has included measures to promote employee share ownership in the enterprise they work for; for example free offers of shares (British Aerospace, Cable and Wireless, Amersham); preference in allocation of shares (B Ae, C & W, Amersham, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company.

S NORTH SEA AND UK ECONOMY

1. New forecast of North Sea revenues?

[Autumn Statement (Industry Act forecast) projections (in money of the day) of Government revenues from North Sea: £6½ billion in 1981-82, £7 billion in 1982-83, £7½ billion in 1983-84. Higher than 1982 FSBR projections, partly because of higher production, partly higher oil prices].

Must remember that oil revenue projections are crucially dependent on inherently uncertain cost, price and production assumptions. Prospects for North Sea tax receipts have improved since 1982 FSBR published because of higher than assumed oil prices and production. New projections assume oil prices do not change much from present levels.

2. Onerous tax system damaging future field developments?

[Shell/ESSO have shelved plans for Tern partly because of tax system; Phillips postponing T-block complex and BP their Andrew field; BP statement issued with their interim results criticised fiscal regime.].

Other adverse factors - falling oil prices earlier this year; high development costs - much more important. Detailed study has shown that under new tax structure, levels of profitability should still be sufficient to make exploration and development attractive. Hope that present structure will provide more secure and stable tax regime.

3. Government about to relax North Sea fiscal regime?

No decisions have been taken, but fact-finding discussions taking place with UKOOA and individual oil companies. Government wishes to give oil companies every opportunity to present their evidence about profitability in the North Sea. The regime is kept under review.

4. Taxation of petrochemical feedstocks

[Government has announced that new rules on valuation of ethane for petrochemical use in interaffiliate transfers (Finance Act Section 134) should be extended to mixed streams of gas with a large ethane component. ICI complain that the extension and the rules themselves give unfair advantage to their integrated oil company competitors and have taken out writ against the Government.]

Government convinced that new formula will give fair valuation. New valuation will not have effect of providing subsidy to ICI's competitors. Have done best to reassure ICI. Will resist ICI's legal action.

5. Government should do more to promote UK Continental Shelf oil production in 1990's?

[Select Committee on Energy's Report on Depletion Policy published 18 May: emphasised development of fields entering production in 1990s by increasing pace of licensing rounds and overhauling fiscal regime. Recommended reserve powers to impose production cuts. Energy Secretary and Chancellor replied in joint memorandum on 29 July].

HMG agrees with general conclusions encouraging North Sea exploration and development, thereby maximising economic oil production over time; eg decision recently announced not to impose production cuts before 1985. Agree uncertainties in oil markets too great to justify deferring new field developments in foreseeable future. Cannot accept Committee's criticism of North Sea fiscal regime - opposed to another fundamental review; industry does not want a structural upheaval.

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

[Contribution of North Sea to GNP estimated at 4 per cent of GNP in 1981. Not projected to rise significantly before 1985.]

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 lower level of interest rates to benefit of industry and economy as a whole. Without North Sea revenue other taxes would be higher or public expenditure lower. But keep revenues in perspective. Less than 6 per cent of total General Government receipts in 1981-82.

7. North Sea revenues should be channelled into special fund?

North Sea revenues are already committed. Setting up special Fund would make no difference. More money would not magically become available.

8. Future North Sea oil prices?

A matter for commercial negotiation between oil companies and BNOC.

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

We are better off with oil - at current oil prices - than we would have been without it. 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.

T WORLD ECONOMIC DEVELOPMENTS AND INTERNATIONAL FINANCE

1. Prospects for world recovery?

[IMF, London Business School and Bank of England Quarterly Bulletin all gloomy about immediate prospects. No overall growth seen in major countries in 1982, and only weak recovery next year. Press reports suggest OECD will also revise its previous forecasts downwards this autumn.]

Output in the major economies appears to have recovered slightly in the spring after the downturn last winter. US economy grew slightly in both Q2 and Q3. The major European economies, however, remain depressed, and it is too early to say that a broad upturn has started. Lower inflation and interest rates however offer prospects for better growth next year.

2. Why don't major industrial countries together expand demand?

Leaders of the major countries agreed at the OECD, Summit and IMF meetings on the need to continue the fight against inflation. As the OECD's Economic Outlook explains, Governments are convinced 'a significant part of any stimulus to demand would increase public sector deficits, and dissipate itself rather quickly as an increase in inflation'.

3. Anti-inflation policies are working

[Consumer price inflation down from a year ago in all 7 major economies on latest available figures: US (from 11.0 to 5.0 per cent), UK (11.7 to 6.8 per cent), Japan (3.8 to 3.1 per cent), Italy (18.3 to 17.2 per cent), Canada (12.5 to 10.4 per cent) France (13.9 to 10.1 per cent), Germany (6.5 to 4.9 per cent).]

Inflation has fallen in all major countries in the past year. Firm fiscal and monetary responses to 1979-80 oil price rise vindicated. UK close behind US and Germany in bringing down inflation, and ahead of some other European countries. Realism in wage settlements is growing; US, Germany and Japan all have wage settlements in single figures.

4. Cuts in public expenditure in other countries?

[Many countries seeking economies. Countries planning to curb public sector pay and costs include Germany, France, Japan, Canada, Belgium and Denmark. Also Germany, France, Canada, Belgium all plan to make economies in welfare programmes.]

UK not alone in facing up to hard decisions. Coming to power of goverments committed to curbing public spending in UK, US, Norway, Denmark and now Germany suggests increasing awareness of need to reduce it.

5. International financial collapse?

Concern about effects of over-borrowing noted at Toronto IMF meeting. But should not exaggerate alarm. Important of course to sustain system's stability. Lower interest rates should help, as should IMF programmes to restore countries' credit-worthiness. Further progress needed on banking supervision including risk assessment and prudential standards; also watertight allocation of supervisory responsibilities.

6. What about US ideas for emergency IMF assistance to countries heavily indebted to the international banking system?

The IMF must certainly be endowed with the resources it needs to carry out its present role. There is widespread agreement that a substantial increase in its quotas is necessary. Its resources may need to be supplemented even further. The US ideas are only among a number which need to be studied carefully.

7. Another oil energy crisis looming?

[Latest World Energy Outlook from International Energy Agency raises possibility that tight oil market could reappear in late 1980's].

Always difficult to foresee future oil prices. But they are weak at present and likely to remain so in near future. In longer term, energy conservation should permanently reduce countries' dependence on oil.

8. US economy?

[US GNP rose only slightly in Q3 after ½ per cent rise in Q2. Unemployment has risen above 10 per cent. Consumer price inflation has fallen to 5 per cent. Interest rates have fallen 4 per cent since July. Press reports suggest that Federal Reserve only expects growth of 2 per cent next year - lower than forecasts by US Administration and other forecasters].

US output rose slightly in Q3 after small rise in Q2. Still too early to say that a strong recovery is under way, but falls in interest rates and inflation hold out better prospects for growth over the next year.

9. US monetary policy

[US interest rates have fallen and Federal Reserve has reduced its discount rate from 9½ to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead].

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker has made clear that reduction of inflation remains a priority and that monetary targets have not been abandoned.

10. Gloomy prospects for Europe?

[EC Commission Annual Report predicts only 1.2 per cent growth in Europe next year and 10.3 per cent unemployment. Medium-term forecast gives gloomy picture of 1983-87 with growth in EC averaging only 2½ per cent and inflation of nearly 8 per cent.]

Short-term prospects for recovery in Europe weaker than in US or Japan. But budget deficits higher and inflation rapid in many European countries. Note that EC Commission draws attention to need to curb budget deficits and reduce labour costs. Always difficult to see into medium run but improvements in competitiveness, lower inflation and interest rates all offer better prospects.

11. Competitive devaluations

[Recent devaluation of Swedish krona by 16 per cent widely criticised by other Governments. Finnish marka subsequently devalued by 6 per cent. Independent 'wise men's' report on Danish economy suggests withdrawing from EMS temporarily in order to allow 20 per cent devaluation].

IMF rules forbid countries to manipulate exchange rates to gain unfair competitive advantage. Authorities in Sweden will have noted strong objections from her major trading partners. Prosperity of world economy depends on maintaining open and fair trading system. Large devaluations may hinder this, and risk encouraging competitive devaluations by others. [IF PRESSED: IMF is examining Swedish action.]

COMMENTARY ON RECENT ECONOMIC DEVELOPMENTS AND STATISTICS 15 NOVEMBER 1982

Summary comment

Recent financial developments favourable - inflation and interest rates falling - but activity remains flat.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. Outside forecasters expect only a weak recovery next year.

. world commodity prices are at their lowest level in real terms for thirty years;

. oil prices are weak and likely to remain so for the near future;

. consumer price inflation (OECD major 7) around 6½ per cent in September ranging from 17 per cent in Italy to 5 per cent in Germany and 3 per cent in Japan;

. average world 3-month interest rates 10 per cent at 1 Novmber a fall of 4 points since October 1981; US 3 month rate stood at 9 per cent on 1 November; real interest rates remain clearly positive;

. world trade volume has been more or less flat since the middle of last year;

. total industrial production for the OECD Major 7 fell 6 per cent in the twelve months to July; in the US it fell by 9½ per cent in the 12 months to September;

. unemployment (major 7) now 8½ per cent, compared with 6½ per cent in mid-1981.

UK Balance of Payments: non-oil trade balance has deteriorated quite sharply but current account remains in strong surplus this year. But both the loss of competitiveness during 1979 and 1980 and a smaller world market are affecting our non-oil trade at home and abroad.

. OPEC and Third World countries are cutting back on imports because of low commodity prices, high interest rates and debt problems in some countries. UK exports in 1981 Q3 4 per cent down on 1981 H2.

. import volume rose sharply as activity recovered last year and import penetration rose too; imports broadly flat this year.

. the effective exchange rate has been broadly stable since summer 1981; currently 92.0.

Financial Developments

.M1, PSL2 within target range for 1982-83, £M3 towards top of range;

.short term interest rates down 7 points since last October; base-rates down 7 points;

.mortgage interest rates down to 10 per cent, first time since 1978;

.real interest rates have fallen but remain clearly positive (higher real rates are being experienced in the US and Japan);

.CGBR £6.5 billion in 7 months to October, consistent with IAF assessment of £9 billion PSBR for 1982-83.

Inflation

.retail price inflation, 6.8 per cent in year to October. Forecast 6½ per cent before Xmas, with prospect of 5 per cent by spring 1983 and at Q4 1983;

.TPI increase in 12 months to October was 7.4 per cent;

.Wholesale price inflation also moderating; input prices up almost 3½ per cent in year to September; output prices 7½ per cent;

GDP and industrial production

.GDP has been broadly flat since 1981 Q4, as has the underlying level of industrial production; but latter 1½ to 2 per cent above spring 1981 trough largely due to increased oil and gas production; the underlying level of manufacturing ouput only slightly above its trough level.

Demand Components

.consumer spending has remained broadly unchanged since 1979, over period when other components of final demand fell some 4-5 per cent. Some fall in RPDI (see below) offset by lower savings ratio. Retail sales in July -September 2 per cent higher than in spring, partly reflecting abolition of HP controls.

.gross fixed investment fell back by 4 per cent in 1982 Q2 - from a strong first quarter - to a level similar to that in 1981 H1 and 10 per cent below the level in 1979. Manufacturing investment has been weak. Plant and machinery investment, however, has held up.

.the massive destocking of 1980 H2 and 1981 is over but the 1982 Q2 figures show no return to positive stockbuilding. October CBI survey suggests some further scope for destocking in manufacturing;

.government consumption in 1982 H1 was 2 per cent above its level in the same period last year. 1982 Q2 data suggests that the upward trend in volume may be flattening out.

.there has been some fall in the volume of exports in recent months reflecting both loss of competitiveness and the flatness in world trade;

.imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising.

Productivity and Competitiveness

.manufacturing productivity continues to rise strongly - at 6½ per cent annual rate so far this year, following 8½-8¾ per cent last year;

.manufacturers' unit wage/salary costs up less than 6 per cnet in 3 months to August on a year earlier;

.during 1981 external price and cost competitiveness improved around 15 per cent but less than 1½ per cent improvement during 1982 H1.

Company Sector

.ICCs pre-tax real rates of return on capital in 1981 were very low; only 2 per cent in the manufacturing sector. Some slight improvement likely this year.

.after falling in first quarter of 1982 gross trading profits (net of stock appreciation) of ICCs rose in the second quarter by 5 per cent; this follows the strong recovery in 1981;

.non-North Sea profits in 1982 H1 were 22 per cent above their level in 1981 H1;

.gross profits of North Sea oil companies rose 10 per cent over the same period;

.ICCs financial deficit was £1.3 billion in 1982 H1, following £0.8 billion surplus in 1981 H2, partly reflecting less destocking. Over same period net borrowing requirement fell from £6½ billion to £5½ billion.

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 in year to July 1982 was about 9-9½ per cent;

.real earnings broadly flat in last 12 months but RPDI is about 1½ per cent lower than the average for 1981.

Labour Market

.UK employment fell 2.4 million (10½ per cent) between 1979 Q2 and 1982 Q2 (two-thirds concentrated in manufacturing); between 1981 Q2 and 1982 Q2 employment fell by 670,000;

.Total employment fell more in the second quarter of 1982 (189 thousand) than in the previous quarter (94,000);

.total registered unemployment fell by 48,000 to 3.3 million (13.8 per cent) in October reflecting seasonal falls in school leavers which more than offset the underlying upward trend (which itself slowed to 23,000);

.UK adult unemployment rose by (only) 23,000 to 3.1 million (12.8 per cent) in October; previously the trend (since June) was accelerating;

.vacancies have not altered much in recent months;

.other labour market indicators - short time, overtime working, etc - continue to suggest sóme flattening out following last year's improvements.

Forward Indicators

.car production (seasonally adjusted) recovered to 79,000 in October from 60,000 in September;

.steel production (seasonally not adjusted) fell from 230,000 tonnes per week in September to 228,000 tonnes er week in October;

.the volume of new construction orders, which remained broadly flat since the first half of 1981, fell 6 per cent in the 3 months to August. Within the total, orders for new housing, particularly in the private sector, remain slightly below their level last spring. Engineering orders also disappointing with a 9 per cent fall in the lastest 3 months.

.total manufacturing order books, as monitored in the CBI's monthly industrial trends enquiry, after strengthening last year, have shown some decline; and export order books have weakened.

.total housing starts, having increased from an average 40,000 a quarter in 1980 to 53,000 in 1982 Q1, fell back in the spring, but average for the first nine months is over 25 per cent up on the same period a year ago. Total completion have remained fairly flat during 1981 Q2 and Q3 having previously drifted slowly downwards.

.seasonal falls in school leavers registrations continue into November and December but a sharp seasonal rise in unemployment occurs in January;

.CSO's index of longer leading indicators rose in August and September reflecting lower interest rates and higher share prices, following a fall from April to July.

CBI's October Trends Survey suggests a further decline in business confidence, further slight falls in total new orders and output. Stock reductions are continuing and investment intentions have weakened again. The survey suggests no recovery in new export orders and deliveries over the next four months. Cost pressures are expected to slow further and a slight improvement in firms liquidity is in prospect. Consumer goods industries are benefiting slightly from some improvement in demand.

Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be ½-1 per cent - about ½ per cent less than expected at Budget time; for 1983 consensus of outside forecasts around 2 per cent, assuming some recovery in world economy, with inflation/interest rates continuing to fall at least for some time into next year.

.New Treasury forecast published November 8th - see summary table attached.

Key Statistics Week-Ending Friday 19 November

Mon 15	:	Retail Sales (Oct - provisional)
Wed 17	:	Average earnings (Sept) and wage rates (Oct)
Thurs 18	:	Monetary aggregates (Oct - final)
	:	GDP output (3rd qtr)
	:	Capital expenditure by manufacturing, distributive and service industries (3rd qtr - prov)
	:	Manufacturers' and distributors' stocks (3rd qtr - prov)
Fri 19	:	Cyclical indicators (Oct)
	:	Sales and orders in engineering industries (Oct).

Reproduced from November 1982 Autumn Statement

Table 1.9 below presents a summary of the economic prospects.

Economic Prospects

		Percentage changes		
		1981 to 1982	1982 to 1983	Average errors from forecasts, relevant for 1983
A	*Output and expenditure at constant 1975 prices*			per cent
	Gross domestic product (at factor cost)	½	1½	1
	Consumers' expenditure	½	2½	1½
	General government current expenditure	2	1	1½
	Fixed investment	3	5	2½
	Exports of goods and services	−1	0	3
	Change in rate of stock-building as a percentage of the level of GDP	2	½	1
	Imports of goods and services	4½	5	3
		1982	1983	
B	*Balance of payments on current account* (£ billion)	3½	0	3
C	*Retail prices index* (4th quarter to 4th quarter)	6	5	3

The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on Government forecasts, notably in Economic Progress Report, June 1981. The calculations for the constant price variables are now derived from internal forecasts made during the period June 1965 to October 1980. For the current balance and the retail prices index, forecasts made between June 1970 and October 1980 are used. The errors are after adjustment for the effects of major changes in fiscal policy, where excluded from the forecast. Quarterly forecasts are grouped so as to be comparable with changes between calendar years as shown. Thus for forecasts of constant price variables and the current account made in quarter 0 the errors relate to the forecast period (quarters 1 to 4) compared with the base year (quarters −3 to 0). For the retail prices index the margin relates to the percentage change between quarter 0 and quarter 4.

/Table 1.10

Table 1.10 Constant price forecasts of expenditure, imports and gross domestic product*

£ million at 1975 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less Imports of goods and services	Less Adjustment to factor cost	Plus Statistical adjustment	Gross domestic product at factor cost	GDP index 1975=100
1980	71 550	24 300	20 450	33 100	−1 550	147 850	34 150	12 200	200	101 700	108·0
1981	71 750	24 450	18 750	32 400	−1 900	145 450	34 100	12 100	0	99 250	105·4
1982	72 150	24 900	19 350	32 150	−150	148 400	35 650	12 150	−600	100 000	106·2
1983	73 800	25 100	20 300	32 200	300	151 700	37 450	12 500	−500	101 250	107·6
1981 H1	35 900	12 150	9 350	15 850	−1 350	71 900	15 950	6 100	−250	49 600	105·4
H2	35 850	12 300	9 400	16 550	−550	73 550	18 150	6 000	250	49 650	105·5
1982 H1	35 750	12 400	9 650	16 300	0	74 100	17 750	6 000	−350	50 000	106·2
H2	36 400	12 500	9 700	15 850	−150	74 300	17 900	6 150	−250	50 000	106·2
1983 H1	36 650	12 500	10 050	15 950	100	75 250	18 500	6 200	−250	50 300	106·9
H2	37 150	12 600	10 250	16 250	200	76 450	18 950	6 300	−250	50 950	108·2
% changes:											
1980 to 1981	½	½	−8	−2		−1½	0	−½		−2½	
1981 to 1982	½	2	3	−1		2	4½	½		½	
1982 to 1983	2½	1	5	0		2½	5	3		1½	

*GDP figures in the table are based on "compromise" estimates of gross domestic product. Figures in £ million are rounded to £50 million. Percentage changes are calculated from unrounded levels and then rounded to half per cent. The GDP index in the final column is calculated from unrounded numbers.