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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 22 November, are sidelined.

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R I G ALLEN

29 November 1982

EB Division  
H M Treasury  
01-233-5503



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## A GENERAL ECONOMIC STRATEGY

### 1. Government's main economic objectives

Main objectives are to achieve, over a period, a sustained improvement in the economy through reduction of inflation, lower interest rates and promotion of enterprise and initiative. Policy must continue to combine firmness and flexibility. Right for Government to have adjusted money supply and PSBR objectives in light of changed circumstances. But also right that medium-term direction of policy is maintained.

### 2. Significance of November 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 a mini Budget?

No. It brings together number of announcements about decisions - on public expenditure and next year's NIC - which are usually made at this time of year. It also includes a fuller economic forecast than has been issued in past - with much more complete statement of fiscal position; tax ready reckoners; and proposals for a reduction in NIS. Autumn Statement in no sense complete Budget - not even a mini Budget - though announcements obviously affect scope for fiscal action in Budget next spring. :

### 4. A S reflationary/deflationary?

There is no change of policy compared with 1982 MTFS. Public expenditure planning total for 1983-84 unchanged. PSBR as percentage of GDP in 1983-84 also unchanged and lower than in 1982-83.

### 5. What help for industry?

Measures announced in Autumn Statement themselves have benefits for industry particularly in helping keep costs down - NIS (see P1-3), NIC (see P1-3), public expenditure decisions. Other announcements made around same time - energy prices (see R2-3), ending of regional development grant deferment (Industry Secretary 9 November), local authority capital spending initiative (see E12-14), a dozen or more sites chosen for enterprise zones (see P15) - all helpful. Also keep in mind wider benefits of lower inflation and interest rates and benefits of 1982 Budget measures still coming through.

### 6. Room for £2-3 billion tax cuts in 1983 Budget?

[CBI forecast £2½ billion fiscal adjustment for 1983-4]  
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.

7. 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. (See also Section E.)

8. Implications of social security announcements

See Section G.

9. Recovery over/Activity flat?

Delayed but not over. Activity still 1 per cent above trough in Spring 1981. Flatness of output this year partly reflects external developments. Expected recovery in world trade and output expected at Budget time has not yet materialised. However, progress on inflation and interest rates more rapid than expected and renewed modest recovery expected in 1983. Expectations supported by upturn in cyclical indicators and by most outside forecasts. [For Industry Act forecast see B12 and last page of Commentary at end of Brief.]

10. Latest figures (for GDP and stockbuilding) throw doubt on Government forecasts for 1982?

GDP figures are quite consistent with Industry Act Forecast which shows no change in the average measure of GDP between first and second half of year. At first sight not so easy to reconcile size of third quarter destocking (nearly £420 million) with IAF expectation for second half (about £150 million). But quarterly movements in stocks tend to be erratic; also some of the destocking may represent adjustment to involuntary stock-building in first half of 1982.

11. Latest CBI assessments: further deterioration?

See B4.

12. Government policy on exchange rate?

See Section M.



13. Implications of recent exchange rate depreciation for domestic inflation, competitiveness and activity?

Government's forecast remains as set out in November Industry Act forecast.

14. Recent exchange rate depreciation signals weakening of monetary framework?

Government's role is to maintain firm, consistent, financial framework, in line with major economic objectives (see 1 above). Government will continue to interpret monetary developments firmly but flexibly. With inflation coming down, should be ample scope within target ranges for rising activity. (See also Section M.)

15. 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 than last year - companies' financial position and encouraging more fixed investment and stockbuilding; increased consumers' expenditure, partly reflecting lower inflation. Medium term prospects depend critically on further progress in reducing inflation and containing costs.

16. 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, has been rising at annual rate of 3 per cent since spring 1981. Problem is external demand and UK's falling share of home and foreign markets (reflecting weak competitiveness). Need improvements in supply performance as much as increased demand. Without former, a boost to demand may be largely wasted, even in the short term.

17. IMF team visiting UK: checking up on us?

[Treasury Press Notice about visit issued 16 November]

Visit from IMF team in December normal routine: part of the Fund's regular 'Article IV' consultations which provide for periodic review of member countries' economic policies.

18. Unemployment prospect?/Government 'fiddling' unemployment figures?

[NB November figures to be published 2 december].

See Section C.

19. Latest Labour Party proposals?

['Programme for Recovery' published Monday 22 November. Aim is to reduce unemployment to less than 1 million in one Parliament. Main points: increased public spending (phased



from £5 billion more in first year to £18 billion in fifth), adjustment of £ to restore competitiveness; price controls and other measures, such as VAT cut, to offset effects of lower exchange rate; abolition of NIS and/or cuts in employers' NIC; cut in interest rates; agreement within National Economic Assessment for growth in incomes to achieve 'planned increase in living standards'.]

Despite attempts to confront some of the many problems such a programme would create, many more ignored - notably effects of package on confidence and financial markets. Testing packages on Treasury model does not mean results definitive - much depends on assumptions fed in. Claim that package would lead to a massive rise in output and un employment depend critically retaining confidence and on assumption of low earnings growth yet no clear ideas on how to achieve latter other than a toothless National Economic Assessment. We have been here before. Don't want to repeat. IMF brought back to reality in 1977. Electorate did in 1979. One or the other would certainly do so again.

20. When will the manual on the Treasury model be issued?

[Copies provided already to TCSC; document referred to by D Lipsey in S.Times 28 November].

Being published 1 December.



(i) Activity. Output broadly flat since Autumn 1981 but GDP and manufacturing output around 1 per cent above levels of spring 1981. IAF (published with Autumn Statement) and most recent major independent forecasts see prospect of modest recovery later this year and next.

(ii) Interest rates. Bank base rates have fallen 6 points since autumn 1981 (now <sup>about 10</sup> per cent). Recent falls reflect several factors:- single figure inflation; moderate growth in monetary aggregates; Government borrowing under control, exchange rate broadly unchanged since summer 1981.

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

(v) Costs.

- Increase in average earnings halved in 1980-81 pay round; further moderation in 1981-82 round, to around 9 per cent.
- Manufacturers' unit wage 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 only 3½ per cent in year to October.
- October CBI survey 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 cyclical peak in 1H 1979.

(vi) Competitiveness. Cost competitiveness (manufacturing) improved by about 15 per cent during 1981 reflecting lower exchange rate, greater pay moderation, higher productivity; but little further improvement during 1982 H1 and position remains a quarter worse than in 1979 H1 and one third worse than in 1975.



(vii) Profits: Industrial and commercial companies' gross trading profits (net of stock appreciation, excluding North Sea) up 16 per cent in 1H 1982 compared with 1H 1981. [NB 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.°NB But broadly flat during 1982.]

(ix) Special employment measures. Total planned provision for special employment schemes £1½ billion in 1982-83. Further measures announced end-July - new community work programme (started October), job splitting subsidy schemes (from January 1983); total planned provision for 1983-84 £2 billion.

(x) Overseas debt repayments. Official 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



## B ECONOMIC ACTIVITY AND PROSPECTS

### 1. Prospects for UK economy

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

Main points from Industry Act forecast and other recent forecasts:-

- 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 is for year-on-year growth around 2 per cent.
- RPI 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 early 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 continues to recover and is provisionally estimated to be ½ per cent up in 1983 Q3 on previous quarter. Forecast is for 2½ per cent increase between 1982 and 1983.
- Current account of balance of payments expected to decline to zero in 1983.

### 2. Recent output figures

[GDP (O) in Q3 rose slightly for second successive quarter to level 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 - almost entirely 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 Quarterly Survey showed 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 had fallen and most (94 per cent of participants) saw orders constraining future output. Stock reductions were continuing and investment intentions had weakened again. Cost and price pressure remained low, and company liquidity might improve slightly in next six months. CBI November Enquiry shows previous trends broadly continuing but with further deteriorations in export order books partly offset by some pick-up in home orders].

Results of October and November CBI reports still disappointing. Deterioration in optimism, and weakness of immediate outlook (next four months), probably reflect in part very depressed level of activity, at home and overseas, this year. But CBI not entirely gloomy - favourable developments continue in unit costs and price expectations; firms' liquidity also expected to improve. November Enquiry implicitly suggests some improvement in home orders. 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. November CBI Forecast suggests no recovery next year?

[Forecast suggests  $1\frac{1}{4}$  per cent GDP growth next year - a  $\frac{1}{4}$  per cent downward revision to August forecast and  $\frac{1}{4}$  per cent below IAF; inflation money down broadly in line with IAF. Sees £2½ billion available for 'fiscal adjustment' in next Budget.]

CBI output forecast only marginally below IAF. Both show modest recovery in total and manufacturing output next year. On PSBR undershoot see A .

6. ABCC 'fast losing patience with Government'

[The Times 29 November reports ABCC as criticising Government's excessively tight fiscal monetary stance over past year as major factor in lost output and lost jobs. Requires a "coherent" industrial and commercial policy and a substantial reduction in industry's costs. Proposed policy measures: abolition of NIS, reductions in rates on industrial and commercial interest rates.]

Government has done well by industry this year. Cuts in NIS worth £1 billion and each percentage reduction in interest rates worth £250-300 million. These benefits derive from moderate restraint on fiscal and monetary aggregates<sup>5</sup> and decision to help industry by reducing NIS rather than other costs. ABCC proposals themselves lack 'coherence'; lower inflation and lower interest rates are a product of fiscal and monetary stance.

7. New orders figures depressing?

[New construction rose by 1 per cent in 1982 Q3 on previous quarter but remains down on 1981 Q3. A 30 per cent increase in public sector housing new orders in 1982 Q3 but 5 per



cent decline in private housing orders. Volume of new orders in engineering industries fell 12 per cent in three months to August compared previous three.]

Some figures encouraging signs but still manifesting depressed economic activity which itself partly reflects flatness in world trade.

#### 8. Fall in investment and reduction in stocks?

[Capital expenditure by manufacturing, distributive and service industries in 1982 Q3 3 per cent higher than Q2 but 2 per cent down in latest six months compared previous six. Investment in manufacturing (including leased assets) in 1982 Q3 over 1 per cent up on Q2 but 4 per cent lower in latest six months than previous six. 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 reflect some modest recovery after disappointing second quarter. [IF PRESSED: latest DOI investment intentions survey shows slight fall in manufacturing investment between 1981 and 1982; Q2 figure not inconsistent with this.]

#### 9. Stock levels a threat to recovery?

[Provisional figures for 1983 Q3 stockbuilding in manufacturing and distribution (80 per cent of total stocks) reveal unexpectedly sharp de-stocking of around £420 million. Apart from 1980 Q4, as large as any quarter in current recession.]

Quarterly movements in stocks tend to be erratic; Q3 de-stocking may partly reflect adjustment to involuntary stockbuilding in 1982 H1. Not too much weight should be placed on single quarter's data. GDP (output) figures (see B1 above) are a better guide to recent movements in activity.

#### 10. Competitiveness not improved this year?

Cost competitiveness has improved about 15 per cent since 1981 Q1 [but virtually no change during 1982 H1]. Taking into account recent exchange rate movements, position remains <sup>some</sup> 20 per cent worse than when Government took office; though over same period exchange rate broadly unchanged. 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 makes it all the more important for companies to maintain close control over their costs. (see also section M).

#### 11. 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.



12. CSO's index of leading cyclical indicators?

Longer leading index rose between July and October reflecting further falls in interest rates and an increase in share prices. Shorter leading index declined slightly in October (but based on two components only). Taken with other indicators - including lower inflation and interest rates - these changes are encouraging pointers to future recovery.

13. Outside forecasts

[GDP profile in recent major assessments and in IAF:

	Per cent change							
	LBS (Nov)	Phillips & Drew (Nov)	Simon & Coates (Nov)	CBI (Nov)	St James (Nov)	OECD (July)	NIESR (May)	IAF (Nov)
1982 on 1981	+ $\frac{1}{4}$	+ $\frac{1}{2}$	+ $\frac{1}{2}$	+ $\frac{1}{2}$	+ $\frac{1}{2}$	+1 $\frac{1}{4}$	+1	+ $\frac{1}{2}$
1983 on 1982	+3	+ $\frac{3}{4}$	+2 $\frac{1}{2}$	+1 $\frac{1}{4}$	+2	+1 $\frac{3}{4}$	+1	+1 $\frac{1}{2}$

Nearly all see prospect of continued recovery and lower inflation.



## C LABOUR MARKET

[NB: Employment Secretary's Statement 18 November on changed basis for unemployment figures from November count onwards. November (provisional) figures will be published on 2 December. On new basis, October headline total would have been 246,000 lower and adult unemployment 173,000 lower.]

1. Recent unemployment figures (on new and old basis) 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 in Table below on both old and new basis. Other Labour market indicators (eg overtime, short time, roughly that for last 6 months).

	1980	1981				1982			
	Q4	Q1	Q2	Q3	Q4	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%)
on new basis	-	-	-	-	2.77	2.86	2.80*	2.94*	3.05 (13.1%)
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%)
on new basis	-	-	-	-	2.61	2.68	2.74	2.84	2.89 (12.4%)
increase in period									
(000's)	+105	+77	+62	+51	+26	+18	+30	+42	+44
on new basis	-	-	-	-	+24	+20	+28	+31	+24
Vacancies (000's)	99	98	89	96	104	112	107	111.0	112

\* Excluding non-claimant school leavers. ]

~~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.

2. Government fiddling the statistics?

No. New basis is cheaper, more accurate and cuts out wasteful procedures. New basis using voluntary registration also reveals similar trend to previous series.

3. What categories of unemployed affected by changes?

Severely disabled now included. Non-claimants registering at Job Centres, and far more people who find jobs before day of count, now removed. Non-claimants are principally married women paying reduced national insurance contributions and some may previously



have been self-employed. Non-claimants number 110-150 thousand in most months of the year.

4. Headline total fell 246,000 in October?

Generally, difference between old and new counts would have been between 170 and 190 thousand. October difference was exceptionally large because many (about 100,000 people) still on register at Job Centres had in fact already found jobs.

5. Does new system affect GAD assumptions for 1982-83 and 1983-84?

Scale of the assumed increase will not be significantly affected, but the assumed GB levels of 2.9 million in 1982-83 and 3.2 million in 1983-84 (excluding school leavers) could be some 200,000 lower ie 2.7 million and 3.0 million. Number of claimants eligible will, of course be unaffected.

6. 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).

7. 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 an accurate count of those eligible for benefit, and provide the best available estimates of trend.

8. Cost of unemployment/Effect on PSBR?

The effects of changes in unemployment on the public finances is likely to vary widely according to the underlying circumstances, for example changes in world trade, United Kingdom competitiveness, the level of United Kingdom earnings and so on. It is not, therefore, sensible to talk about the cost of unemployment as though there were a single figure.

Payments of unemployment benefit and supplementary benefit to people registered as unemployed are currently expected to total about £5 billion in 1982-83. Comparable figures



for the total of taxes and national insurance contributions not collected cannot be given. There is no basis for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

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. 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).

11. 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 and £2 billion in 1983-84. Within the latter, £950 million allocated to Youth Training Scheme and £260 million (gross) to (a) the new community programme - designed to provide up to 130,000 places for long term unemployed - and (b) the 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.

12. 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 September fell 11,000 to 5,531,000 (compared 5,553,000 in September 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 C11 above).



13. 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 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 39½ 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. Cuts in taxation in 1983 Budget?

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

### 5. Why not integrate tax and NIC systems?

[Paper from Institute of Fiscal Studies reported in FT 25 November].

Government has done much to simplify and streamline income tax and NIC systems. Benefits of more radical changes of this sort must be set against disadvantages. Integration could result in substantial redistribution of incomes; action to compensate the losers could be costly. A sub-committee of the TCSC is currently inquiring into the structure of personal income taxation and income support; Government looks forward to reading the Committee's report.



6. Future of married men's personal allowance?

[Guardian article 29 November contains details of Government's plans for White Paper on Taxation of Husband and Wife].

Government launched debate with December 1980 White Paper on Taxation of Husband and Wife. Green Paper set out a number of different options; these are being considered in the light of the very wide range of views received. [NB Labour Party commitment to phase out in favour of increased CB etc; SDP proposals ('Attacking Poverty') to abolish as part of new scheme to assist lower paid. ]

7. SDP plan to abolish poverty trap?

Their scheme ('Attacking Poverty') 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.

8. 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.

9. Government unconcerned about poverty and unemployment 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 poor and unemployed or to let costs rip. A necessary step in 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.

10. 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.

11. 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  $\frac{1}{4}$ p in the basic rate.

12. Changes in corporation tax on way?

[Speech by FST on 24 November].

Government will shortly start limited trial of new type of corporation tax return form. If trial successful, could open way to new arrangements for assessing and collecting corporation tax. But trial is exploratory. Government will not make move to self-assessment for corporation tax without wide consultation. Trial not concerned with structure of corporation tax, which government is examining in light of responses to Corporation Tax Green Paper.



## 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 REVIEW AND AUTUMN STATEMENT

1. Does underspending indicated by provisional outturn figures for first half 1982-83 imply substantial underspend for year as a whole?

[Figures presented to Parliament in FST's Note on Winter Supplementary Estimates].

At the moment we are tentatively estimating that 'Supply Expenditure' will amount to about £79½ billion. Total provision including Winter Supplementaries [of £1½ billion] is just over £81 billion. If there are no substantial Spring Supplementaries, the underspend in 1982-83 will be about £1½ billion. Underspends in 1980-81 and 1981-82 were about £1½ billion and £2 billion respectively.

2. 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 at 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.

3. 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.

4. Is it <sup>true</sup> ~~true~~ that although the total of public expenditure in 1983-84 has been held to the Budget time total in cash it is higher in cost terms?

Public expenditure is planned in cash. Expenditure for future terms expressed in cost terms depends upon assumptions made about the change in the GDP deflator. For a given cash total, the lower the increase in the relevant prices, the greater the level of service that can be provided.



5. Should not all programmes have been reduced with the fall in inflation?

Under cash planning we do not go about it in this way. Presumption is that planning totals will be maintained, unless any major change invalidates the main assumptions on which they were based. Level of services is then what can be obtained with the cash available after making every effort to reduce costs. Inflation in 1983-84 is now being put at about 5 per cent higher than in 1982-83 which compares with 6 per cent implicit factor used when the old 'volume' series converted to <sup>cash</sup> ~~cont~~; in reviewing the plans took view this reduction not great enough to justify wholesale adjustment to plans.

6. 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.

7. 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.

8. What are public expenditure totals now planned for years following 1983-84? How do they compare with those announced at Budget time?

[Chief Secretary 23 November referred to figures for '1984-85 and 1985-86' being entirely within the provisional totals announced at the Budget.]

Figures for these years will be published will be published in next Public Expenditure White Paper, early in New Year. Planning total for 1984-85 will be within total announced at Budget time. [NB No figure for 1985-86 has yet been announced].

PUBLIC EXPENDITURE - GENERAL

9. 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.



10. 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.

11. 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 E16-18 and R10).

12. 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.

13. 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.

14. What allowance will Government make for pay increase in public services for 1983-84?

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.

15. 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

16. LA capital underspending in 1982-83

Following underspend of £ $\frac{3}{4}$  billion in 1981-82, local authorities seem set to underspend their capital cash limits for 1982-83 by between £1 and £1 $\frac{1}{2}$  billion (GB figures). Some steps in hand to reduce the underspend: Prime Minister has written to local authority associations; local authorities can apply for extra allocations, and can spend without limit on improvement grants; extra £150 million made available to the Housing Corporation.

17. 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.

18. LA capital spending plans for 1983-84

Plans for LA capital as a whole allow net spending one third higher than likely outturn in 1982-83; (gross) housing spending up £350 million (13 per cent); urban programme (including Urban Development Grant) up by £70 million (to £350 million). Local authorities will be allowed to spend above allocations on improvement grants.

19. 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.)

20. 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.



21. 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.

22. Holdback of RSG in 1983-84?

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

23. 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. If that figure confirmed, will be possible to provide for real increase in capital investment in housing next year.

24. 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 P10.)

FALKLANDS EXPENDITURE

25. Falklands defence costs?

[Parliamentary Answers 26 October cols 885-6; 28 October 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. For the garrison extra provision of some £420 million has been made in 1983-84. [Composition of garrison to be announced in Defence Secretary's White Paper in December].

26. 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.

27. 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). About £8.6 billion is now expected to be spent this year of which £3 million will be found from the Aid Programme and the balance from the Contingency Reserve. 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.]

28. 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 £1½ million has so far been paid out, but this is no guide to what the final total might be. Costs this year will be absorbed within the 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 10½ per cent to 655,000. 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 21.



## 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, thus increasing contracted-in rates for Class 1 from 8.75 per cent to 9 per cent (employees) and from 10.2 per cent to 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); thus increasing rates from 6.25 per cent to 6.85 per cent (employees) and from 5.7 per cent to 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]

#### 1. Why increase employees' contributions?

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

#### 2. Very large increase for contracted-out?

Change in contracting-out terms announced last March - following report by Government Actuary - and not part of this year's review. Reduction in rebate reflects Government Actuary's assessment of fall in cost to contracted-out schemes of providing guaranteed minimum pensions.

### 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].

#### 3. Government renegeing on pledge to maintain value of pensions?

On contrary, pensioners will be better off during next year by extent of overshoot. Only question 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.

#### 4. Level of overshoot?

Cannot say exactly until late 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.



5. 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.

6. 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.

7. 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 RPI 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 from 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.

8. Retirement age?

[Social Services Committee Report published 24 November: principal recommendation a more flexible State retirement scheme with 'fulcrum' pension age of 63 for both men and women].

Government welcomes this Report and the political consensus the Committee achieved. Report deals with important issues which Committee recognises as not for this Parliament. Their emphasis on equality and flexibility absolutely right.

9. Restore abatement of unemployment benefit?

Social Services Secretary made Government position clear in debate on 22 November. Government do not regard abatement of unemployment benefit as permanent measure; are considering question of its restoration in light of available resources and other decisions on uprating of benefits which will be taken as usual in context of uprating statement to be made at Budget time.



10. Death grant - increase to realistic level?

[Consultative document 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 current 8.75 per cent to around 22 per cent; or rise in basic rate income tax to 46p in £.

12. SDP proposals?

See D7-8.



## 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 Section K). <sup>Short</sup> term interest rates <sup>6 1/2 per cent below last autumn's peak.</sup> ~~have been much lower~~ Benefits seen in recovery of debenture market. IF PRE SSED : Government would like to see rates lower still, so long as further reductions not likely to endanger progress on 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 3 1/2 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. PSBR for 1982-83 now expected to be lower than FSBP forecast?

[1982-83 FSBP forecast £9 1/2 billion. New Industry Act Forecast (IAF) £9 billion.]

Change is small (and insignificant compared with forecast errors of plus or minus £2 billion at this stage in year). Outturns for PSBR and CGBR so far consistent with PSBR of £9 billion this year.

4. 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.]

Wrong to multiply seasonally adjusted half-yearly outturn by two to get PSBR for 1982-83. Many erratic and irregular influences which seasonal adjustment does not pick up (nor is it meant to). Examples: public corporations expected to borrow more in rest of year than first half; outstanding pay awards (eg nurses); National Insurance benefits up-rating of 11 per cent.

5. 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. housing announcements by Environment Secretary.

6. 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 Q3).

7. 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 (2¼ per cent) of money GDP. Reduction in money GDP forecast since March merely means that this implies £8 billion rather than £8½ billion.

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

[IAF showed £1 billion 'fiscal adjustment' 1983-84; CBI suggest scope for £2.5 billion].

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.

9. 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.

10. 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

[(Full) money and banking figures for October published 18 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  $\frac{1}{2}$  -  $1\frac{1}{4}$ ,  $\frac{3}{4}$  -  $1\frac{1}{4}$  and  $\frac{3}{4}$  -  $1\frac{1}{4}$  per cent respectively in banking October. Implied rates of growth in 1982-83 target period were 9-10 $\frac{1}{2}$ , 11 $\frac{1}{4}$ -12 $\frac{1}{4}$  and 8 $\frac{3}{4}$ -9 $\frac{1}{2}$  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.

### 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. 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.

### 4. Effect of US developments?

[US interest rates fell substantially during July/August, and in October. Discount rate cut again 19 November and prime rates cut 22 November.]

The falls in US interest 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. Effect of high US money supply figures and delay in cutting Federal discount rate combined, weakened gilts market and sterling in last fortnight.

### 5. Will slide in sterling affect monetary conditions?

Exchange rate is one of several important factors taken into account in judging domestic monetary conditions. Government has no intention of allowing lax financial conditions to jeopardise progress in defeating inflation. Steadfastness of Government reaffirmed by PM 26 November (Edinburgh speech).



6. Why have interest rates gone up?

[Barclays Bank increased their base rates by 1 per cent (to 10 per cent) and Midland theirs by 1½ per cent (to 10½ per cent) on 26 November. Lloyds and Natwest followed on 29 November with increases at 1 per cent (to 10 per cent) but still down by 6 points since peak in October 1981. [Long term interest rates also reduced significantly over past year.]

Structure of interest rates in domestic money markets has been dislodged by fall in sterling. Interest rates in domestic money markets rose sharply at end of last week. Bank base rate increases and increase in Bank of England's dealing rates reflected this. Government remain determined to maintain sound monetary conditions and to continue progress <sup>[9]</sup> towards lower inflation.

7. Rise in interest rates will stifle recovery (as in autumn 1981)

The fall in the exchange rate will, of course, be of benefit to many companies provided they maintain control over domestic costs. But no purpose would be served by allowing inflationary conditions to reappear. Overall interest rate reductions over past year are still substantial.

8. Did Government engineer rise in interest rates?

Rises in base rates and Bank of England's dealing rates were a response to higher market rates, but are consistent with Government's intentions to maintain sound monetary conditions.

9. Bank lending growing too fast?

[Lower growth rate in May/June not maintained. Increased by (seasonally adjusted) £1.3 billion in banking August, £2 billion in September, and £1.8 billion in October. (October figure distorted upwards by sale of STC.)]

Reasons for growth of bank lending to companies not entirely clear. Companies may have been 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.

10. 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.



## 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. Further falls likely in 1983?

Industry Act forecast is for 5 per cent early next year. That assessment still stands.

3. 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.

4. 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.

5. 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.



6. 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.

7. TPI now shows pay increases need to be  $\frac{1}{2}$  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.

8. 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. But sustained improvement only possible if industries succeed in holding down current costs, particularly pay. (See also R1).

PAY

[NB: GAD Report published 8 November included assumption that average earnings in 1983-84  $6\frac{1}{2}$  per cent higher than in 1982-83.]

9. 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.

10. 5-5 $\frac{1}{2}$  per cent settlements in year ahead?

[5-5 $\frac{1}{2}$  per cent settlements quoted by T Burns to TCSC 16 November as consistent with 6 $\frac{1}{2}$  per cent assumption given to Government Actuary.]

True that settlements around 5 per cent would be consistent with Government Actuary assumption. But so would lower figures. If 'drift' was 2 per cent - as last year - 6 $\frac{1}{2}$  per cent earnings would imply 4 $\frac{1}{2}$  per cent settlements. But important point is not the assumptions used but the need to get settlements as low as possible.



11. 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.

12. 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.

13. 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.

14. 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.

15. 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.

16. Average earnings index

[Year on year growth 6.8 per cent in September compared with 7.8 per cent in August. Underlying increase about 8¼ per cent in September.]

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



17. 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.

18. 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.

19. 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.

20. 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. When relatively large increases have been approved by Ministers responsible (in consultation with Chancellor) it is because these have been justified by such factors as the need to recruit people of ability, inadequate differentials with senior staff and the performance of the industry. Because board pay has been held back in previous years, many salaries are now seriously out of line with market rates.

21. 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

[October 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 from Q3 onwards. Cumulative current account surplus of £3.0 billion in ten months to October. 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. Trade in manufactures in deficit this year for first time?

[Max Wilkinson in FT 23 November].

'Financial Times' got it wrong. Trade in manufactures not in deficit this year when exports and imports are valued on a comparable basis. On the contrary, a substantial surplus so far this year - around £2 billion up to October. [NOT FOR USE: Figures underlying IAF suggest that trade in manufactures may go into deficit next year].

### 3. Export trends - recent

Month-to-month movements in exports during 1982 have been very erratic. There was a sharp recovery in exports in September and October 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.

### 4. 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.

### 5. Import trends

Manufactured imports fell  $\frac{1}{2}$  per cent in 3 months to October: there has been little change 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.



6. 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 tariffs and quotas in some other countries. Pressing for positive European Community action to remedy this. 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.

7. 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 £?

[£ suffered repeated bouts of selling pressure during the two weeks from Friday 12 November, touching low points on Friday 26 November. Confidence in the pound has been restored following the firming of interest rates on that day.

:

	12 Nov <u>close</u>	26 Nov <u>low points</u>	29 Nov <u>noon</u>	12-29 Nov <u>% change</u>
\$/£	1.6512	1.5700	1.6036	-2.9
DM/£	4.2783	3.9584	3.9925	-6.7
£ effective	91.3	84.9	86.2	-5.6

Previous lows for sterling were \$1.5675 (28.10.76), and DM 3.9475 (31.1.80). The fall reflected a number of factors: the market's reassessment of sterling in the light of poorer balance of payments prospects and weakening oil markets; some profit-taking moves out of gilts by non-residents; and a mistaken fear that the Government was easing domestic monetary conditions.]

Government has no target for the exchange rate. Policy is for rate to be determined largely by market forces with intervention limited to that required to seek to moderate excessive fluctuations and maintain orderly markets. Exchange rate only one of factors taken into account in interpreting domestic monetary conditions and taking decisions on policy. But it should be beyond doubt (after Friday's developments) that the Government has no wish to devalue sterling whether by 7 or 10 per cent or any other figure.

2. The rise in base rates proves the Government has an exchange rate target

No. Interest rates last week were affected by the fall in sterling and movements in other currencies; and towards the end of the week rates in the domestic money markets rose sharply. This triggered the subsequent increase in clearing bank base rates. Government policy is one of unchanged determination to maintain sound monetary conditions and progress towards lower inflation. In judging monetary conditions the policy remains to take account of movements in a range of indicators alongside the monetary aggregates, including the exchange rate.

3. Should not Government welcome fall in pound?

A lower exchange rate means higher costs to industry and the consumer: no-one should welcome that. Of course, recent fall in pound may bring some relief to British firms that are facing difficult competitive pressures in home and overseas markets, particularly from Europe and the Far East - but they <sup>m</sup>ust contain their costs rigorously in order to retain that benefit. We cannot solve our basic problems of competitiveness by depreciation, and no-one should doubt our determination to adhere to our counter-inflation policies. Sound money remains at the heart of the Government's economic strategy. As PM <sup>s</sup>aid in Edinburgh



last <sup>F</sup>friday, those who attribute to us ambitions to see our currency devalued are talking utter nonsense. They do not understand the steadfastness of this Government.

4. Why not improve UK competitiveness directly by encouraging exchange rate down further?

Past experience shows that devaluation is no answer. Any temporary gains in competitiveness are eventually swamped by the effects of higher inflation. UK's problems caused by failure to contain costs (effective rate now at level in May 1979 but cost competitiveness perhaps 18 per cent worse). Industry itself has mixed views about desirability of bringing the rate down (illustrated at CBI Conference in October).

5. 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.

6. Bank of England intervention?

Policy is unchanged. Bank intervene to smooth excessive fluctuations and preserve orderly markets particularly when conditions unsettled. But Bank do not attempt to resist underlying trend of rate. Not practice of Government to comment in detail on intervention undertaken.

7. 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 which provides for a basic refund of about £470 million with provision for change if our unadjusted net contribution varies from the Commission estimate of £880 million. Final agreement on implementation on the settlement was reached by Foreign Ministers on 25/26 October. Although UK will only be compensated for 75 per cent of our contribution to German refunds, we shall receive our 1982 refund of 1092 million ecus, about £600 million gross, much earlier than originally envisaged.

2. Progress in implementing 1982 Budget Agreement

Commission has submitted draft implementing Regulation which is now being considered by the Council and the European Parliament. The Parliament is also considering draft supplementary and amending budget which Council established on 8 November to provide necessary budgetary provision for our refunds payments. [IF PRESSED ON consequences of Parliament blocking either the Regulation or the Amending Budget: cannot speculate on hypothetical question].

3. Refunds for 1983 and later

On 17 November Commission produced its proposals for dealing with UK budget problem in 1983 and later. Commission communication does not suggest what size of our refunds or our net contribution after refunds should be. We think it provides a suitable framework for discussion of problem within the Community. However, we recognise with regret that end-November deadline for decisions on 1983 and later will not now be met: hope nevertheless that progress will be made quickly.

4. 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.

5. 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.



6. 15/16 November ECOFIN/'Jumbo Council' discussions on economic policy

All member states agreed to conclusions of the Joint Council which stress need to control level of public borrowing and inflation as precondition for lasting reduction in unemployment.

7. 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.

8. Policy for CAP reform

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

9. 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

10. 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.

11. 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 A 9 and Section B.

5. Prospects for construction industry?

[Construction employers still looking for more public investment FT 22 November.]

Current picture for industry rather mixed (construction orders falling off recently, private housing starts showing little increase recently, though more than 20 per cent higher than last year) but Government has been doing a good deal to help. Lower inflation and above all lower interest rates - including mortgage rate down 5 percentage points from autumn 1981 peak - especially valuable to construction industry. Decisions announced 8 November - additional capital allocations to local authorities and increased spending provisions for the Housing Corporation - could give an extra £¼ billion of work to the industry in 1982-83. And Autumn Statement plans for 1983-84 include provision for a one third increase over 1982-83 (to £4 billion) in LA capital spending; a substantial increase in capital spending on urban and derelict land programmes; and a £350 million increase in housing investment.



6. Companies' financial position?

[	1979	1980	1981 Year	£bn		1982 H1
				H1	H2	
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.

7. 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.

8. 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.

9. High interest rates damaging for industry and investment?

Before last weekend  
 banks' base rates had 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.



10. 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.

11. Lower energy prices

See R2-3.

12. 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.

13. 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.

14. Response to Loan Guarantee Scheme?

[Well over 6,900 guarantees already issued - about half to new businesses. Total lending under scheme over £230 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.

15. New enterprise zones

Proposed sites for new zones in England announced by Environment Secretary 15 November; sites for two new zones for Scotland, one for Northern Ireland and one (possibly for more) for Wales have also been announced. Total (12 or 13 in all) slightly more than the eleven new zones announced by Chancellor (27 July); this reflects number and quality of applications received from local authorities.



16. 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.



## 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. Differential between RPI (all items) and NI prices (including water charges and London Transport fares) 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 November 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 (domestic and industrial) 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?

19-20  
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. Wasteful to provide funds for public sector projects with lower returns than those in private sector. Unfortunately, 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?

[PM has stressed to chairman of NI Chairmen's Group 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 Britoil sale by tender?

Choice between tender and fixed price offer considered carefully. Tender allows price to take into account upward movements in market during period of offer for sale. In fact, movements were down. This does not make the choice wrong.



16. Marketing of public assets unsuccessful - Amersham and Britoil failures in different ways?

[Heavy oversubscription for British Aerospace, Cable and Wireless, Amersham International, followed by large increases in prices when shares first traded; about 75 per cent of Britoil shares left with subunderwriters and large discount when first traded].

No. These companies successfully privatised. Pricing an issue not easy especially when company's shares have not previously been traded. In addition, cannot accurately anticipate movements in market after price fixing but while offer still open.

17. 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, Britoil); preference in allocation of shares (B Ae, C & W, Amersham, Britoil, BP); provision for matching shares - one for each share subscribed for - (B Ae, Amersham, Britoil, BP). Most radical initiative taken by consortium of managers and employees who bought National Freight Company. Inclusion of small shareholders' bonus in Britoil sale designed to reward small investors who retain an interest in the company.



## S NORTH SEA AND UK ECONOMY

### 1. 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 FSBP 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 FSBP 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. Aberdeen University study shows UK taxation on marginal fields to be one of world's 'more lenient'.

### 3. 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.

### 4. 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.

5. 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 1982-83.

6. 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.

7. 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?

Output in major economies appears to have recovered slightly in spring 1982 after downturn last winter. Since then, major European economies have remained depressed. In US output flat in Q3 after small rise in Q2. Lower inflation and interest rates however offer prospects for better growth next year.

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

Widespread agreement among leaders of the major countries expressed at the OECD, Summit and IMF and, most recently, 'jumbo council' 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 (3.9 to 3.2 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 governments 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. US economy?

[Revised figures show that US GNP was flat in Q3 instead of small rise previously indicated through GNP rose  $\frac{1}{2}$  per cent in Q2. Interest rates have fallen 4 points since July while inflation has fallen to 5 per cent. Press reports suggest that Administration now admit Federal deficit likely to rise over next few years, instead of declining as previously forecast. Director of Budget Bureau reportedly forecasting deficit for FY 1984 maybe US \$175 billion.]

US output flat 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 next year. However, important that US Administration curb budget deficit if progress in reducing inflation and interest rates is to be maintained.

## 7. US monetary policy

[US interest rates have fallen and Federal Reserve last Friday reduced discount rate from  $9\frac{1}{2}$  to 9 per cent. Chairman Volcker has said US authorities will be attaching much less than usual weight to M1 over period ahead. Press reports suggest that Federal Reserve has suspended M1 target and intends to allow M2 growth above long term ceiling set in February.]

Accept that monetary indicators in US must be interpreted flexibly in light of financial innovations. Federal Reserve Chairman, Mr Volcker, has made clear recently in evidence to Congress that reduction of inflation remains a priority and that monetary targets have not been abandoned. Mr Feldstein, chairman of Council of Economic Advisers, has commented: 'no reason to be concerned about the Fed's policy being too expansionary'.

## 8. 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  $2\frac{1}{2}$  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.

## 9. Competitive devaluations

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. Recent 'jumbo' council re-affirmed Community's determination to combat protection and in particular competitive devaluations. 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 examining Swedish action.]



Summary comment

The effective exchange rate has fallen by about 5 per cent and interest rates have risen 1 point. Activity remains flat but generally financial developments remain favourable compared with last year and inflation continues to fall.

World Economy: expectations held by most forecasters for an upturn in activity of 1 per cent this year unfulfilled. IAF expects 2% increase in GNP of major 6 in 1983.

- . 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 22 November a fall of 4 points since October 1981; US 3 month rate stood at 8.9 per cent on 22 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 5 per cent in the twelve months to Aug; 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. Non-oil



export volumes have weakened slightly recently after remaining broadly unchanged between 1981 H2 and 1981 H1.

. import volume rose sharply as activity recovered last year and import penetration rose too; this year non-oil import volumes have shown little change since 1981 H2.

. the effective exchange rate fell 5 per cent last week as sterling depreciated against the dollar; currently at 86.7. The pound has now fallen below the range 87-93 that it occupied for the last year.

### Financial Developments

. M1, PSL2 within target range for 1982-83, EM3 towards top of range;

. most banks raised base rates by 1 point wef 29 November; short term interest rates down  $6\frac{1}{2}$  points since October 1981; base-rates down about 6 points;

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

. real interest rates 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  $6\frac{1}{2}$  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  $3\frac{1}{2}$  per cent in year to October; output prices  $7\frac{1}{2}$  per cent;

### GDP and industrial production

. GDP rose slightly in Q3 1982 for second successive quarter but remains at Q4 1981 level. Underlying level of industrial production also remains broadly flat but is  $1\frac{1}{2}$ -2



per cent above spring 1981 trough largely due to increased oil and gas production; the underlying level of manufacturing output 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 August-October 2½ per cent higher than preceding 3 months, partly reflecting abolition of HP controls. Consumers' expenditure in Q3 1982 (provisional) over 1½ per cent up on previous quarter.

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.

destocking of £420 million occurred in 1982 Q3. The CBI's October Survey suggested there was some scope for further destocking but stock figures are volatile and too much should not be made of one quarter's figures;

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;

non-oil exports have weakened since 1982 H2 after remaining broadly stable since 1981 H1;

imports rose very sharply between the two halves of 1981, reflecting both the increase in activity and increased import penetration, before stabilising but non-oil import volumes this year have shown little changed in 1981 H2.

### 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 cent 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 September 1982 was about 8¾ 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; manufacturing employment fell a further 95,000 (1¾ per cent) between Q3 and Q2 1982;



.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); on the new basis the headline total for October was 246,000 lower at 3.1 million (13.1 per cent);

.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. On the new basis unemployment in October at 2.9 million (12.4 per cent) was 173,000 lower than on the old basis;

.vacancies have not altered much in recent months;

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

#### Forward Indicators

.car production (seasonally adjusted) recovered to 78,000 in October from 60,000 in September;

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

.the volume of new construction orders, which remained broadly flat since the first half of 1981, rose 1 per cent in 1982 Q3, but remains 2 per cent down on Q2 1981. Within the total, private housing orders fell 5 per cent in Q3 1982 but remain 25 per cent higher than Q3 1981. Engineering orders also disappointing with a 12 per cent fall in the latest 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 between July and October reflecting lower interest rates and higher share prices, following 3 months of little change.

CBI's October (Quarterly) 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. November Trends Enquiry suggest a deterioration in export orders but implicitly also shows a pick up in domestic orders. CBI November forecast projects GDP(O) growth at  $1\frac{1}{4}$  per cent next year with manufacturing investment contracting. Also assumes £2½ billion fiscal adjustment in 1983/84 whereas IAF suggests £1 billion.

#### Outside forecasts

.Outside forecasting groups are now less optimistic about recovery in 1982, suggesting that growth this year will be  $\frac{1}{2}$ -1 per cent - about  $\frac{1}{2}$  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 falling at least for some time into next year.

#### New Industry Act Forecast

.New Treasury forecast published November 8th assumes a modest (2 per cent) world recovery in 1983. Forecast includes a £1 billion fiscal adjustment in 1983-84 within a fiscal/monetary stance broadly in line with 1982 MTFs. Between 1982 and 1983 GDP grows by  $1\frac{1}{2}$  per cent and manufacturing output by  $\frac{1}{2}$  per cent. Principal demand increases are from consumers expenditure ( $2\frac{1}{2}$  per cent) and capital investment (5 per cent). Reflecting strong import growth balance of payments current account goes to zero in 1983. RPI inflation is about 5 per cent in early 1983 and 1983 Q4. Government Actuary assumes unemployment (old basis) averages 2.9 million (GB, ex school leaver) in 1982-83 and 3.2 million in 1983-84. On new basis figures could be up to 200,000 lower.



Key Statistics Week-Ending Friday 3 December

Mon 29 : New vehicle registrations (Oct)  
          : CBI trends (Nov)  
Thurs 2 : UK official reserves (Nov)  
          : UK unemployment and vacancies  
Fri 3 : Company liquidity survey (3rd qtr)