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Econ. Pol

Prime Minister (2)

Not a very illuminating discussion.

MS 7/3

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

7 March 1983

Michael Scholar Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

IMF ARTICLE IV CONSULTATION

The Chancellor thought that the Prime Minister might be interested to see the attached summing up by the Acting Chairman of the 1982 Article IV Consultation with the United Kingdom.

The Prime Minister might like to know that the Executive Board discussion of the UK this year was very positive.

Yours sincerely,

Jill Rutter

JILL RUTTER
Private Secretary

February 25, 1983 - 83/61

The Acting Chairman's Summing Up at the Conclusion
of the 1982 Article IV Consultation with the United Kingdom
Executive Board Meeting 83/36 - February 23, 1983

Directors warmly commended the U.K. authorities for the success of their anti-inflationary policies, which, it was stressed, had been much more striking than earlier expected. However, bearing in mind that the effects of the recent significant depreciation of the pound had yet to be reflected in retail prices, most Directors concluded that the prospects for consolidating the recent gains in dampening inflation hinged critically on further substantial moderation of pay settlements.

While recognizing that pay increases had slowed down markedly since 1981, Directors nevertheless viewed with concern the fact that wage increases were still rising much more rapidly than prices at a time of little, if any, growth in real national income. That development had tended to retard progress in restoring profitability and international competitiveness in the non-oil traded goods sectors, despite the quite exceptional growth in productivity that had recently been achieved. Recognizing the limitations of incomes policy in the U.K. context, some Directors nevertheless thought that progress in containing incomes could be enhanced by a more active role of government in the establishment of wage guidelines and in enhancing constructive dialogue regarding the labor market among the interested parties.

Directors stressed that the emphasis the authorities had placed on financial restraint in combating inflation, coupled with the slow response of wages, had resulted in very large costs in terms of foregone output and increased unemployment. The large shedding of labor by hard-pressed enterprises, particularly in manufacturing, had contributed to raising unemployment to a very high level with relatively little prospect of early improvement. Most Directors nevertheless considered the strategy pursued to have been necessary to lay the basis for sound growth in the medium term.

Speakers generally welcomed the increased flexibility that the authorities had shown, especially the budget for 1982-83, in adjusting their specific monetary and fiscal targets in the light of changing circumstances while adhering to the broad anti-inflationary thrust of the Medium Term Financial Strategy (MTFS). That flexible approach, together with the rapid abatement of inflation, had provided the basis for the recovery in real money balances and domestic demand that was now under way and that, Directors hoped, would lead to a broadly based upturn in domestic output and employment before long.

There was general agreement that the poor rate of return on capital and the unsatisfactory level of international competitiveness were the main obstacles that had to be overcome if the eventual payoff of the MTFS in the form of sustained expansion in output and employment was to be realized.

Some Directors felt that exchange rate policies should be pursued in a more flexible manner in order to help eliminate the remaining distortions in relative prices and to arrest the tendency for the United Kingdom to lose market shares at home and abroad. Most Directors, however, agreed that too rapid a depreciation of the exchange rate would risk a reacceleration of the rate of inflation, which had been brought down at considerable cost. Therefore, they stressed that continued and accentuated moderation in wage settlements should remain the critical element in the control of inflation and in the improvement in international competitiveness. In that respect, Directors commended the authorities' continuing efforts through legislation and other means to restore the balance in industrial relations. The importance of labor mobility and manpower training measures was also stressed.

Some Directors believed that in view of recent trends in unemployment, capacity utilization, prices, and the balance of payments, the emphasis of economic policy should be shifted toward stimulating growth. They believed that there was scope for some relaxation of fiscal policy and that monetary policy should be eased. Most Directors, however, felt that the current stance of monetary policy was generally well-balanced and appropriate. Some adjustment in the quantitative targets for the main aggregates might be necessary from time to time, but the room for maneuver remained limited.

With regard to fiscal policy, the reduction of public expenditure as a proportion of GDP, which was becoming apparent, was welcomed by a number of Directors. Most Directors agreed that the present projection of the Public Sector Borrowing Requirement (PSBR) for 1983-84 was within the appropriate range. If room could be found for fiscal adjustment in the forthcoming budget, it was felt that the emphasis should be on improving the cost competitiveness of industry.

Some Directors noted with concern the recent increase in the strength of protectionist pressures in the United Kingdom and they urged the authorities to resist firmly such pressures. While noting with approval the sizable private financial flows to developing countries, Directors also welcomed the real increase in development assistance planned for 1983-84 and they encouraged the authorities not to scale down such assistance.