PREM 19/266

Meetings with the CBI
Correspondence on the Government's Economic Strategy

Part I

Industrial Policy

PM. MAY 1979.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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15.9.80							
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PART 1 ends:-

CAW to Pennock 15.9.80

PART 2 begins:-

FILE

Int AT

10 DOWNING STREET

From the Principal Private Secretary

15 September, 1980.

As we agreed before your meeting with the Prime Minister on Friday, I enclose a copy on a personal basis of the note which we have prepared on the meeting.

C. A. WHITMORE

Sir Raymond Pennock

10 DOWNING STREET

MR. WHITMORE

Here is the note of the meeting and a covering letter for you to send to Ray Pennock.

R

15 September 1980

RESTRICTED

File

cc: D/Ind
D/Emp
D/Trade
Paymaster-G.

DSG
Ind Pol

10 DOWNING STREET

From the Private Secretary

bc: Mr Wolfson
Mr. Ingham
Mr. Hoskyns
Mr. Vereker

15 September 1980

CO
CPRS

BF 24/9

I enclose my note of the Prime Minister's meeting with Sir Ray Pennock last Friday afternoon.

Page 4 of the note records that they discussed trade union restrictions on apprenticeships and the demarcation issue. The Prime Minister would like some examples of both of these for possible inclusion in forthcoming speeches. She has in mind her Party Conference speech and her speech to the Society of Motor Manufacturers and Traders. I would be grateful for a note from the Department of Employment, consulting the Department of Industry as necessary, on this - to reach me by the end of next week.

We agreed to a request from Sir Ray Pennock that he should have - on a personal basis - a copy of the note of the meeting, and we are therefore sending him one.

I am sending a copy of this letter and enclosure to Ian Ellison (Department of Industry), Richard Dykes (Department of Employment), Stuart Hampson (Department of Trade), Richard Prescott (Paymaster-General's Office), David Wright (Cabinet Office) and Gerry Spence (CPRS).

T. P. LANKESTER

John Wiggins, Esq.,
H.M. Treasury.

RESTRICTED

Subject.

NOTE OF A MEETING BETWEEN THE PRIME MINISTER AND SIR RAY PENNOCK AT 1600 HOURS ON FRIDAY 12 SEPTEMBER 1980 AT 10 DOWNING STREET

Present:	Prime Minister	Sir Ray Pennock
	Mr. David Wolfson	
	Mr. Clive Whitmore	
	Mr. Tim Lankester	

* * * * * * * * * * * * *

Sir Ray Pennock first described the pay situation as he saw it. He had met the Chairmen of a number of major companies in early August, and had urged them to hold out for moderate settlements. The general message seemed to be getting over that no more than single figure settlements could be afforded in the coming round, and the negotiating prospects from management's stand point appeared to be better than for several years. There was a much greater realism in industry that excessive pay settlements would cost jobs. For example, two vehicle companies had made sensible offers, and BP had made an offer of 10% - though this was subject to possible review next March. But industry remained very concerned about pay in the public sector. He cited as the latest example the rejection by the local authority white collar workers of a 13% offer, and the decision by the employers to accept arbitration. There was always a tendency for arbitrators to ignore what could be afforded, and he found it difficult to understand why the employers had agreed to this course. Although the Clegg Commission was being disbanded, industry was worried that the comparability arrangements implicit in the Pay Research Unit agreement were being continued; they were also concerned about index-linked pensions, though they noted that these were being reviewed by the Committee chaired by Sir Bernard Scott. In addition they were concerned - as always - about the prospects for the miners settlement. If the NCB had to borrow from the banks, rather than from the Government, the situation might be very different.

Sir Ray went on to say that the general position of industry was not as bad as appeared from the press. Nonetheless, it was very patchy. On the one hand there were companies such as his own (i.e. BICC), and companies in the electronics and oil sectors, which were doing very well. On the other hand, many companies were

/ in

in real difficulty. Many companies were citing the exchange rate as the main cause of their difficulties: for example, ICI had told him that even if their wages were zero, they could no longer compete in several of their product areas. There was a strong feeling in industry that if interest rates came down, the exchange rate would fall - though there was disagreement amongst bankers as to whether this would happen. As to the effect of a fall in interest rates on borrowing, many industrialists - for example, he had recently heard this in Scotland - felt that borrowing would not increase. Although the effect of high interest rates and the high exchange rate palled into insignificance compared with the effect of moderate or excessive pay settlements, interest rates - and the exchange rate - were a major concern. He wondered whether public expenditure was still too high, and whether this was the cause of the continued high interest rates.

The Prime Minister said that the Government were deeply concerned about public sector pay, and also about the high interest rate/high exchange rate problem. As to the former, pay settlements in the public sector had been more or less level pegging with those in the private sector, and both must come down. It was crucial in the coming round that public sector pay settlements did not undermine the new-found realism of the private sector. She agreed that the reported decision to take the local authority white collar claim to arbitration was worrying. As regards the miners, people would not be too concerned if a high settlement for the face workers did not go through to the surface workers; but this always seemed to happen. Much would depend upon the negotiating tactics of the NCB Chairman. The general financial position of the nationalised industries, of which pay was a part, was one of the biggest problems that the Government had to face: it was essential to the success of the Government's strategy that the resources pre-empted by the nationalised industries should be reduced. As regards PRU, she hoped that CBI members would give evidence to the Scott Committee.

Turning to the problem of high interest rates, the Prime Minister said that the main difficulty was that the banks had continued to lend to the private sector at a high level. If MLR were reduced in advance of market rates, there would almost certainly be "round-

/ tripping"

tripping", and this would inflate the money supply still more. It was not clear whether a small fall in interest rates would reduce the exchange rate. Nonetheless, it was essential to get interest rates down as soon as possible, and the CBI could be assured that Ministers were giving this high priority. The announcement of the new "Granny Bond" should help. Public expenditure was being kept under a tight rein, despite the huge demands of the nationalised industries. For example, the Government had set tough cash limits; a prospective overspend of £650 million on the defence programme had been cut back to £200 million; and the Civil Service was being cut.

In further discussion the following points were made:

(i) The Prime Minister said that Ministers would have to make more of the nationalised industries' problems in speeches - and of the fact that they were, by their appalling performance, doing so much damage to the economy. Public pressure had to be brought to bear upon nationalised industry managements to improve efficiency and cut costs. Sir Ray said that, while the general economic message seemed to be getting over, it would be worth emphasising the extent to which exports were now at risk if pay went up too fast in the coming round.

(ii) The Prime Minister said that she was concerned about the effectiveness of the Training and Youth Opportunities Programmes. Given the large amount being spent, it was essential that we produced the skills that were needed. Sir Ray said that many large companies had not done enough to help with the Youth Opportunities Programme, and he intended to take this up with them. He had also written to every CBI member to persuade them to absorb as many school leavers as possible.

/ (iii)

(iii) Sir Ray said that, largely because of trade union restrictions on apprenticeships, there continued to be a shortage of craftsmen - even at a time of deep recession. The unions controlled the whole system of apprenticeship - for example, no-one over 21 could become an apprentice - and without having completed an apprenticeship, it was impossible to obtain a union card. At the same time, we did not make full use of those who were trained because of over-manning and demarcation. There were many examples - for example in the chemical and motor industries - where British industry was obliged because of union restrictions to use far more employees than were strictly needed; and this showed up in comparative productivity figures as between the UK and other countries. Whenever he visited a plant, he always asked the manager how many men could run it if there were no union restrictions, and how many hours per day did the fitters work. The Prime Minister said that it was time the Government exposed the trade unions on both the apprenticeship and the demarcation issues. She wondered whether, on the demarcation issue, it would be worth the CBI promoting a campaign under the head of productivity or efficiency through the NEDC.

(iv) Sir Ray said that the Government ought to do more to publicise our industrial successes. There were many fine examples of British inventiveness and efficiency. The Prime Minister said she would give some examples of "success" in her Bordeaux speech.

/ (v)

(v) Sir Ray said that the level of employee involvement in British industry remained abysmal. Two surveys had been carried out, one at the time of the Bullock Report, and the other last year, and the latter showed that - if anything - the situation had got worse. There was no way in which industry could be successfully managed unless problems and prospects were properly discussed with employees. Employee participation arrangements in most companies compared very badly with the arrangements for political participation available under our democratic system. He intended to bring this issue to the fore. The Prime Minister said that she might be able to help by, say, attending a CBI Council meeting and raising this issue.

(vi) The Prime Minister said she was delighted with the appointment of Sir Terence Beckett as Director-General of the CBI.

TL

15 September 1980

COVERING CONFIDENTIAL

Ind Pol. –

Prime Minister

TL 11/9

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

11th September 1980

(Any note of your last meeting with Pennock is also for this folder)

TL 11/9

T.P. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

...... I attach a brief prepared by the Treasury for the Prime Minister's meeting with Sir Ray Pennock on 12 September. As you suggested in your letter of 8 September, it concentrates on pay; but some short notes are provided on other topics in which the CBI may be interested.

Yours

John

A.J. WIGGINS

SIR RAYMOND PENNOCK'S CALL ON THE PRIME MINISTER

There is no fixed agenda. We know that Sir Raymond is interested in discussing the pay scene. We know also, from the press and from contact with the CBI, that he will wish to go wider and discuss industrial problems generally and what the Government might do to alleviate them.

2. The meeting will take place after the discussion the Prime Minister is to have on 12 September with Ministers about industrial problems. That discussion will therefore provide part of the background.

3. The developments on the monetary front, and in particular the statement of 9 September, have already been the subject of substantial briefing. The notes following are therefore limited to the additional material which it may be useful for the Prime Minister to have in connection with Sir Raymond's call.

PAY

4. (a) Factual

August 1 traditionally marks the beginning of a new pay round, when negotiators look for a change in the typical level of settlement. Settlements in the round which has just ended averaged 17½%. With wage drift and catching-up payments from the last round, earnings will have increased by 22% over the round. These averages conceal some important features:-

(i) In the private sector, settlements averaged 18½%. Settlements in manufacturing industry averaged just under 17% (confirmed by CBI's Databank, which reports manufacturing settlements at 16.6%). Non-manufacturing settlements averaged 18½%. Exposure to the high exchange rate and recent job losses seem the factors operating to produce the lowest level of settlements. Because of low output, earnings in the private sector increased by 19½%, little more than the average settlement level.

(ii) The public trading sector settled on average at 18%, reflecting the same sort of factors as operated in the private sector.

(iii) The public services settled mostly for 14% increases, except for those with independent pay reviews. The average level was 15%, but comparability payments, the staged implementation of the April 1979 settlement for the non-industrial civil service, and wage drift raised average earnings for public service workers by another 12%.

(iv) About a quarter of manual workers negotiated reductions in the working week, mostly reductions of one hour effective in 1981. Many workers secured longer holidays. These improvements are likely to become more generalised in the coming round. Most of these changes do not show up in estimated settlement levels or earnings statistics.

(v) There was a continuing erosion of the principle that settlements should last for not less than 12 months.

(vi) There was no apparent acceleration in the rate of increases during the round; but also no signs of deceleration at the end of the round (despite press stories).

5. Some groups still await settlements from the last round, mostly in the public services and the Post Office. They will probably follow earlier settlements in those services. Talbot is the only major company still to settle in the private sector.

6. Very few settlements have been reached for the new round. Those that have been reported appear to be subject to the same influences and at the same levels as prevailed through the last round. It is too early to predict what private sector settlements will average; or whether a "going rate" will emerge. The main influences are likely to be:

- price movements. Now just under 17%; downward trend until the new year, though with hiccups, and then to fall;
- past earnings movements. Liable to move to 22% and not to fall markedly until the new year;
- unemployment. A major preoccupation of unions now;
- falling demand. Reflected in touch negotiating postures adopted by some employers (eg EEF, RHA);
- high cost of borrowing and high exchange rate.
- comparability. Groups who settled at relatively low levels in the last round (some manufacturing companies; many public services) may be looking to reclaim their old, or at least

retain their new, relative positions.

7. (b) Aims for the future

The financial and economic pressures on manufacturing industry, the Government's commitment to its monetary targets, and the need to avoid a further decline in international competitiveness, all point to settlements in single figures. Otherwise, the inevitable consequence will be a further and unnecessary increase in unemployment. Sir Raymond Pennock will be well aware of this and has been doing a valuable job in putting across the message himself. The Prime Minister might take the opportunity to thank him.

8. Some signs of a new atmosphere are already appearing in the private sector (the Talbot settlement at an annual rate of about 10%, the Lucas 10% imposed settlement, the Vauxhall 8% offer, which is going to secret ballot and has been narrowly accepted at Dunstable, the EEF stance on the National Engineering Agreement, although their 6.2% offer has been rejected. Nevertheless the latest Financial Times survey of business opinion shows half the respondents expecting wages to rise by 15%-19% over the next 12 months, whereas a year ago over half the respondents put the bracket at 10%-14%.

9. The Prime Minister can assure Sir Raymond Pennock that the Government will do all that it can to ensure that pay settlements in the public sector will not embarrass firms in achieving these low settlements. In the public services, this will be achieved through cash limits. It is too early to set these, but the Chancellor has indicated that the increases this year will need to be significantly lower than last year. The Prime Minister might speak in confidence in terms of single figures as a strong possibility.

10. Nationalised industries are more of a problem. Some will be heavily constrained by their financial position and EFLs and their workforces have relatively little bargaining power in current circumstances. Others (miners, electricity, water, perhaps railways) are either not so financially constrained and/or have workers with powerful muscle which they are prepared to use. Sir Raymond Pennock will be well aware of the problems here. The Prime Minister can assure him that the Government will do all that it can to hold settlements to realistic levels, but he will not under-estimate the

the difficulties. Since most nationalised industries are CBI members, it would be helpful if he could help to bring pressure to bear on nationalised industry managements through the CBI. It will be helpful to build up public opinion to voice its distate for excessive pay settlements (not just price increases) in monopoly nationalised industries.

11. This is not only a problem in the public sector. There are areas of the private sector - banks, oil companies, insurance - where firms have traditionally conceded high settlements and are not financially inhibited from doing so this year. The Government has no intention of intervening directly. But anything the CBI can do through their own contacts would be helpful. The Prime Minister mightask Sir Raymond Pennock whether he has any idea on how settlements might develop in this sort of area.

12. Finally, as Sir Raymond Pennock will be speaking also about interest rates and their effects on the exchange rate, profitability, output and employment, it is important that he should appreciate the links: interest rates are high partly because pay is being settled on a basis which is incompatible with the monetary targets - that lesson has not yet fully got across to the public and is important.

FISCAL SUGGESTIONS

13. The CBI have hitherto supported two proposals in particular, and may refer to them again:-

(a) Reduction in the NIS.

(b) The 'Lord' proposal that companies should be able to pay interest net of corporation tax.

Reduction/abolition of NIS

13a. The Chancellor's present thinking is that this is not the best way of using any money that could be found to give relief to manufacturing industry. A cut in the NIS would be very costly. Even a reduction of one percentage point (from 3½% to 2½%) would cost £750 million in a full year. It would also be rather indiscriminate - about two-thirds of the benefit would go to other than manufacturing industries, including the banks and oil companies. For a reduction to take effect in April 1981 a decision would need to be taken by mid-November. But there are precedents for a mid-year change which could be announced in Budget.

Interest Payments net of Corporation Tax

14. The "Lord" proposal was rejected by Ministers at the Committee Stage of the Finance Bill and the decision was reaffirmed by the Chancellor in correspondence with the CBI. The proposal would have assisted only those companies paying not mainstream tax. It would have complicated monetary policy and encouraged borrowing.

EXCHANGE RATE

15. The CBI supports the Government's main monetary objectives as the route to reducing inflation and accepts that a flexible exchange rate is a necessary counterpart to the firm monetary policy. Nevertheless they have shown great interest in any devices which could be employed to make the exchange rate lower than it now is, and there have been some contacts at technical level between the CBI and the Treasury about this. The problem with most such devices is likely incompatibility with monetary policy.

Level of Exchange Rate

16. We have no target level for the rate which, apart from some smoothing of excessive fluctuations, is determined by the balance of market forces. The rate is sensitive in the short-term to movements in relative interest rates, but the main factors underlying its present strength are probably our possession of North Sea oil at a time of continued uncertainty in the world oil market and overseas confidence in the Government's fiscal and monetary policies. On the other hand, as a result of the abolition of exchange controls the rate will probably be lower in the long-term than it would otherwise have been.

Intervention to reduce rate

17. Government intervention in the foreign exchange markets to seek to depress the exchange rate would risk monetary control, increasing inflation - and thereby damaging competitiveness except ~~in~~ possibly in the very short run. (CBI are unlikely to press this.)

Accelerate overseas official debt repayments

18. Repaying overseas official debt only affects the exchange rate if financed by intervention in the foreign exchange market to purchase the required foreign currency. The proposal would then be identical to that above. Repayments are in practice made directly from the reserves and thus have no effect either on the exchange rate or on the money supply.

Inflow controls

19. The experience of other countries is that inflow controls tend not to be effective for more than short periods. Taking into

/account

account the extremely sophisticated UK capital markets, it seems unlikely that the creation of barriers of this kind to the working of the market would have more than a temporary effect on the exchange rate.

NOTES ON RECENT INDUSTRIAL PERFORMANCE

Output

20. Provisional estimates to June show that industrial output fell during the first half of the year. Industrial output in the six months to June was some 3½% lower, and manufacturing output some 4½% lower, than in 1979 as a whole.

Index of Industrial Production (1975 = 100)

	All Industries	All industries other than North Sea	Manufacturing
1979	112.6	104.2	103.8
1980 Q1	110.3	101.7	100.7
Q2	107.4	99.1	97.9

Employment

21. Employment in index of production industries fell by 385,000 between June 1980 and June 1979. Over the same period employment in manufacturing industries fell by 355,000. There was a considerable reduction in the number of hours of overtime worked in manufacturing from 15.6 million in June 1979 to 12.4 million in June 1980. The number of workers in manufacturing on short time working also rose significantly from 36,000 in June 1979 to 205,000 in June this year.

Investment

22. The volume of capital expenditure by manufacturing industry fell 3% between the last quarter of 1979 and first quarter of 1980. The provisional estimate for the second quarter shows a further fall of 1%. A longer comparison, which gives a better indication of trends, shows the volume of investment in the first half of 1980 3% below the previous half year. Over the same period investment in plant and machinery, new building work and vehicles fell by 1%, 14% and 6% respectively.

23. The May Department of Industry Investment Intentions Survey indicated a fall in manufacturing investment of 8-12% between 1979 and 1980.

Manufacturing Industries Stocks

24. It is estimated that manufacturers' stocks fell by about £480M at 1975 prices in the first half of 1980. This is a turn round from a rise of £130m in the second half of 1979. During the first half of 1980 stocks of materials and fuel felly by £230m, work in progress by over £200m and stocks of finished goods by £50m. Despite this fall in stocks the stock/output ratio continued to rise due to the fall in manufacturing output more than offsetting the fall in stock levels. The August CBI monthly trends enquiry reported that the number of firms reporting that stocks of finished goods were more than adequate continued to rise to 42%. Further attempts at destocking are therefore likely.

Profits

25. Profit margins are being squeezed by weak demand, rising unit labour costs and reduced competitiveness. The CBI forecast that the real pre-tax rate of return of non-oil industrial and commercial companies to fall this year to below 2% the lowest level ever recorded. Measured by their net acquisition of financial assets industrial and commercial companies are estimated to have had a deficit of £2.4 billion in the six months to March 1980 compared with a deficit of £1.5 billion in the previous six month period.

COMPANY SECTOR LIQUIDITY

26. The Department of Industry's survey of company liquidity for the second quarter of 1980 was published in 'British Business' on 5 September. It showed a slight improvement in the overall position compared with the first quarter of 1980, but the liquidity ratio (total current assets as a percentage of total current liabilities) was still at the mid-74 level. The ratio for manufacturing companies deteriorated to its lowest level since mid-1975, while the position of non-manufacturing companies improved, with the ratio nearly back to the first half of 1979.

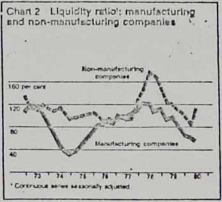

Chart 2 Liquidity ratio*: manufacturing and non-manufacturing companies

* Continuous series seasonally adjusted

/Prospects: not for disclosure: the outlook for the company sector, especially for industrial and commercial companies excluding the North Sea, is bleak. Profits and real rates of return are expected to fall and there is likely to be continued pressure on company liquidity./

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10 DOWNING STREET

From the Private Secretary 8 September 1980

BF 11.9.80

Sir Ray Pennock is coming to see the Prime Minister on Friday at his own request to discuss pay. I would be grateful if you could let me have a brief by Thursday evening.

T. P. LANKESTER

A J Wiggins, Esq
HM Treasury

PRIME MINISTER

Ray Pennock has telephoned to say that he will be holding a press conference at 1500 hrs this afternoon to announce the appointment of Terry Beckett as successor to John Methven as Director-General of the CBI, and I imagine Ford have some good people at second rung level from whom to pick a new chairman.

You are seeing Pennock on Friday at his request to discuss pay generally. He offered to bring Terry Beckett with him, but thought on the whole - since Beckett is very busy at the moment and will not be taking over until 1 October - it would be better if he came on his own.

T.

8 September, 1980

10 DOWNING STREET

MR. LANKESTER o/r

Sir Ray Pennock, President of the CBI is coming in on Friday, 12 September at 1600 hours to see the Prime Minister about "pay". I have not requested any briefing from anyone.

12 August 1980

Ind Pol. 1140/7

Covering Confidential

I'm not sure whether the P.M. will need this but it might be best to send it to Mr. Lankester for use if he thinks best.

WSR. 23/7

1. Mr ~~Ryrie~~ RG 23/7.
2. Principal ~~Private~~ Secretary
3. Mr Lankester - No 10.

copies attached for:
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir Douglas Wass

copies sent to:
Mr Burns
Mr Unwin
Mr Battishill
Mr Butt
Mr P Rayner
Mr Ridley

IPCS

SIR RAYMOND PENNOCK'S CALL ON THE PRIME MINISTER

Sir Raymond Pennock is due to call on the Prime Minister on 24 July in order to discuss pay, unemployment and related presentational questions.

2. We understand that a brief has not been called for, but that we have been invited to put forward something if we think it worthwhile. I attach a note for this purpose.

(attached)

3. It might be sensible in addition to send to No. 10 a copy of Mr Lord's letter to the Chancellor about paying interest net of corporation tax and say that the Chancellor is considering his reply. So far as we know, this is not likely to be raised in discussion, but, if it were referred to, the Prime Minister might show awareness of it, and I attach a very short note on this.

PVD.

P V Dixon
23 July 1980

CONFIDENTIAL

SIR RAYMOND PENNOCK'S CALL ON THE PRIME MINISTER

Sir Raymond Pennock is calling on the Prime Minister on 24 July, in order to discuss, we understand, the public stance of the CBI and the Government on pay/inflation/unemployment, etc.

2. The Prime Minister should be aware of the attached letter which Sir Raymond Pennock has written to the Chancellor. The letter is helpful. It is possible that the Chancellor will have sent a friendly acknowledgement by the time the meeting takes place, in which case the reply will be added to the brief. The Government's answers on a number of points will become clear when there are announcements relating to the discussion at E Committee on 23 July. Meanwhile this brief deals with the CBI's approach in fairly general terms.

3. The line Sir Raymond Pennock has been taking in public in the last few days has been most useful from the point of view of talking down the likely level of pay settlements.

4. He is reported (e g Sunday Times, 20 July) as having said:

(a) The country's economic performance suggests that there should be no wage increase at all in this round, though such a goal would be impracticable.

(b) Firms should settle for less than 10%, and he does not mean 9%.

(c) Any notion that pay can rise in step with the retail price index is foolish.

5. On the other hand, he evidently sees the causation of inflation in different terms from the Government: ". . . unlike the Government we do not believe that monetary influence and control is the most important factor affecting inflation - we believe it is wages" (BBC Radio 16 July). So far as the past is concerned, the two views are not wholly incompatible: under previous Governments there was a tendency to allow the money supply to accommodate itself to the level of pay settlements and inflation of prices was the result. But the present policy

of adhering to firm monetary targets (which would be adequate to finance a growing economy if there were less inflation in it) means that inappropriate behaviour regarding pay will increasingly be reflected in lower profits and higher unemployment rather than higher prices. Sir Raymond Pennock is clearly seeing the link between pay on the one hand and competitiveness and unemployment on the other, even if he is still emphasizing the (short-term in the Government's view) link between pay and prices.

6. One other area of difference is the trend of public sector pay. Sir Raymond Pennock is reported to believe that the Government showed a loss of control. This is not altogether fair. So far as public services are concerned, the large increase in earnings in 1980/81 by comparison with 1979/80 is partly because the inherited liability for catching up settlements was large, and partly because the non-payment (through staging) of amounts which were due in 1979/80, by depressing the base year for comparison, made the year-on-year increase in 1980/81 look large; new settlements in the public services during the 1979/80 pay round, the Government's first year, averaged 15%, which was less than the rate of increase in the private sector, even manufacturing.*
Nationalised industries have been roughly on a par with the private sector.

7. So much for interpretation of the past. The more important question is how to settle the future. Sir Raymond Pennock will no doubt seek guidance on whether the line he has been taking fits in with the Government's approach; he will wish to pick up further suggestions; and no doubt he will make suggestions as to what the Government can do to help.

8. On the first point, his attempt to talk down pay increases below 10% can be strongly welcomed. He bases this argument primarily on the need for greater competitiveness, which was one of the arguments in the Chancellor's paper for E on influencing national pay behaviour. Another argument he could use is that settlements which do not reflect the target rate of growth of the money supply (7 - 11%) put a stress on the financial system which is reflected in interest rates and the

* 16½% according to the CBI

real exchange rate - it is not just the Government's operations which lead to the level of interest rates, but the totality of actions in the private sector and their compatibility with the monetary targets. It is right, therefore, to encourage the CBI to carry on talking in terms of single figures with the aim of getting the maximum deceleration possible.

9. As regards what the public sector can do to help, Sir Raymond Pennock can be reassured that the Government is determined that the rate of earnings increase in 1980-81 should be such as will make the task of deceleration in the private sector easier and not more difficult. The normal mechanisms for reviewing and settling pay may possibly have to be disengaged, e g what has been done on the TSRB (and the E Committee decision) - if they show incompatibility with the trend which the Government wishes to see established. It has been made clear that cash limits in the next round will be set so as to reflect assumptions on pay significantly lower than in the last round. The precise level has not yet been decided; nor is it yet clear how great will be the incompatibility with the normal methods of settling public service pay. Sir Raymond Pennock's efforts to influence the climate generally will assist the Government in playing its part. If a single figure outcome looked genuinely possible in the private sector, the Government would wish to ensure that such possibilities were not vitiated by setting cash limits on a more generous basis. The next few months will be very important as regards the climate.

10. Finally, Sir Raymond Pennock may urge that the Government do more, and in a greater variety of ways, to get its message across. The problem, of course, is not simply uttering the message - Ministers have been doing this on an impressive scale since coming into office. The problem is persuading the public to believe it - the consistent speculation in newspapers and elsewhere on the likelihood and timing of the "U-turn" reflects disbelief rather than

non-comprehension. It is possible that the seriousness of the Government in its adherence to monetary targets for a run of years is being better understood now. If the Government had been believed, it is almost inconceivable that both sides of industry could have set bargains during the last year at levels which, for their results in terms of profitability and unemployment, both must now regard as having been disastrous. It is therefore important that the CBI should do what it can to enhance the credibility of the Government regarding its monetary policy and not argue for modification of it, which the Government could not accede to; but the argument itself would help to perpetuate the public impression that engines were about to be reversed.

11. So far as comprehension of the message is concerned, it does involve time and a lot of repetition and certainly not all has yet been achieved. But the message is essentially a simple one, intuitively obvious. Everyone has been brought up in the knowledge that inflation is too much money chasing too few goods. The Government will stop there being too much money, and that will stop the inflation. That being so, there are problems ahead for anyone who promises to pay what he can't afford or makes a bargain on the basis that the money will be forthcoming from somewhere. But the message, though simple, is very different from that of previous Governments and much effort is still needed to put it over.

12. A particular opportunity, though on a limited scale, will be the August meeting of the NEDC, when the macro-economic discussion will be continued, partly on the basis of a paper by the Chancellor on "pay, prices and unemployment". It is possible that the CBI will put in a paper of their own (e g reflecting what Sir Raymond Pennock has been saying); but whether or not they do so, if would be helpful if they could at the NEDC meeting speak in support of the Chancellor's paper and not leave the debate to the Government and the TUC - to be fair, Sir Raymond Pennock's contributions on these questions at recent meetings of the NEDC has been most notable and influential and it would be right to compliment him on this.

Industrial Policy Group
H M Treasury

23 July 1980

CONFIDENTIAL

CORPORATION TAX - THE "LORD SCHEME"

Alan Lord, Chairman of the CBI Taxation Committee, has put forward a proposal whereby companies that have exhausted their normal corporation tax liability would be able to get relief on interest payments. The CBI have recently been pushing it hard. The scheme is complex and likely to be costly, particularly since it would be open to abuse. It would by definition only help particular categories of industries, i e those which do not pay mainstream corporation tax. The Government has hitherto taken the view that it is more important to get interest rates down by reducing the burden of financing the public sector than to help selected companies by measures which would increase the PSBR. Mr Lord has, however, recently written again to the Chancellor and his letter is being considered.

Industrial Policy Group
H M Treasury

23 July 1980

TREASURY PRESS CUTTING SECTION

ROOM 107/2 Tel: Ext. 3639

Extract from: Sunday Times Page 49 Dated: 20/7/80

Stand firm on 10% pay rises, says CBI boss

by Roger Eglin, Industrial Editor

A REPETITION of pay increases on last year's scale in the forthcoming pay round will be a disaster for the economy, CBI president Sir Raymond Pennock warns.

In an exclusive interview with The Sunday Times, Sir Raymond says, "CBI projections show that settlements in the 20% area for the next year will produce a massive leap in unemployment, cut company profitability in real terms to 1% or less and undermine the ability of companies to invest. This will only cause further unemployment as the country's industrial base declines even more.

"August sees the start of next year's pay round. If it follows the usual pattern, the settlements in the first three months will be crucial in influencing the whole round."

While he recognises some evidence that there will be a decline in inflation, he is far from sharing the new mood of optimism gripping the government. "There is a long way to go," he insists. "We have had a great deal of talk about moderate pay settlements but what we now have to see is deeds, not words."

The country's economic performance suggests there should be no wage increase at all in this round, he says, but without a government pay policy, which the CBI would not support, this goal is impracticable. His advice for the current round is that CBI members should "follow the example of the 10 to 12 firms in the Midlands who in the last month have settled for less than 10%. Any notion that pay can simply rise in step with the retail price index is foolish in the extreme, he says. "The evidence shows that settlements around the RPI, even if it declines, are not enough to regain competitiveness because we have had a succession of settlements in the 15%-20% area for three years running when our competitors in Germany, Japan and the US have settled on average over that period in the 5%-7% area."

The CBI sees a reduction in wage settlements, and thus inflation, as the top priority in restoring the international competitiveness of British industry.

Disagreeing with those ministers who see harsh monetary policies as the answer to inflation, Pennock says that detailed research by the CBI's economics staff shows a very close connection between wages and prices. "When wage settlements in 1974-75 shot to 20% price increases of over 20% followed within six months," he says. "A year later, with Jack Jones's £6 flat rate pay policy, wage settlements on average were down to 12% and again, within six to eight months, price increases fell to similar levels. Yet from the May figures, there is little doubt that settlements from the last round are still running at about 21%. This is an unmitigated disaster for the British economy."

New figures which show that UK manufacturing production fell 8% in the last quarter, and that total output is less than in 1975, are a direct consequence of excessive pay settlements which, according to Pennock, mean "we are paying ourselves 102% more for this reduction in output." He emphasises that this has been a main contributor to cutting out 250,000 jobs in manufacturing industry and to the sharp increase in company bankruptcies in the first quarter of this year.

So straitened is the economy now, he says, that soaring oil prices have had a disproportionately greater effect on British industry than its major competitors.

With little publicity the CBI recently organised two conferences, each attended by over 70 top executives of the country's biggest companies, in its bid to moderate pay claims. At these meetings, the central theme reiterated by Pennock was that last year's failure was a responsibility that all had to share—trade unions, managements and government.

After the government's loss of control over public sector pay, Pennock feels that it has a special responsibility to set a better example this year. "If it does not," he says, "it means that public spending cannot be controlled, that they are not bringing down interest rates, and they are setting an example, as happened last year, which makes it difficult to achieve moderation in the private sector."

Without moderation, the golden opportunity offered to government by North Sea oil revenue, which will be between £11bn and £18bn by 1984, will be lost.

Confederation of British Industry
Centre Point
103 New Oxford Street
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Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From the President
Sir Raymond Pennock

CBI CONFEDERATION OF BRITISH INDUSTRY

CH/EXCHEQUER	
REC.	16 JUL 1980
ACTION	Mrs Heaton
COPIES TO	CST
	FST
	Sir D. Wass
	Mr Ryrie

Mr Middleton
Mr Dixon
Mr Unwin
Mr Ridley
Mr P Rayner
Mr Monck

16th July 1980

Mr Rayner

PRIVATE

Dear Geoffrey

You will remember that at our meeting on 13 June, I mentioned that we were intending to hold two conferences of chief executives and key industrial relations personnel from selected companies and employer organisations to consider the outlook for pay. The conferences were held on 20 and 23 June, and have been followed by further discussions with members of our Employment Policy Committee and the President's Committee.

Perhaps the three most important points emerging from the conferences were these:

first, a growing determination to secure a substantial reduction in the level of pay settlements in the months ahead and a clear recognition that pay increases cannot continue to match price increases. Although we would like to see more concrete evidence, there were clear indications in the conferences of a decline in settlement levels, particularly in engineering;

secondly, there was a strong feeling that concessions on hours and holidays should be minimised and that it was essential to avoid leapfrogging on these issues between manual workers and staff;

thirdly, considerable concern was expressed about pay in the public sector.

In bringing this concern to your attention in a private letter, I would emphasise that we have no desire to interfere in a matter which is the responsibility of employers in this sector, but I feel I should write because of the impact of public sector pay on our members - both through its effect on pay in their own companies, and through its effect on government expenditure and hence interest rates.

59/16/7

/ ...

While our members are determined to play their part in reducing the rate of pay increases, they believe that there are a number of steps which government might take that would be extremely helpful.

The first would be to bring the work of the Clegg Commission to an end as soon as possible. We appreciate that the Commission has still to complete work on a number of references. We are concerned, however, that even though these references cover relatively small numbers of employees, the Commission's report may attract public attention and, if the awards are for substantial pay increases, raise the expectations of other employees in the early stages of the next bargaining round. There may, therefore, be advantages in government reviewing the remaining references before the Commission to see if they can be withdrawn with the agreement of the parties concerned, and settled more quickly by negotiation.

We believe that there is a case for re-examining the whole role of comparability in determining pay in the tax-dependent public services. This is, however, a complex question, and might best be dealt with by means of a wide-ranging enquiry covering the institutional arrangements for determining public service pay, including the levels at which bargaining takes place and the timing of settlements; the role of comparability; and, if comparability is to have an important role, which groups should be covered by comparability mechanisms, what these mechanisms should be, and the methodologies on which comparability should be based.

Pending the outcome of this enquiry, we suggest that, with the possible exception of those covering the police and armed services, the work of the existing pay research and review bodies should be suspended, and the pay of the groups concerned should be negotiated between the employers and the unions involved in the light of the government's overall economic objectives and within the discipline of cash limits.

We have also considered further whether there would be advantages in government making a single comprehensive statement detailing the financial targets of all the nationalised industries, making clear the responsibilities of both government and boards of the nationalised industries to see that these targets are achieved and spelling out the implications of these targets for pay bargaining between the managements of the nationalised industries and their unions. We feel that this would have attractions, and shall be discussing it with the nationalised industries' chairmen later this month.

As I have already mentioned, our members are determined to do all in their power to moderate the level of settlements. I believe that government action on the lines I have suggested will help them succeed.

Yours sincerely,

Ray.

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street, SW 1.

FILE

Copied to Master Set. [initials]

c Mr Hoskyns
Mr Ingham

10 DOWNING STREET

From the Private Secretary

25 July,1980

As you know, Sir Ray Pennock called on the Prime Minister yesterday afternoon. The following are the main points which came up in discussion.

Sir Ray said that the next three months were critical for industry. What happened to pay at the beginning of the pay round would have a major effect on the outcome for the whole round. For this reason, he had been vigorously advocating the need for single figure settlements - and to get settlements down as low as possible within single figures he had been arguing that the country needed "a range of single figure settlements, and I don't mean 9%". Unfortunately, the oil companies and the banks settled early in the pay round, and because of their high profits they were all too likely to settle well above single figures. The same went for Ford, and for different reasons, the mine workers. He was planning to hold a meeting the following week with the chairmen of the major oil companies, the chairmen of Ford and Vauxhall and of the National Coal Board, and also Sir Jeremy Morse in order to persuade them to hold out for moderate settlements. He was not all that confident that he would be able to succeed because, for example, Shell's profits, even on a current cost accounting basis, were very high. But it was worth trying. He would argue that with the economic situation as it was, most companies would only be able to settle within single figures, and that it was unreasonable that profitable companies should use their profits to pay much higher pay increases rather than to lower their prices. It would help if the Prime Minister and other Ministers could support the CBI in arguing for markedly lower settlements at the beginning of the new pay round. This should, however, be done without giving any impression of connivance with the CBI. Furthermore, in so far as the more profitable companies would still almost certainly settle at relatively high levels, it was crucially important to try to distance less profitable companies from them in their own negotiations. There was some evidence that this was happening already; but the point needed to be emphasised a great deal more.

/Sir Ray

Sir Ray went on to say that, while stressing the seriousness of the current situation, he hoped that Ministers could hold out a ray of hope for the medium-term. The message needed to be that provided we got the inflation rate down, then with the help of North Sea Oil revenues we would have the prospect by the mid-1980's of a prosperous decade; if we did not get inflation down, industry will become increasingly uncompetitive, and more and more imports will be sucked in, and the economy will continue to stagnate.

Sir Ray made the following further points:-

(i) He hoped the Government would do everything possible to play down the forthcoming settlement for the Police, which he understood would follow the Edmund-Davies formula. Ministers should stress the exceptional circumstances, including supply and demand considerations.

(ii) In response to a question from the Prime Minister about large companies delaying their payments to small businesses, Sir Ray said that he had recently written to his members to try to get them to pay more promptly.

(iii) Sir Ray said that he hoped that the Green Paper on Trade Union Immunities would include tough proposals so as to redress still further the balance of power between employers and employees. The history of the last twenty years was one of companies being faced with pay demands which they could not afford, and yet settling because the cost to them of strike action was even greater. As a consequence, profits had been continuously eroded and investment had consequently suffered; only if the balance of power in industry changed would British industry really recover. The Prime Minister commented that the CBI had been distinctly lukewarm about more radical changes in trade union immunities when the Employment Bill was being prepared; she was glad to hear that the CBI were now taking a more robust line. Sir Ray denied that the CBI had ever been lukewarm on this matter.

T. P. LANKESTER

A J Wiggins, Esq
HM Treasury

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From the President
Sir Raymond Pennock

Mr Lankester No 10

CBI CONFEDERATION OF BRITISH INDUSTRY

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CH/EXCHEQUER	
REC.	23 JUL 1980
ACTION	CST
COPIES TO	FST
	Sir D. Wass
	Mr Burns
	Sir K. Couzens

23/7

Mr Lovell
Mr Unwin
Mr Ridley
Mr Rossiter
Mr Dixon

23rd July 1980

Dear Geoffrey,

We have now received the results of the latest CBI Industrial Trends Survey. Although this information will not be released before 00.30 hours on Wednesday 30th July it does reveal, as we expected, such a serious situation that I thought it worthwhile to let you have the main features of the Survey as far in advance as possible.

We will be using the results to keep up the pressure in our campaign for moderate wage settlements in the ensuing pay round. At the same time they confirm the statement I made at the last NEDC meeting about the serious impact of current Government measures on manufacturing industry. I would therefore like to reiterate the contention also made at that meeting that the continuing reduction of interest rates and some relief from N.I.S. would be especially welcome at the present time.

A CBI team led by Campbell Fraser is meeting Keith Joseph on Thursday to discuss the state of industry and this will provide an opportunity to discuss these results with him also.

Yours sincerely,

Ray

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
HM Treasury,
Parliament Street,
London, SW1P 3HE

STRICTLY CONFIDENTIAL: NOT FOR PUBLICATION BEFORE 00.30 HOURS WEDNESDAY 30 JULY

Briefing note for Chancellor of Exchequer and Secretary of State for Industry on Results of July 1980 CBI Industrial Trends Survey

The July quarterly CBI Industrial Trends Survey was conducted between 27 June and 16 July and replies were received from 1961 manufacturing firms. The sample normally directly accounts for about 3 million employees and over half of the UK's manufactured exports.

The main points of the results, which show a sharp deterioration in manufacturing activity levels, are set out below.

1. There has been a rapid decline in the past four months in the levels of new orders and of output. This has occurred to a greater extent than forecast in the previous quarterly survey. Over the next few months the decline is expected to continue at least as rapidly.

2. Reflecting this fall in activity levels there has been a further worsening in capacity utilisation, and 76 per cent of firms are now working "below a satisfactory full rate of operation". Chart I illustrates the extent to which below capacity working has become more widespread since the peak in July 1979.

3. For the next four months an unprecendented proportion of firms (see Chart II) expect a lack of 'orders or sales' to limit output.

4. Accompanying this fall in activity levels, manufacturers have become less optimistic about the general business situation in their own industries to almost the same extent as during the three-day week (Chart III).

5. Investment intentions have once again weakened sharply, following the cyclically small decline recorded in the April Survey (see Chart IV).

6. Consistent with the spread of under utilisation of capacity, labour shedding in manufacturing industry has become as widespread as ever previously recorded. Over the next four months the rate of decline in manufacturing employment is forecast to be even greater than in the past four months.

7. Chart V shows the reported trends in average unit costs and in average domestic selling prices. There has been a sharp decline in the proportion of firms raising their prices and a much less marked easing of unit cost increases. Over the next four months cost pressures are expected to ease slightly further while a continued low proportion of firms expect to raise their domestic prices.

8. This pattern is much more apparent for export prices; 34 per cent of firms have raised export prices over the last four months but 19 per cent have implemented price reductions. In spite of this, a record percentage of exporting firms expect "prices relative to those of overseas competitors" to limit their ability to obtain new export orders over the next four months (see Chart VI).

9. There has been a sharp falling off in new export orders and deliveries; and this is forecast to continue just as rapidly over the next few months.

10. Participants' optimism about their export prospects over the next twelve months has declined to a previously unsurpassed extent (see Chart VII).

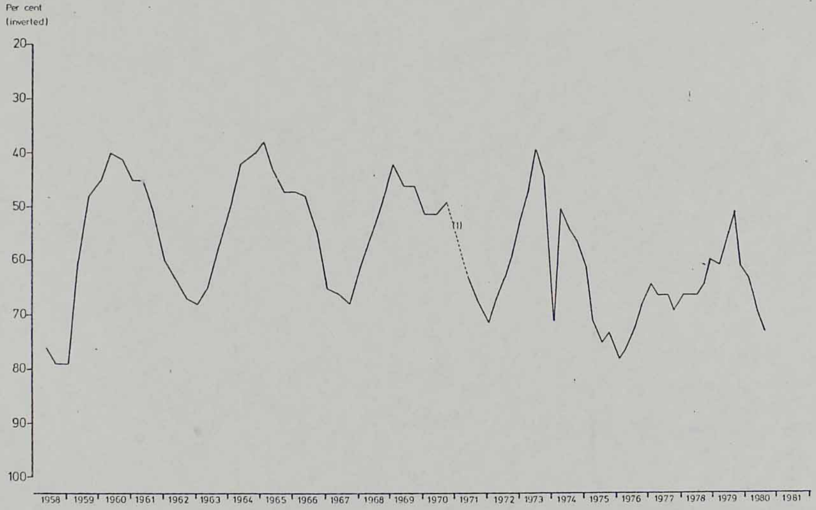
Industrial Trends and Economic Forecasting Department

22 July 1980

CHART I

CBI INDUSTRIAL TRENDS SURVEY

Q 4 Is your present level of output below capacity (i.e. are you working below a satisfactory full rate of operation.)

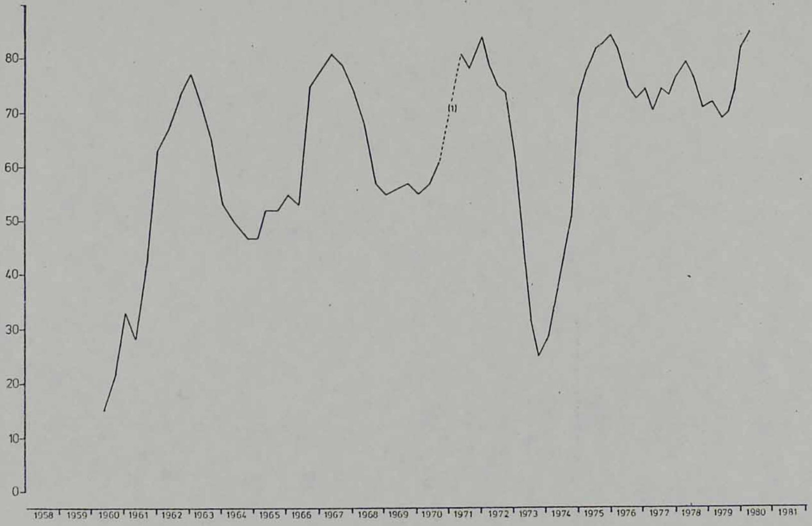


(1) Survey 40 (Feb 1971) was abandoned owing to the postal strike

CHART II

CBI INDUSTRIAL TRENDS SURVEY

Q 14 Is shortage of orders or sales a factor which is likely to limit output over the next four months



(1) Survey 40 (Feb 1971) was abandoned owing to the postal strike

CHART III

CBI INDUSTRIAL TRENDS SURVEY

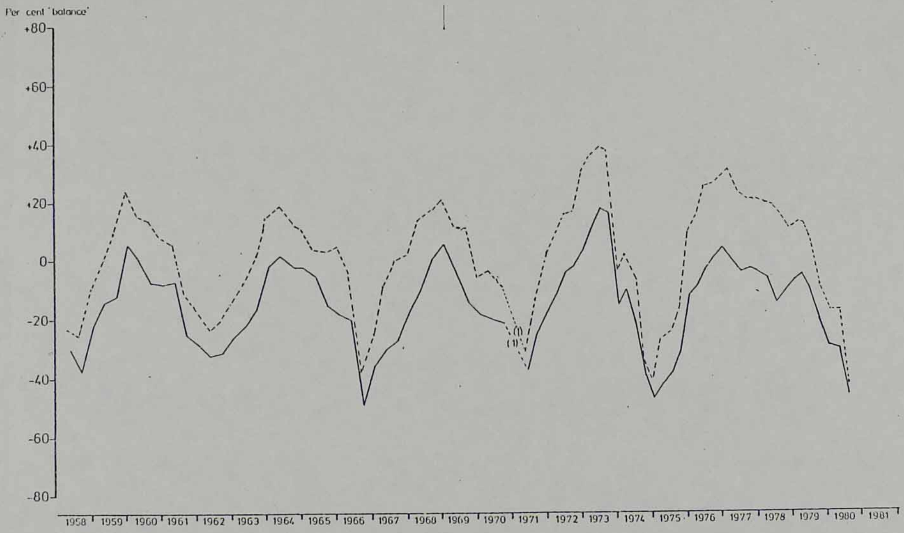
Q1 Are you more, or less, optimistic than you were four months ago about the general business situation in your industry.

(1) Survey 40 (Feb 1971) was abandoned owing to the postal strike

CBI INDUSTRIAL TRENDS SURVEY

CHART IV

Q 3a Do you expect to authorise more or less capital expenditure in the next twelve months than you authorised in the past twelve months on : BUILDINGS ——
PLANT & MACHINERY - - - - -



(1) Survey 40 (Feb 1971) was abandoned owing to the postal strike

CHART V

Q 11 What has been the trend over the past four months with regard to the average costs per unit of output - - - - -

Q 12a What has been the trend over the past four months with regard to the average prices at which domestic orders are booked ———

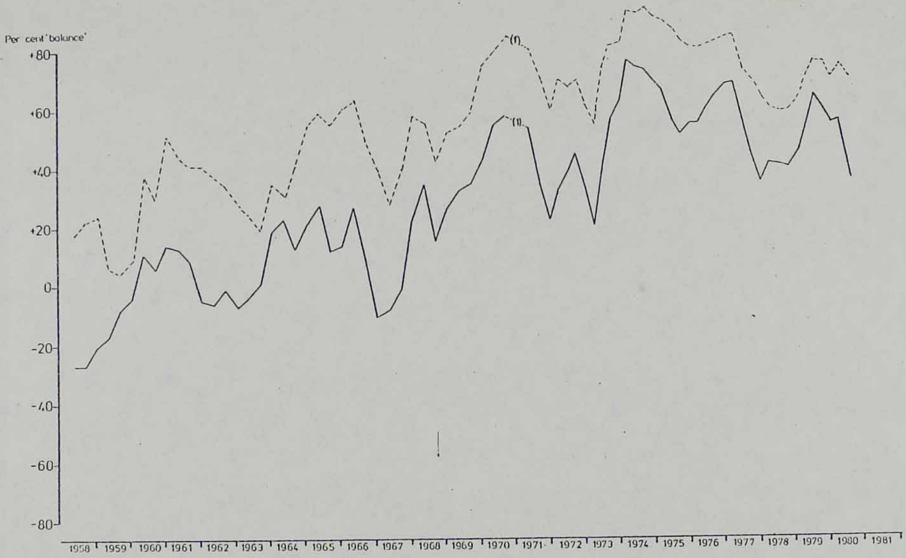


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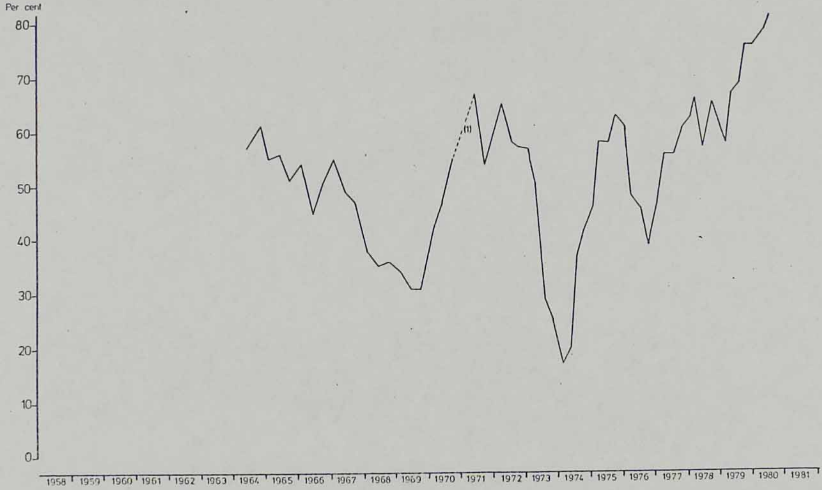
CHART VI

CBI INDUSTRIAL TRENDS SURVEY

Q 15 Is the price of your exports (compared with those of overseas competitors) a factor likely to limit your ability to obtain export orders over the next four months.

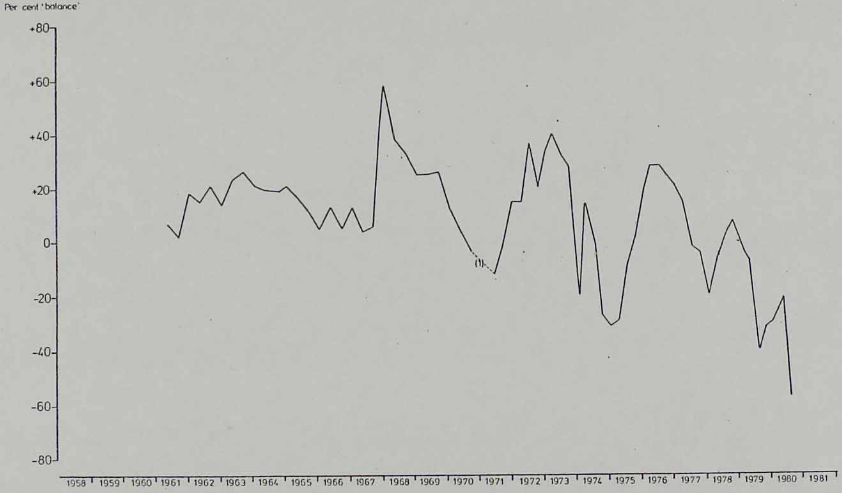


(1) Survey 40 (Feb 1971) was abandoned owing to the postal strike

CHART VII

CBI INDUSTRIAL TRENDS SURVEY

Q 2 Are you more or less optimistic about your export prospects for the next twelve months than you were four months ago.



(1) Survey 40 (Feb 1971) was abandoned owing to the postal strike

NOT for publication before 0030 hours on Wednesday 30 July 1980

CBI INDUSTRIAL TRENDS SURVEY SUMMARY OF RESULTS FROM APRIL 1979 TO JULY 1980

(All figures are percentage balances of 'ups' over 'downs' except where otherwise stated)

	TOTAL TRADE	Apr 79	Jul 79	Oct 79	Jan 80	Apr 80	Jul 80
1	Optimism re business situation	+ 6	-22	-40	-45	-41	-70
2	12 month forecast of capital expenditure authorisations compared with previous 12 months on:						
a	buildings	- 6	- 9	-20	-30	-31	-47
b	plant and machinery	+12	+ 8	- 9	-18	-18	-43
4	Firms working below capacity *	55	51	61	63	70	76
6	Numbers employed - past 4 months	-19	-14	-20	-31	-43	-50
	Numbers employed - next 4 months	- 6	-15	-25	-35	-40	-58
7	Volume of new orders - past 4 months	+11	+ 6	-18	-18	-26	-55
	Volume of new orders - next 4 months	+14	-10	-18	-24	-21	-47
8	Volume of out put - past 4 months	+ 8	+13	-17	- 1	-14	-38
	Volume of output - next 4 months	+24	+ 4	+ 4	-11	-14	-41
10a	Stocks of raw materials - past 4 months	+ 6	+13	+10	- 3	-17	-12
	Stocks of raw materials - next 4 months	+ 3	- 9	-20	-24	-23	-41
b	Stocks of work in progress - past 4 months	+10	+13	+ 9	0	-10	-10
	Stocks of work in progress - next 4 months	+ 4	- 5	-11	-16	-16	-39
c	Stocks of finished goods - past 4 months	- 1	+ 6	+ 4	+ 6	+ 5	+ 7
	Stocks of finished goods - next 4 months	+ 3	- 6	-10	-12	-13	-30
11	Average unit costs - past 4 months	+73	+77	+77	+72	+76	+71
	Average unit costs - next 4 months	+72	+76	+74	+76	+72	+63
12a	Average domestic prices - past 4 months	+57	+64	+60	+55	+57	+35
	Average domestic prices - next 4 months	+65	+65	+60	+65	+56	+33
14	Four month forecast of factors limiting output *						
	Orders or sales	69	70	74	82	85	91
	Skilled labour	23	21	20	13	10	5
	Other labour	6	5	3	2	1	0
	Plant capacity	16	15	11	8	7	4
	Credit or finance	3	2	5	4	5	7
	Materials/components	8	9	9	13	6	2
	Other	3	4	7	6	3	2

EXPORT TRADE		Apr 79	Jul 79	Oct 79	Jan 80	Apr 80	Jul 80
2	Optimism re export prospects	- 7	-40	-32	-30	-21	-57
7b	Volume of new export orders - past 4 months	+ 1	- 2	-22	-14	-10	-40
	Volume of new export orders - next 4 months	+ 7	-11	- 6	-12	- 6	-35
9b	Volume of export deliveries - past 4 months	- 4	+ 8	-29	- 8	- 3	-32
	Volume of export deliveries - next 4 months	+20	+ 4	+ 4	- 9	+ 2	-30
12b	Average export prices - past 4 months	+45	+36	+40	+37	+43	+15
	Average export prices - next 4 months	+45	+37	+50	+53	+37	+22
15	Four month forecast of factors limiting export orders *						
	Prices	67	69	76	76	79	83
	Delivery dates	17	14	20	13	12	6
	Credit or finance	8	7	5	8	6	8
	Quota and licence	12	11	15	14	10	10
	Political/economic conditions abroad	33	37	39	39	34	39
	Other	12	12	11	7	9	4

* Percentage figures

CONFIDENTIAL

E folder pl

cc Mr Ibbs
Mr Le Cheminant
Mr Moore
Mr Miles

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000 18 July 1980

Richard Dykes Esq
Private Secretary
Department of Employment

Dear Richard,

THE OUTLOOK FOR PAY

The Chancellor thought your Secretary of State, and other interested Ministers, would like to see the attached letter he has received from the President of the CBI, before the E Committee discussion on pay on Wednesday 23 July.

I am copying this letter, and the letter from Sir Raymond Pennock, to the Private Secretaries to the members of E and E(NF) Committees, and Sir Robert Armstrong.

yours sincerely

John Wiggins

A J WIGGINS

Confederation of British Industry
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London WC1A 1DU
Telephone 01-379 7400
Telex 21332
Telegrams Cobustry London WC1

From the President
Sir Raymond Pennock

CBI CONFEDERATION OF BRITISH INDUSTRY

CH/EXCHEQUER
REC. 16 JUL 1980
ACTION Mrs Heaton
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Sir D. Wass
Mr Ryrie
Mr Middleton
Mr Dixon
Mr Unwin
Mr Ridley
Mr P Rayner

Bring to other E colleagues before E?

16th July 1980

PRIVATE

Dear Geoffrey,

You will remember that at our meeting on 13 June, I mentioned that we were intending to hold two conferences of chief executives and key industrial relations personnel from selected companies and employer organisations to consider the outlook for pay. The conferences were held on 20 and 23 June, and have been followed by further discussions with members of our Employment Policy Committee and the President's Committee.

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/ ...

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Yours sincerely,

Ray.

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street, SW 1.

MANAGING DIRECTOR

Things – all news to me – <u>both</u> sides. Many thanks – a letter by [illegible] time for [illegible]

01-930 6700

DUNLOP HOLDINGS LIMITED
DUNLOP HOUSE, RYDER STREET,
LONDON, SW1Y 6PX

16th July 1980

Geof / 16/7

The Rt. Hon. Sir Geoffrey Howe, QC, MP
H.M. Treasury,
Parliament Street,
London SW1.

CH/EXCHEQUER	
REC.	16 JUL 1980
ACTION	Mr Middleton
COPIES TO	CST
	FST
	MST(C)
	MST(L)
	Sir D. Wass

Mr Burns
Mr Ryrie
Mr Battishill
Mr Bridgeman
Mr Dixon
Mr Unwin
Mr Ridley
Mr Cropper
Mr Isaac (IR)
B/IR

Dear Chancellor,

STOCK RELIEF

I am writing to you urgently as Chairman of the CBI Taxation Committee, on a matter of great importance to British business. I refer to the provisions in the current Finance Bill which will allow for the deferment in certain circumstances of stock relief recovery charges.

For some time now the CBI have been pressing for such a relaxation in the stock relief rules, primarily in order to relieve the grave financial difficulties which may confront companies if a temporary fall in their stock levels (generally for reasons beyond their control) co-incides with the end of their tax year. We were encouraged to hope, before the Budget this year, that the Government were fully aware of this problem and intended to take steps to remedy it.

We were therefore dismayed by the details of the Government's proposals, and in particular by the intro-duction of the new and highly suspect concept of 'net indebtedness'. This concept is out of keeping with stock relief as a whole, since net indebtedness is not relevant in calculating either stock relief or clawback. We have taken every available opportunity to explain to your colleagues and officials why we regard this aspect of the new relief as totally inappropriate. For reasons which remain unclear, they did not appear to accept our arguments but they will, I am sure, have reported to you our view that the principle is misconceived and illogical, and that any attempt to make practical sense out of it would result in excessive administrative problems for both the Revenue and taxpayers.

So far as those practical problems are concerned, the Revenue conceded that in theory the legislation as drafted could give rise to difficulties. But they assured us that in practice tax inspectors would take a reasonable line.

We always viewed this reassurance with scepticism and our misgivings have now been confirmed by the enclosed draft statement of practice from the Revenue which attempts to explain how the concept of 'net indebtedness' will be interpreted. The Taxation Panel of the CBI studied this draft statement very carefully yesterday afternoon, and I have to tell you that I cannot remember any Government document getting such a universally hostile reception. It is clear from even a cursory inspection of these 'broad guidelines' that they are theoretical in their approach, naive in their appreciation of the real problems of industrial cost allocation and that any company which attempted to comply with these requirements would be faced with an extremely costly additional administrative burden even if it was already equipped to produce full monthly CCA management accounts.

There are only two ways in which this draft statement can be interpreted. It may simply be that it fails to achieve what it sets out to do, which is to explain clearly and concisely how the 'net indebtedness' concept will be interpreted. Alternatively, and we think more probably, the defects of the statement confirm the view which we have always taken, namely that the 'net indebtedness' proposals encapsulates a conceptual flaw so basic that it cannot be concealed by a working practice, however emollient. Leaving aside the unrealistic degree of detail which the guidelines would require, I can best illustrate this central objection by noting that their effect would be to deny relief to companies which have the greatest liquidity problems and confer greater relief on companies which have a relatively strong liquid position. In short, the practical effect of the legislation would be to achieve precisely the opposite result of that for which the CBI originally sought it.

I should add that the Report Stage Government amendment proposing that the net indebtedness restriction should only apply where the sum at stake exceeds £100,000 does nothing to weaken our arguments: indeed it reinforces them for it effectively concedes that the restriction is inoperable except in cases where considerable resources of human skill, both in companies and the Revenue, can be brought to bear. The effect of the amendment may be to eliminate a large number of small cases and therefore ease the burden of work in tax offices. It will do nothing to help the larger case, where there may be an equal need for relief.

I know well how busy this time of year is for you and I much regret that my Committee feel it necessary to trouble you with this matter. But I am sure that you should be aware of this document and the strength of feeling which it has provoked. The only conclusion to be drawn from it, as I have already implied, is that the 'net indebtedness' restriction is misconceived and ought to be excluded from the Bill.

I am sending copies of this letter by hand to Mr. Peter Rees, Lord Cockfield and Sir Lawrence Airey.

Yours sincerely,

Alan Lord

Alan Lord

File

lnd Pol DSG

cc: D/Emp.
D/Ind.
B. Ingham
J. Hoskyns.
Master

10 DOWNING STREET

From the Private Secretary

2 June 1980

As you know, Sir John Greenborough and Sir Ray Pennock called on the Prime Minister this evening. They were only able to have a short discussion. The following were the main points raised:

i) Successor to Sir John Methven

Sir John said that this appointment was crucial. He and Sir Ray had identified a few good names who might be willing to serve. But it would be very helpful if, when they had finally decided on a candidate, the Prime Minister would be willing to lend her support. If she could indicate that this was a post of national importance, that would help to persuade the person in question that he should take on the post. They hoped to have identified a suitable candidate within the next two to three months. The Prime Minister said that she would willingly do what she could to help.

ii) Getting over the realities

Sir Ray said that one of his main tasks would be to continue Sir John's efforts to get over the realities of business life to the trade unions. Management in British industry was signally weak at explaining to employees the "facts of life"; the CBI had to help change this. They would do all they could to persuade trade union leaders that pay bargaining must be realistic. The Prime Minister commented that it was better for the CBI to do this than for Ministers to do so - though she and her colleagues would continue to do what they could in speeches. Sir John said that he hoped that Ministers would make even greater efforts in this area.

iii) Discussions with the trade unions on other matters

Sir Ray said that the CBI were talking to the trade unions on various matters. He mentioned, in particular, talks about profit sharing schemes, and at some stage they might want to meet the Prime Minister, along with trade union leaders, to discuss them.

iv) Trade union legislation

Sir Ray said that the trade unions were too strong, and that more radical measures were needed if a better balance in pay bargaining was to be achieved. The Prime Minister commented that

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the CBI in its representations had not appeared to have been in favour of more radical legislation. Sir John explained this by saying that it was important not to alienate moderate rank and file trade unionists to whom the Government and employers had to look if a greater sense of reality was to emerge. The Prime Minister, however, said that it appeared to her that moderate trade unionists were in fact asking for greater protection under the law.

v) Interest rates

Sir John said that the continued high level of interest rates was a major concern to CBI members, particularly small businesses. Their members felt that, now that there was evidence that M3 was well within the target range, MLR should be reduced. They did not want anything spectacular, but rather a small downward move to show that the Government was sympathetic to their worsening financial position. They would rather the Government took the risk of an early reduction, with the possibility that this would have to be reversed, than maintain MLR at its current rate. They felt that the Government was now achieving firm monetary discipline. But they were also disappointed that public spending had not been reduced more. Both Ministers in charge of Departments and civil servants were too resistant to cutting back the programmes for which they were responsible. The Prime Minister commented that it would be a mistake to reduce interest rates until there was clear evidence that bank lending to the private sector was coming down. She was concerned that lending to the personal sector was continuing to expand, and that this was being encouraged by advertising of credit cards. Insofar as the banks were members of the CBI, she wondered whether the CBI could bring pressure to bear on them to reduce this advertising.

vi) National Insurance Surcharge

Sir Ray said that he hoped the Government would be prepared to consider allocating some of the savings on the EEC budget to a reduction in the National Insurance surcharge. The Prime Minister replied that the first priority must be to get interest rates down, and that the savings on the EEC budget would go to reduce the PSBR.

I am sending copies of this letter to Richard Dykes (Department of Employment) and Peter Stredder (Department of Industry).

T. P. LANKESTER

Martin Hall, Esq., MVO,
HM Treasury.

ONE NATION? A new series on a way out of the British crisis

S. TIMES 1. 6. 80

Sterile folk memories that impoverish Britain

by SIR RAYMOND PENNOCK, president of the CBI

WEALTH creation is a state of mind, a state of mind, that unfortunately, we in Britain, for all our many admirable qualities, have not had for many years.

There are many signs that Britain is heading into a recession, and a recession which bears some of the alarming signs of a grim old-fashioned slump. It would be foolish to suggest I have a complete answer to a problem which has bedevilled us for nearly 20 years. Nor would it be sensible to be unduly optimistic when the mutter and grumble of an economic storm can plainly be heard.

But some worthwhile contributions can be made to the economic national debate we must now have about the future. The Confederation of British Industry has put forward some far-sighted ideas and does have some useful thoughts on wealth creation. The CBI has positive proposals for improving both collective bargaining and industrial relations.

Almost 20 years ago, in 1961, Harold Macmillan, the then prime minister, became alarmed at what he described as "a major problem of novel character." This was rising personal demand not being met by rising productivity. Wages and salaries in the previous year had risen by 8 per cent — national productivity by 3 per cent. The alarm that this caused gave birth to the "pay pause."

The government introduced a "crisis bank rate" of 7 per cent. At the beginning of 1962 the Union of Post Office Workers began a month-long work to rule because, under the pay pause, their wage claim of 4 per cent was rejected.

Nothing has changed since then, except that the tiny malignancy spotted by Mr Macmillan as a problem of "novel character" has now grown into a dangerous tumour threatening our entire economic stability.

Substitute for a crisis bank rate of 7 per cent a lending rate of 17 per cent. For a month-long Post Office work-to-rule in pursuit of a 4 per cent wage increase, substitute a three-month-long steel strike for a 19 per cent wage and local bonus rise. And for the alarming inflation rate of 5 to 7 per cent which so frightened Mr Macmillan, substitute the present figure of [illegible] and 20-22 per cent.

The diagnosis remains the same: workers seek and employers concede increases they have not earned and have no way of earning.

There has been no shortage of treatment. Indeed, we have had more pills, prescriptions, and panaceas for our national ills than ever came from the fertile imagination of a horse-doctor. We have had pay pauses, guiding lights, incomes policies, "solemn and binding undertakings," Phase One and Phase Two, dashes for freedom, social contracts. You name them, we have tried them.

Yet the disease is now a great deal worse and the patient a great deal weaker than when Harold Macmillan first identified it as a case for treatment.

Which brings be back to wealth creation being a state of mind. I am a great believer in the intelligence and quality of the British worker. I also know, from personal experience, that given the chance and the right environment, British management can be as good as any in the world.

Yet we go on punishing and punishing ourselves, leaving the Germans, the Japanese, the Americans, the Singaporeans to benefit. We have last year's abysmal record with two major strikes, four times the hours lost in the nation compared with the previous year, and the biggest loss of man-hours from disputes since the year of the General Strike in 1926.

There has to be some explanation for this contradiction. There is one obvious one and one even more fundamental one. The first is that over the last 15 years the reasonable balance of power between unions and employers was tilted dangerously and unhealthily in favour of the unions and that, in turn, the balance of power between national, sensible union leadership was tilted in favour of militants.

> **"Until we have laid confrontation to rest and accepted that managers and workers are on the same side, there is little chance of real wealth creation and national prosperity . . . We cannot afford to fail again"**

The more fundamental explanation, crucial to wealth creation, is that the British, alone among world industrial powers, are essentially confrontalist in their attitudes. Mentally, spiritually, and historically we are still not geared up (as are the Germans, the Japanese and the rest) to the fact that wealth creation is a co-operative process.

The classic example is industry itself: "Them" and "us," "the bosses" and "the workers," "wages" and "salaries." Virtually all our competitors accept that workers and management are on the same side. But in Britain the Tolpuddle Martyrs, the Luddites, the Jarrow marchers and many other groups of faded folk heroes are still vividly alive and acting as a baneful irritant on industrial relations.

But it goes wider than that. Our politicians are confrontalist. When Harold Wilson evoked the grouse moors and City get-rich-quicksters to win a General Election it bore little relevance to the real issues, but it brought in the votes and kept confrontation alive. The media, automatically and consciously, look behind the press release for the conflict because it is a better story. There is little chance of real wealth creation and national prosperity until we have laid confrontation to rest and accepted that we are on the same side.

The CBI support government policies. We support it because, frankly, everything except monetarism and giving industry more freedom has been tried and failed. At the same time we are bound to say that we are disappointed at the speed of implementation of that policy, especially in the control of public expenditure, through which we expected the public sector borrowing requirement to be reduced and interest rates to be brought down.

After 12 months of monetary policy, inflation is still rising and none of us, government, trade unions, employers or employees, have paid enough attention to the effect of high wage settlements on inflation. In the pay round shortly to begin, they all have a part to play.

The government are right to keep out of wage negotiations. But they are failing to warn and warn again that wage rises above inflation lose jobs at home and business abroad.

Trade union leaders know full well how wage restraint can bring down inflation. If they continue to encourage high settlements for political reasons, they are in reality failing their membership. Employers should not simply view the short term cost of a strike against a settlement and decide on the latter so that their competitive base is increasingly eroded.

Employees must see, what their wives already know, that settlements above inflation simply fuel inflation still further, whereas settlements well below the level of inflation will bring it down within months. Last year at this time we talked about single figure settlements and we failed. We simply cannot afford to fail again.

Next week: The union view

CONFIDENTIAL

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

30th May 1980

T. Lankester, Esq.,
No.10, Downing Street

Dear Tim,

PRIME MINISTER'S MEETING WITH THE CBI

You asked for briefing for the Prime Minister's meeting with Sir John Greenborough and Sir Ray Pennock on Monday.

Flags A & B

my note of

Flag C.

You have already seen the Chancellor's speech to the CBI Annual Dinner, and the record of the Chancellor's meeting with Messrs. Greenborough and Pennock on 16th May. For the sake of completeness, I enclose copies of Sir John Greenborough's speech at the Annual Dinner and a larger meeting the Chancellor held with the CBI, also on 16th May (as amended by John Isaac!) To go with this material, I enclose a note on import protection, picking up recent press reports of statements by Sir Greenborough. It is interesting to note that the tone of Sir John Greenborough's speech at the CBI dinner was distinctly tougher than what he said at the meeting with the Chancellor. We think this reflects increasing pressure from CBI member firms.

Flag D.

All this by way of background. It is likely that the CBI will press on the Prime Minister their view that interest rates should be lowered fairly soon. They may also complain about the exchange rate. I enclose short notes, as an aide memoire, for the Prime Minister following her recent discussion with the Chancellor and Treasury officials.

There were two subjects which the Chancellor thinks the Prime Minister might usefully raise with the CBI, viz

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pay and discussion with the trade unions. A Treasury brief on these points is enclosed. (The Chancellor has not seen it.) I consulted the Chancellor over the telephone, and he asked me to bring out one or two specific points. Firstly, it would be well worth asking the CBI what kind of bilateral contacts they think the Government could most usefully pursue with the TUC/the trade unions. This would be useful background to the Prime Minister's meeting on Tuesday with the Chancellor and the Secretary of State for Employment. On pay, the Chancellor sees three specific roles for the CBI - as keeping the Government up to the mark on public sector pay by analysis and comment; as a means of influencing nationalised industry chairmen (who are members of the CBI) on pay; and finally as an influence on "market leaders". This last point is, of course, double-edged, in that there clearly has to be some reflection in pay settlements that some companies are more profitable and have better productivity growth than others; but equally, the e.g. toolmakers at BL are part of the same labour market as those at Ford, and it is hard to see how settlements at Ford will not have some influence on other firms.

Yours ever,

MH

M.A. HALL

SPEECHES AT THE CBI DINNER 20 MAY

Chancellor's Speech

A copy is attached. The main theme of the speech was the need to face up to economic realities. The Chancellor's more specific references to the exchange rate; interest rates; pay bargaining and the level of pay settlements; and the Government's readiness to talk to the TUC are sidelined.

Sir John Greenborough's Speech

A typescript of the speech is attached. The key points addressed to Government were as follows;

> The CBI support the Government's main economic objectives and strategy. In particular they support the overriding priority given to curbing inflation, and the financial and monetary disciplines that have been introduced (page 6).
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> But
>
> (i) excessive pay settlements in the public sector create major difficulties for the private sector. The Government must recognise this and act accordingly to control increases in public sector pay (page 11)

(ii) The Government is not yet doing nearly enough to get across the message about the need to face up to economic realities (page 12).

(iii) The CBI's major concern is with the current financial situation in many companies, particularly in manufacturing (ie low profitability, tight liquidity and high interest rates). The CBI:

- accept that any reduction in interest rates should be consistent with the monetary targets, but believe that the targets have now been achieved and that the time has come to reduce interest rates (page 13)

- urge the Chancellor to look again at the inhibiting effect of maintaining the National Insurance Surcharge at its current level (page 16)

- urge the Government to look again at what more could be done to control public expenditure, particularly current as opposed to capital expenditure (page 17)

Please note p. 6

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Chancellor of the Exchequer,
Ministers,
My Lords,
Ladies and
Gentlemen:

I extend to you all a most cordial welcome to this CBI Annual Dinner. It is by tradition a warm and happy, albeit serious occasion, but this year it is tinged with a deep sadness brought about by the tragic, sudden, untimely death of our Director General, Sir John Methven. Eloquent and moving tributes have been paid to him publicly by people in every walk of life and from many countries, by those in high rank in industry, in politics and in the trade union movement;

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tributes to the exceptional qualities and outstanding success of this great business leader. John Methven worked, lived, perhaps even died for the prosperity and well-being of Britain, and he fought to remove any obstacle that he felt would impede progress to this end. For him it was always "business-as-usual", and I know that he would not have wanted his passing to cast a long shadow on tonight's proceedings. He would have wished the evening to take its traditional form of bonhomie, warm companionship and good humour - And so be it. A Memorial Service has been arranged at Westminster Abbey on June the 4th at midday, when full tribute will be paid

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to our friend and colleague.

And so, it's "Business as usual" tonight, and therefore it is my great pleasure to propose the health of all our guests and in particular our Guest of Honour, The Rt. Hon. Sir Geoffrey Howe, the Chancellor of the Exchequer.

The return of a Conservative Government coincided almost to the day with our Annual Dinner last year, so you will not find it unnatural on my part to have looked up what I said on that occasion. ~~I naturally~~ congratulated ~~the winning party and wished~~ the new ~~Government~~ well. ~~Also I expressed the [illegible] Opposition~~

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~~would perform their role constructiv~~
~~and in a manner that would permit an~~
~~enlightened legislation programme be~~
~~developed that would set a background~~
~~against which the achievement of the~~
~~economic and social goals to which t~~
~~nation as a whole so justifiably asp~~
~~could be brought about.~~

We were, at that time, greatly encouraged of course to learn from the Queen's Speech that many of the policies which we had advocated, (policies that would support, encourage and enthuse British industry), had been included in the legislative programme. But my main message was that in this changed political atmosphere it was up

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to British management to grasp the opportunity and exert effective leadership: building on this political support in a way that could lead the country back to economic success. I said this was management's task, that this was management's duty. The task and duty encompassed all its responsibilities from design, R & D, production, marketing, and sound industrial relations.

The ensuing year has passed quickly, and against the background of the many freedoms and initial incentives that the CBI had been asking the Government of the day, over a number of years, to give us, we would all have welcomed by

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now the establishment of a set of economic statistics, and short term prognoses, far more enthusing than those that we read.

But it is with long term prosperity that we are basically concerned, and we must not be blown off the main course by the many problems that beset the country today. The CBI supports the main strategy and objectives of the present Government. We still maintain that the winning of the fight against inflation is the nation's top priority, with the inevitable short term burdens this imposes. And we support the financial and monetary disciplines that have been introduced in order to bring

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about sustainable long term growth and enhance job prospects.

A nation that has so much going for it in, let us say, infra-structural terms, needs to bring about the right positive attitudes with which it can build its national wealth. But although we all know that attitudinal change takes time, the end of one year in office is ~~time~~ an opportunity to take stock, to take a look at what has been achieved, to review what more needs to be done and to decide on the tactics for the year to come. And there is clearly no necessity to make an apology for saying that much, much more needs to be done by all concerned and involved.

[illegible]

So let me point the finger, first, at the employers' glass-house and say that we still have an enormous amount to do to improve the overall productivity of our companies and to bargain effectively so that we achieve realistic wage settlements within the current freedoms of negotiation. In aggregate terms the outcome of this recent pay round can play no part in the scene of national pride. High average percentage wage increases against no increase in output will only lead us into further economic decline. However, this year appears to have marked a mile stone in the annual pay round in one way. That is that there has been, in the private

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sector, no single going rate, and the range of company settlements has been extremely wide starting from some quite low levels. It is obviously clear, therefore, that the message has got across in some companies that their ability to pay and maintain their markets, and maintain people in employment, has required realistic settlements. And so we need to make, employers and employees alike, and indeed all the people in this country, understand the close relationship which exists between their own individual pay rises, their productivity, the level of inflation, and therefore the level of our international competitiveness, on which, ultimately,

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the prosperity and the job creation capability of this country depends. The policy of 'live now - pay later' is a policy of personal and national suicide. It can only lead to higher and higher unemployment; higher prices, more and more firms going to the wall, and a lower standard of living for all.

But as you so well know, Chancellor, pay problems are not exclusive to the private sector. You've had your problems. But can we take encouragement from some recent reports suggesting that the Government is recognising its responsibilities as a major employer in the public sector - and that Ministers are considering how to set an example on future pay settlements there.

Chancellor, I don't expect you to comment tonight on the precise accuracy of the various permutations that have been floated - 10%, a few points below RPI, or whatever.

What we do hope you'll confirm is the basic message: that Government does recognise the problems stemming from public sector pay - the inevitable implications for the rest of us in the private sector - and will <u>act</u> accordingly.

We'll play our part to the best of our ability. But we can't do it all. And we can't do it alone.

Indeed, Chancellor, we need far wider ranging public debate on these issues than we have had to date, and that is not because of any lack of trying on the part of the CBI. But while management has its own clearly defined target audience (i.e. its workforce), and while we welcome a great deal of the disengagement of Government from

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business affairs, in answer to our old war-cry "Get Government off our Backs", I don't absolve the Government from the responsibility of communicating the economic realities to the nation in a manner that can be truly effective. The Government can't leave it all to management. You are just as involved in this communication business as we are, and we need your help in reinforcing the message we put across at company level, and in giving it a national perspective.

May I say, in all frankness, that I do not believe the Government is yet doing nearly enough to get the message of the realities across. Those of us

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who have been associated with marketing, salesmanship, and advertising know, from hard experience, that the required degree of repetition is usually way beyond that which would be considered adequate by the communicator.

Now I have said that the CBI supports the broad objectives and strategies of this Government, but tonight I want to flag-up one or two items of prime concern to us at present; admittedly on the understanding that we, for our part, realise the onus which is we, as managers and employers, have on us for getting the economy back on an even keel. Indeed, as I said last year at this Dinner, we welcome the fact

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that the Government has thrown down the gauntlet to us as a challenge. However that gauntlet we hope is made of such material that will allow a little flexibility to be exercised, if we are to make the most of the opportunities that this country can have. As a matter of fact an American commentator said to me, the other day, that "Britain is a land of insurmountable opportunities".

High on our list of concern is the current financial situation of many companies throughout the country, particularly in the manufacturing sector. We have made you fully aware of the problems of the low levels of

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real profitability, the tightness of company liquidity etc., in our Representations to you, and we have left you in no doubt that the rise in MLR has greatly added to companies problems, particularly small companie While we accept that a reduction in interest rates should be consistent with the monetary targets which have been set, we would urge Government not to delay ~~once~~ when the these monetary targ have been ~~achieved~~ achieved. - and many of us would argue that the moment has now arrived. We believe the time is now ripe for a reduction in MLR

We have always supported, and in fact urged on successive Governments, the need for firm fiscal and monetar

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policies if we are to break out of our long endured economic constraints. But in the present climate we are particularly conscious of the need for some of the enormous financial pressures on the private sector to be eased so that we can minimise the erosion effect that the current necessary general disciplines will have on the infra-structure of British industry, thus permitting us to sustain a sound launching-pad from which we can again achieve economic lift-off when the time comes.

We would also urge you to take a hard look again at the inhibiting effect of maintaining the National Insurance

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Surcharge at its current level, in terms of our international competitiveness. Again we do not ask you to divert from your basic disciplines in controlling the growth of the money supply, or your close surveillance of the level of the PSBR. What I do want you to do is to take another hard look at what you have achieved to date - of perhaps better, failed to achieve to date - in terms of the control of Government expenditure, especially on revenue account as opposed to the relatively easy option of cutting capital account, which has such a pernicious effect on industry, particularly the construction industry.

...

[illegible]

In essence, Chancellor, our call to you is for some alleviation of the major pressure points in the system, and a call to you and your Ministerial colleagues to explain, convincingly, the economic realities to the nation with a much higher frequency of communication. Our message to our own members is to face the basic problems of productivity and effective pay bargaining with resolve and confidence, and to become increasingly persuasive through greatly improved communication systems to the workforce and the exercise of open style management.

And finally I must add that those

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who occupy positions of national leadership of the trade union movement must also take on board the message of economic reality and lead from the front, and lead from an industrial and not a political standpoint, in the long term interests of their members.

Mr. David Basnett has warned that trade unions will make no attempt to restrain wage increases while the Government continues with its current economic and industrial policies. So what's new about that? The TUC made no attempt to restrain wages when the last Government had brought inflation down. They seem to be adept at pulling out the plug, but they have yet to understand that this causes jobs and living standards to drain away with the bath water - leaving an inflationary tide-mark.

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The TUC has doubtless heard the words of Frank Chapple when he denounced the 'Day of Action' as a futile gesture and said that union leaders need to rethink their role and stop wasting the precious loyalty of their members.

The past year has seen some significant developments concerning industrial relations law. As you know, the CBI have supported - indeed advocated - a measured adequately paced strategy - with the first step being to tackle major abuses such as secondary picketing and the worst injustices of the closed shop. By and large the Employment Bill does this - although I make no secret of the fact - I couldn't if I wanted to! - that some of our members wished it went quite a bit further.

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But we believe the Government - and employers - must now consider the longer term - just what legal framework is appropriate for the economic, industrial and social climate we face over the next ten years and more? Frankly I don't believe the answers are known yet - and that's why I welcome the Government's intention to publish a Green Paper. I hope that it is comprehensive, and that the Government will allow ample time for full and wide debate.

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The Presidency provides a great challenge to the incumbent and keeps his elastic at full stretch during his term of office. But it also provides him with what is, I think, a unique experience in British industry and one that is at once both rewarding and fulfilling.

I count myself most fortunate to have been chosen to be your President during what I think I can rightly describe as an exciting period in the CBI's history, and I shall lay down office with a genuine sense of sadness. I shall remember my term of office with great affection, and that affection embraces you all. But I shall pass it into the experienced, wise and dedicated hands of Ray Pennock who will continue to build on the firm foundations laid with such effectiveness by John Methven.

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NOTE OF A MEETING HELD AT NO.11 DOWNING STREET: 5.00 P.M., FRIDAY, 16TH MAY, 1980

Present:

Chancellor of the Exchequer	Sir John Hedley Greenborough
Mr. Ryrie	Sir Raymond Pennock
Mr. Middleton	Sir Adrian Cadbury
Mr. Battishill	Mr. Alan Lord
Mr. Dixon	Sir Donald MacDougall
	Mr. D.R. Glynn

The Chancellor invited Sir John Greenborough to expand on the arguments set out in his letter of 6th May.

2. Sir John Greenborough said that in their Budget representations, the CBI had expressed concern about the liquidity of the corporate sector, and the declining profitability of manufacturing industry. They had argued that a PSBT somewhat larger than the Government's target was acceptable, and had put forward the case for abolishing the NIS, though they had not at that time thought it essential. They had also expressed concern about interest rates, but would not want the Government to compromise their monetary policies. By March, however, the CBI had concluded that an early reduction in MLR was unlikely. This lay behind the proposals in Sir John Methven's letter of 14th March, putting forward the "Lord scheme" of special relief for interest payments by companies that have exhausted their normal corporation tax liability.

3. In the intervening weeks, the CBI's concerns had heightened. Pressure from members led them to press the Lord proposals more strongly. They also considered

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that there was now a strong case for an early reduction of MLR, and that the arguments for abolishing the NIS were much stronger than before. The CBI believed that these measures were possible within the Government's target for this year's PSBR. Room would be made by settlement of the dispute over the British net contribution to the EEC Budget, and, if necessary, further reductions in public expenditure. The CBI had been particularly disappointed at what they saw as a heavy concentration of cuts on capital expenditure, and insufficiently vigorous action on the current side. Finally, the CBI were most concerned about the excessive burden of rates on industry.

4. The CBI saw the Lord proposals as well worth implementing in themselves; but if there was no early movement in MLR they became vitally important. Sir John invited Sir Adrian Cadbury to amplify his opening remarks.

5. Sir Adrian Cadbury said that the CBI well understood that inflation had to be brought down. But it was essential that when the Government's policies begain to show results, industry should not be too weak to take advantage of them. The CBI's April survey showed that many firms were now reducing stocks and cutting back investment plans. The number still seeking to borrow from the banks was now falling. The level of income gearing was high, and companies were now finding it very difficult to borrow more. Action to help industry over the next few months was becoming urgent. He could understand the Government's caution in not wishing to lower MLR if there was a real risk of having to put it up again. But he regarded this risk as low, and worth taking. He also commended the Lord proposal.

6. The Chancellor said he had recently made several regional visits, and had received very much the same message. Manufacturing companies showed great concern over the strength of the exchange rate; but there was little that the Government could do to bring it down. But the success of the Government's monetary

policies would lead to a fall in interest rates, which should in turn remove one of the more important factors pushing the exchange rate up. The rate of growth of the money supply was certainly falling; but bank lending was still high. He remained reluctant to lower MLR whilst bank lending remained so high and there was a risk that the rate would have to be raised again. The de-stocking which was now taking place should reduce companies need to borrow. Sir John Greenborough said that the CBI membership would not necessarily be averse to rapid changes in direction of interest rate movements. Mr. Ryrie observed that the effect of such fluctuations on the gilts market would certainly be adverse.

7. Mr. Lord said that the Government's present fiscal policies had upset the established balance between the access of manufacturing industry to bank borrowing and that of the rest of the commercial sector. Within a given quantum of bank borrowing, a manufacturing company had less capacity to borrow than a profitable commercial company. He construed the Inland Revenue's "fundamental objection" as simply opposition to new ideas. The effect of his proposal would be to redress this balance, so that manufacturing companies could, so to speak, sell their notional interest ~~national stock~~ relief to the banks, thus reducing the rate of interest they had to pay. If this relief could be given, many potentially worthwhile investment projects would be saved. If not, investment would be seriously cut back, and manufacturing industry would emerge in 1981-82 in even poorer shape than before the Government's policies were introduced. He believed in any case that companies would find a way of reducing the cost of their borrowing. It was better to do this directly and transparently than by off balance sheet techniques.

8. Mr. Isaac said that the cost of Mr. Lord's proposals could be as high as £700 million. There was just insufficient fiscal headroom to accommodate it. Furthermore, for the scheme to be successful depended on the banks having substantial taxable profits. The high level of their leasing activities severely curtailed the scope for the scheme. Mr. Lord thought that

these two objections were on the face of it inconsistent. Mr. Middleton said that tax relief on short term interest payments was one of the reasons why bank lending was not responding to the high level of interest rates. If the fiscal position permitted assistance to companies, it should arguably be applied to longer term borrowing. Mr. Battishill observed that if the Lord scheme were to be successful, the implication was that other sectors would suffer, e.g. by a reduction in the banks' leasing activity.

9. Mr. Lord said he was confident that the scheme would be helpful to manufacturing industry, and that if something like it were not introduced, the companies would find their own ways, e.g. by stock adjustments and more leasing, to reduce the cost of their borrowing. He did not think it would be right to follow up the Chancellor's own suggestion that this scheme be examined in the context of the Government's review of corporate taxation. It was a two-year temporary relief which the CBI were seeking. Mr. Glynn commented that an advantage of the scheme was that it would show up in next year's PSBR rather than this year's. Sir Greenborough urged the Chancellor to reconsider the scheme, would would be immensely valuable to manufacturing companies. The CBI were under great pressure from their members to say what they were doing to press the Government to reduce the cost of borrowing. They had not yet revealed these particular proposals to their members. They would be pressed very hard at the next Council meeting. The Chancellor undertook to re-examine the proposals in the light of this discussion.

Pay

10. The Chancellor said it was extremely important to get across to employers and unions the message that the general level of pay settlements had to be substantially reduced. The CBI could help in this by publicly keeping the Government as an employer up to the mark.

Employee Participation

11. Sir Raymond Pennock said he saw further discussion of "employee participation" as one of the ways of involving the TUC in a wider dialogue. At this stage, however, he thought that this discussion was more profitably pursued as a dialogue between the CBI and TUC, rather than with Government involvement Sir John Greenborough said that the dialogue was proceeding at two levels, centrally between the national organisations, and regionally between regional TUC and CBI officials. In many ways, the regional dialogue was more fruitful. The TUC's regional officers felt isolated both from the shopfloor and from the General Council in London. The ~~Chancellor~~ said that there was no doubt that an accurate perception of economic realities did exist at various levels in the trade unions and industrial management. The closer to the coalface, the more realistic the perception. Sir Raymond Pennock commented that when faced with a crisis, liaison between the TUC and CBI worked well, but it was difficult in normal circumstances to overcome the TUC's negative attitude. The NEDC 6 were quite unable to deliver any kind of agreement on pay; they themselves realised this, and were concerned about it.

(M.A. HALL)
20th May, 1980

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5.00 PM MEETING WITH CBI, FRIDAY 16 MAY: AMENDMENT

I am sorry to circulate a further amendment to this ill-fated record. I am however content that the revision suggestion in Mr Isaac's letter below be substituted for the present version.

...

MAH

M A HALL
30 May 1980

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

23 May 1980

M A Hall Esq
HM Treasury
Treasury Chambers
Parliament Street
SW1

Dear Hall

MEETING WITH CBI ON FRIDAY 16 MAY

Paragraph 8 of your note does not quite get right the discussion of the Lord scheme - I recognise that it was an elliptical discussion on some rather complex issues. I do not ordinarily like to suggest corrections of minutes. However, given that the CBI is likely to revert to the scheme, and that there are points factually wrong, as well as important omissions, I wonder if you would consider revising the beginning of this paragraph on the following lines -

"Mr Isaac said that the cost of Mr Lord's proposals could be several hundred million £s. The prior question was whether there was sufficient fiscal headroom to accommodate that. Furthermore, and even leaving aside the questions of fiscal principle which Mr Lord had mentioned, officials had doubts about the effects of the scheme on bank lending; and in some of its possible forms the scheme's success would depend on the banks having substantial taxable profits. In practice, bank profits were at present substantially sheltered by leasing. Mr Lord thought that these two objections were on the face of it inconsistent. In the following dicussion, Mr Lord said that the CBI did not propose (as had been suggested in earlier discussions) that the bank should be able to claim repayment of the income tax notionally "deducted" by companies under the Lord scheme. Mr Middleton said ... ".

I am sending a copy of this letter to Peter Middleton and Tony Battishill.

Yours sincerely

A J G ISAAC

C

IMPORT PROTECTION

Recent press reports suggest a renewed interest by the CBI in the question of selective import controls, though there was no mention of this in Sir John Greenborough's speech to the CBI Dinner. But at a speech on 29 May to the Export Houses Association Sir John did say that "selective import controls may provide temporary respite for hard pressed industries here at home who can make out a case". He went on to say, however, that selective controls would not tackle the "fundamental and probably self-inflicted" problems of high wage rises and inflation and that the main emphasis with regard to trade policy should be to "establish the principle and practice of fair trade to a greater extent than it is at the present time".

2. It is not clear whether the CBI intend to touch on this subject at their meeting with the Prime Minister, but there is nothing in what the CBI has said so far which would suggest a fundamental difference between them and the Government. The Government (like the CBI) does not regard general import controls as likely to help resolve our economic problems; such controls would put up domestic prices, reduce the freedom of choice to the consumer and would undermine the competitiveness of UK industry. It is moreover likely that if the UK were to restrict imports in this way other countries would follow suit, and this could not fail to have adverse consequences for our exporting industries and for the employment which depends on them.

3. This is not to deny that imports, particularly low cost imports, may cause serious problems for certain sectors of industry. It is for this reason for example that the Government supports the Multi Fibre Arrangement which is designed to ensure the orderly growth of trade in textiles. The Government has also stated its willingness to consider the imposition of temporary controls where sudden surges of imports threaten disruption and loss of jobs. Moreover, imports from a number of sources are already subject to restrictions and understandings at industry or Community level (see annex) and these cover sensitive sectors such as cutlery, footwear, TVs and audio equipment, vehicles and steel.

4. The Government's policy on trade restrictions was set out in the Secretary of State for Trade's open letter to the TUC dated 3 April (copy attached). A major theme was the Government's belief that the main emphasis should be on persuading other countries to bring down their barriers to trade, rather than in erecting fresh ones of our own. This, again, seems entirely in accord with the views expressed by Sir John Greenborough.

Annex.

IMPORT CONTROLS
[illegible]

Objectives

Government supports free and fair trade within framework of international agreements. This offers best prospects to both producers and consumers through allocating resources efficiently and widening choice.

Factual

1. Present UK tariff regime

(a) Since transitional arrangements for UK entry to EEC expired in 1977, trade in all goods between UK and EEC countries is free of tariffs.

(b) EEC Commission and not national governments has competence in trade matters. UK tariffs towards rest of world same as those of EEC.

(i) imports from EFTA countries virtually free from tariffs except agricultural goods, where Community levies generally apply

(ii) imports from Lomé Convention countries (mainly former British and French colonies) have virtually free access, including many agricultural products

(iii) imports of non-agricultural goods from rest of world subject to Common External Tariff, which averaged 9.8 per cent on dutiable industrial goods (equivalent to [illegible] per cent averaged over all non-agricultural imports)

(iv) preferential tariffs accorded some developing countries under Generalised Scheme of Preferences (GSP).

(c) Two thirds of UK imports of industrial goods are from countries against whom no tariff is levied.

2. Results of the Multilateral Trade Agreements

MTAs provide for staged reductions in tariffs over eight years from 1 January 1980. EEC (and hence UK) tariffs on dutiable industrial goods will be cut on average from 9.8 per cent to 7.5 per cent. Average reduction in tariffs against US exports is around 30 per cent, and 20 per cent against those from Japan. There will be minor reductions in agricultural tariffs. US will reduce average tariff against EEC industrial exports by around 30 per cent, and Japan by some 20 per cent. Major steps also taken towards reducing non-tariff barriers to trade, such as import licensing procedures, technical standards and customs valuation. Specific measures to liberalise government procurement and trade in civil aircraft.

3. Present Quantitative Restrictions and Voluntary Restraint Agreements

(i) National Institute study claims 13 per cent of UK trade in manufactures is 'managed' - slightly lower than OECD average of 15 per cent. Difficult, however, to make reliable estimates because QRs and VRAs not necessarily always the main factor limiting trade. Underlying figure, therefore, possibly lower.

(ii) Multi-fibre Agreement provides for QRs on imports of low cost textiles from many countries. In total 98 per cent of UK low cost textile imports subject to restrictions. Quotas introduced from January 1980 on synthetic fibres mainly from US and Canada.

(iii) TVs, cutlery, shoe imports from some countries (mainly Korea, Japan, Taiwan and some E. Europe countries etc.) subject to some restrictions.

Cont.

(iv) Cars, special steels, pottery, consumer electronics from Japan subject to VRAs.

(vi) EEC has negotiated VRAs with major iron and steel exporters outside Community.

4. Dumping

EEC now responsible in general for investigating alleged dumping. Exporters have mostly given satisfactory undertakings on price and/or volume.

5. Recommendations of import controls

(i) Cambridge Economic Policy Group (director Wynne Godley) argues for policy of co-ordinated world demand management coupled with discriminatory trade restrictions to achieve growth without external payments constraints. (CEPG alternatively argues for general unilaternal UK import tariffs or quotas and claims ensuing domestic growth would mean no absolute reduction in import levels.)

(ii) TUC Economic Review argues for "selective and temporary" import controls to protect core industries - cars and steel cited as examples. TUC also wants increased efforts by NEDC and Sector Working Parties to monitor and counter import penetration.

(iii) Mr Alan Clark, Conservative MP, suggested (Times 7 March) that controls on 60 per cent of imports, coupled with a rising import surcharge over time, would allow faster economic growth and a lower PSBR.

Positive

(i) Government believes free and fair trade in best interest of both producers and consumers.

(ii) Government is prepared to protect particularly hard-hit UK industries from unfair and disruptive imports. Current protective measures are all selective and temporary. They are either voluntary or internationally agreed. They are designed to allow domestic industry time to adjust.

(iii) Government also seeks to ensure no unfair obstacles against UK exports - includes both tariff and non-tariff barriers. UK exports 30 per cent of GDP and has particular interest in free access to world markets.

(iv) Government policies to reduce inflation and improve supply side offer best way to limit penetration.

Defensive

(i) Government opposed to general import controls on grounds likely to breach international obligations, risk retaliation and no guarantee that they would lead to extra domestic output rather than higher inflation. Also reduce competition and foster inefficiency.

(ii) General and permanent import controls would foster inefficiency among domestic producers and limit choice of consumers.

(iii) Newly Industrialized Countries' (NICs) account for only 10 per cent of UK's manufactured imports. We have large manufactures surplus with NICs, one of UK's fastest growing markets. But Government vigilant against unfair trade by NICs and pressing them to open their markets.

(iv) Recent action against US synthetic textile imports and possible US action against European steel not part of an Atlantic trade war. Isolated and unconnected [illegible]. Firm grounds needed for such action and must comply with international [illegible]. Textiles action was taken by EEC Commission.

From the Secretary of State

The Rt Hon Lionel Murray OBE
General Secretary
Trades Union Congress
Congress House
Great Russell Street
London, WC1B 3LS

3 April 1980

Dear Mr Murray.

Thank you for your letter of 13 March enclosing a statement issued by your Economic Committee. You wrote in similar terms to Keith Joseph, and I am replying on behalf of us both.

I fully share your concern at the size of our trade deficit and in particular at the rising rate of import penetration in some manufacturing sectors. The figures for 1979 of course reflected a number of special adverse factors; the exports side was affected by the loss of much of the Iranian and Nigerian markets and the road haulage dispute, whilst a substantial pre-election boom sucked in imports on the other side. Nevertheless, I am far from satisfied. But the question we need to consider is whether import controls would in fact offer a solution to our wider economic problems, of which increasing import penetration is itself only a symptom.

The key factor here has been the relatively low growth of productivity in some UK manufacturing sectors compared with that in competitor countries, accompanied by a disastrously high rate of inflation. Import controls would treat the symptom rather than the disease, and they would do so in a way which would be likely to make the situation worse. Widespread controls would be bound to create distortions and bottlenecks in the economy which would reduce efficiency. They would deprive British manufacturers of supplies of imported equipments and materials on which success in the home and domestic market might depend. They would divert our exports back into the home market to satisfy domestic demands. They would put up prices, thereby fuelling inflation and restricting consumer choice. The removal of the spur of competition would encourage complacency, and shelter the inefficien rather than lead to modernisation and re-equipment. To the extent that current performance is due to the high value of the pound, import controls by themselves would, if effective, drive the pound even higher and make life yet more difficult for our exporters.

Public attention is concentrated on the level of imports but neglects the fact that a third of our manufacturing output goes into exports, and millions of jobs depend on our maintaining access to overseas markets. We export a greater proportion of our GDP than all our major competitors - double the proportion of Japan and four times that of the United States.

Although we are importing more, we are also exporting more each year, and our share of world trade over the last 6 or 7 years has been constant at about 9% despite increasing competition. We are therefore particularly vulnerable to retaliation and have to be careful about setting an example in flouting trade obligatio

I am not ruling out import controls in limited and particularly difficult areas and, as you know, we do (in textiles and clothing iron and steel, consumer electronics, Japanese cars and a variety of other products) already have various types of restraints. An important recent measure was the imposition of import restriction on American polyester filament and nylon carpet yarn. And I certainly believe strongly in vigorous action through the Communi against dumped or subsidised imports. But the more general polic of import controls which is implicit in your proposal for import penetration ceilings seems to me very much the wrong raod for a major trading nation - and particularly for the country with the single greatest dependence among the major industrial nations on the growth of world trade. We can hardly encourage that growth by inhibiting it ourselves.

Much the same arguments apply to the concept of "core" industries, to the extent at least that they would need to be protected by import controls. I am sceptical too about our ability to determine from the centre where our industrial future lies. I have also noted that the production of food (which must surely rank as a major core industry) is one which many advocates of this policy propose should be exposed to more open trade.

You mentioned the threat from imports to a number of particular industries. But we need to distinguish between cause and effect. In several of those industries rising imports are the effect caused by our own industry's failure to be sufficiently competitive. Nowhere has this been more true than in the case of the motor vehicle industry, whose productivity has long been notoriously lower than that of our overseas competitors. The poor performance of this one sector significantly affects the overall trade figures. Indeed if motor vehicles are excluded from the figures, the export/import ratio in 1979 deteriorated by only 1% from its 1978 level in spite of the special adverse factors which I mentioned above. The Government has agreed to provide a further £300m of investment frunds to BL in 1980/81. But the major concern is to improve productivity and performance in this industry; for example, Ford's substantial imports into the UK could be reduced if the company could produce more in its UK plants. This is very much an international industry; as you know, last year 40% of BL's sales went overseas. Import controls would not bring about the improvement in performance required but would certainly be likely to promote countermeasures against some of our important overseas vehicle and component business - and our exports of components amounted to £1.7 billion in 1979.

As regards steel, British Steel Corporation's purchases of coking coal are a matter for their commercial judgement, but to force them to rely entirely on UK coking coal would push up costs and render them less competitive, facing us with a choice of either increased import penetration (which would destroy jobs in the steel industry) or import controls (which would put up the cost of steel to the manufacturing industry and thereby present an equal threat to jobs). But BSC have agreed with the NCB that they will not enter into additional commitments for the import of coking coal in 1980.

There is certainly a widespread belief that other countries operate more non-tariff barriers than we do, and it is of course the case that the efficiency of the UK distribution system acts as an encouragement to imports. In particular, there are special problems in some markets, such as Japan, and when I was in Tokyo in January I impressed on the Japanese Government the concern which we feel on a number of issues. But we should neither exaggerate the extent to which our exports are hindered by the trade barriers of our major trading partners nor overlook the fact that in some areas (such as textiles where 95% of imports from low cost sources are subject to control) we are regarded as being more protectionist than most - and about one third of Japanese goods imported into the UK are subject to some kind of restraint. We believe that the solution to this problem lies in persuading other countries to bring down their barriers rather than in erecting fresh ones of our own. In this respect the GATT codes concluded as part of the recent multilateral trade negotiations represented an important step forward. Any evidence which your members wish to put forward on trade barriers will be actively pursued.

Developing countries certainly are more protective, but we have to accept that they have quite different problems. Under the Generalised System of Preferences there is a general agreement among the industrialised countries to provide these countries access to our markets and our obligations to the third world have recently been recalled through the publication of the Brandt report; it was interesting to read the speeches of MPs on this subject in last week's debate. I do believe though that the stronger of them should start opening up their markets. Whenever the Minister for Trade or I visit one of the newly industrialised countries we press strongly for a liberalisation of import regimes, and I intend that continuing pressure should be brought on them to this end.

Selective financial assistance has a role to play in strengthening our industries' ability to compete both in the domestic and in export markets and is guided by these considerations. Import controls are not necessary for it to be effective. Selective financial assistance continues to be made available both on a regional and national basis, although the qualifying criteria have been tightened to ensure a greater degree of cost-effectiveness. In the longer term it is the Government's intention that its policies to create conditions which stimulate economic growth and new investment will reduce the need for selective financial assistance.

The Minister for Trade and I are endeavouring to visit most of our main markets overseas so as to encourage greater export penetration by British manufacturing industry. In general, industry is doing a splendid job in some of the most competitive markets in the world. In this respect we should look to our successes - rather than dwelling on our failures. To enhance these successes we need to become more competitive, to build on a tradition for high quality, on-time delivery and good after-sales service. The achievement of this objective will lead to a growth in our exports and substitution of British goods for imports. This, I am sure, is where the trades unions and management should concentrate their efforts. The Government's task is to ensure that trade is free and fair. If we both succeed the benefit will accrue to your members and to industry as a whole.

With kind regards

Yours sincerely

John Nott.

JOHN NOTT

MONETARY POLICY AND THE EXCHANGE RATE

Key Facts

1) Money Supply. £M3 grew an annual rate of 6½% in 4 months to mid April, compared with 12¼% in previous 6 months. But CGBR averaged only £80 million in last 4 months, compared with £960 million in previous 6 months (and with a monthly average Budget forecast of £780 million for 1980-81).

2) UK Interest Rates. 3 month interest rates have eased over last 2 months (from 18½% early April to 17¼% early May to just over 17% now). Longer term money market rates fallen further (1 year rates from nearly 17½% early April to about 15% now). Over same period, long term gilts fallen ½% to 14% now. MLR and banks' base rate remained at 17%.

3) Overseas Interest Rates. 3 month US rates have fallen substantially after reaching a peak (for the euro $ rate) of 19¾% in early April. There was a sharp fall in April and early May, to 11¾% on 9 May, and a moderate fall since (to about 9¾%). Rates in other countries have remained broadly stable. In West Germany they have increased slightly in the last 2 months.

4) Exchange Rate. Sterling's effective exchange rate has risen in the last 2 months from 72.3 on 1 April to 74.4 (peaking at 74.7 on 28 May). The rise against the dollar has been more marked (nearly 10% over the 2 months); from $2.14 on 1 April to $2.35 on 29 May. The greater part of the rises have been in the last 10 days following further oil price increases.

Points for Discussion

1. Monetary Objectives: Government's objective is in terms of money supply, not bank lending (and £M3 growth in 10 months to mid April was, at an annual rate of 10% within the target range). But there is a need for caution: CGBR returning to more normal level and bank lending still increasing rapidly. Before reducing interest rates, must be confident that money supply growth can be contained within target range despite more normal CGBR.

2. Interest Rates: Whole thrust of medium term policy is to reduce public sector spending and borrowing, thereby reducing reliance on interest rates to bring down money supply growth. Recognise burden

high interest rates place on industry, and intend to bring them down as soon as there is a reasonable chance of sustainable lower rates. Caution is not pessimism; it will be possible to lower interest rates. But foolish to speculate about timing which will depend on developments. CBI's proposal for tax relief for bank borrowing would worsen, not help, prospect for lower general level of interest rates: it would mean assisting company sector in way which increased the PSBR (and possibly also bank lending).

3. Exchange Rate: Relatively high UK interest rates, particularly following falls - which were preceded by a sharp rise - in US, among factors pushing up exchange rate recently. But North Sea oil, at a time of uncertainty and rising oil prices abroad, is also important. As explained, UK interest rates must be primarily determined by domestic monetary requirements. (In this respect, cannot follow falls in US rates. US economy moving sharply into recession and underlying inflationary pressures much less. In other countries activity, and with it interest rates, has remained high.) Exchange rate not under Government control and mainly determined by market forces. Holding down exchange rate not feasible; and attempts to do so would make reducing inflation more difficult. Long term competitiveness can only be improved by keeping down domestic costs.

CONFIDENTIAL

PAY

The CBI were disappointed with the outcome of their publicity campaign for the last pay round. They intend to launch a new campaign for the next round. They are also urging the Government to press on with a more vigorous and sustained attempt to get the message across. They are also concerned about public sector pay and comparability. You may like to draw on the following.

2. We are very concerned about pay settlements which are incompatible with the monetary framework because (a) they may force undertakings to put up prices when this is not justified by market conditions and (b) - partly because of (a) - they force a contraction of activity and extra unemployment. Eventually a firm monetary policy will curb inflation. But folly over pay carries a cost meanwhile in terms of lost output, lower living standards and higher unemployment. Greater imagination and understanding on the part of bargainers and the public generally would enable the lesson to be learnt without going through all the agony in practice. It is frustrating to watch injuries being self-inflicted, and we owe it to the public to provide as much enlightenment as we can.

3. At the same time we must not slip imperceptibly into having a pay policy as such - all experience shows that coercion will fail and leave a worse condition than that from which one starts.

4. Therefore action by government (and the CBI) cannot be more than (1) trying to bring market and other pressures to bear effectively and (2) trying to get the message across.

Public services

5. Apart from catching-up, new public service pay settlements have lagged behind the private sector in the current round. The public trading sector has been only marginally above. But because of (a) catching up (e g Clegg) and (b) delayed implementation of earlier settlements, earnings in the public sector in 1980/81 will show a larger rise in 1979/80 than those in the private sector.

6. The Government is concerned about the present procedures for establishing pay in the public services. Throwing out all the comparability arrangements is not necessarily the best answer in the longer term, though there could be a case for it in logic.

7. If we do decide to keep some form of comparability, it is difficult to see how it can be allowed to remain the sole determinant of pay, since pay levels must also be negotiated within cash limits fixed at levels consistent with the Government's strategy for reducing monetary growth. From this point of view there is no skin off the government's nose if the CBI continues to draw public attention to the problem of public service pay. But . . .

Private sector

8. In the last resort the government can control the pay of its own employees and ~~in the last resort~~ it is private sector pay which is predominant in scale, most difficult to influence and rising fastest now in terms of settlements. Nothing should be allowed to obscure this: it is therefore very important that anything the CBI say about public services should not be such as to direct attention away from the private sector problem.

9. While the government does not wish to discourage pay increases for employees in firms which see them as commercially justified and can afford them, such increases may nevertheless make it more difficult for less profitable firms to resist increases which can only result in further redundancies. Moderation by all is therefore important, with the Government playing its part in the public services to reinforce the weaker impact of market forces in those areas.

Tripartite discussion

10. It may be worth enquiring from the CBI what value they see in direct CBI/TUC discussion or tripartite CBI/TUC/ Government discussion (e g in the NEDC) as helping to create the right climate for getting inflation down with the minimum industrial damage, i e through deceleration of pay settlements.

11. The NEDC's macro-economic discussions have been constructive but have so far reached agreement on counter-inflation only as an objective: there is no agreement on its importance in relation to other objectives (e g employment) or on means of achieving it. At least no one (not even the

TUC) has proposed any alternative to monetary policy as a counter-inflation tool. While useful so far, there is a danger of such talks becoming sterile, particularly if they appeared to be exclusively about pay.

12. At the May meeting of the NEDC, the CBI and TUC proposed to conduct some bilateral talks. It would be useful to enquire what is expected from this. It would be useful if the TUC were induced to see how the unions could contribute to keeping inflation down and employment up. But it could be damaging if the TUC were to persuade the CBI to espouse any of its approaches on economic policy.

13. Both the CBI and present Ministers in opposition saw value in the idea of a wider (and presumably more public) forum than the NEDC. But this has not been proceeded with because of likely opposition by the TUC and also the probability that some of the parties might address their constituents rather than each other and so make understanding less likely.

14. There therefore seems no alternative to proceeding broadly as at present, using existing channels but trying to get a clearer message across in public.

MFJ

19 May 1980

Sir John Greenborough and Sir Ray Pennock have asked to call on the Prime Minister to mark their hand-over as President of the CBI. The Prime Minister has agreed to see them on Monday 2 June. I imagine the discussion will range widely over CBI - Government relations, trade union legislation, pay and economic policy generally. There is no need to provide a brief on all these matters, but if there are any particular points which the Chancellor would like the Prime Minister to take up, I am sure the Prime Minister would welcome advice.

TPL

M.A. Hall, Esq., M.V.O.,
HM Treasury.

Prime Minister -

I think this is a good idea. Agree to see them? .

16v.

1.

10 DOWNING STREET

MR. WHITMORE

Sir John Greenborough is handing over to Sir Ray Pennock next week and they wondered whether the Prime Minister would receive them both. I said that next week was out of the question, but apparently they would not mind waiting until after the Recess.

Do you think that this is something that the Prime Minister should do? Apparently it happened when Lord Watkinson handed over to Sir John Greenborough.

CS.

Yes - delighted MT.

15 May 1980

Monday 17.15 2 June

Ind Pol

Mr Wolfson /
Mr Lankester.
AWH 2.v.80

Confederation of British Industry

21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
Telex 21332
Telegrams
Cobustry London SW1

29 April 1980

C A Whitmore Esq
Principal Private Secretary to Prime Minister
for the Civil Service
Prime Minister's Office
10 Downing Street
LONDON
SW1

Dear Private Secretary

I thought you would like to be aware of the changes in day-to-day responsibilities at the CBI that have been necessary with the most unfortunate death of Sir John Methven.

For the time being, Mr E F James and Mr B Rigby the CBI's two Deputy Directors General will carry overall responsibility individually for the following policy and administrative matters:

Mr E F James

Information	Mrs D Drake, Director
Administration	Mr D E Jackson, Secretary
Company Affairs	Mr P S Taylor, Director
Regions	Mr N Tate, Director
Membership	Mr J R E Warburton, Deputy Director
Personnel	Mr D J Smee, Deputy Director

Mr B Rigby

Economic Affairs	Mr D R Glynn, Director
Social Affairs	Mr R J V Dixon, Director
International Affairs	Mr H Herbert-Jones, Director
Smaller Firms	Miss S I L Elkin, Director
Education, Training and Technology	Mr M O Bury, Director

Would you please be so kind as to pass on the above information to the appropriate departments.

Yours sincerely

Andrew Shrager
Personal Assistant to the late Sir John Methven

Director-General
Sir John Methven

Secretary
D E Jackson

MR. LANKESTER   cc. Paymaster General
Mr. Sanders

Attached is an extract from a speech by Sir John Greenborough at the Mansion House last evening. I suggested that the CBI might make some comment on the TUC's proposed national one-day stoppage and the attached is the result.

B. INGHAM

28 February, 1980

EXTRACT FROM A SPEECH BY THE PRESIDENT OF THE CBI ON WEDNESDAY, 27 FEBRUARY, 1980

Speaking at the dinner of the Ironmongers Company, he said:

"There was never a more important time for us - Parliament, employers and trade unions - to work together to put this country back on the road to recovery. In saying this, I see no place for talk of calling a national one-day stoppage in protest against the Government's policies. This can do nothing to help solve the nation's problems.

Despite the difficult financial position which many companies are suffering at present, the CBI continues to support the Government's economic strategy and objectives. God knows the route of high Government spending, high taxes, wage and price control has been tried - and it just didn't work. If I may say so, the TUC didn't seem to think much of it either. Just cast your mind back to this time last year, for who was it who blew the whistle on the Government then?

So, let's give the alternative strategy a real chance. No one can expect economic miracles in nine months. And we certainly can't expect miracles unless we all work together to give it a go. Businessmen are showing that they are prepared to do their bit - despite the difficulties. But if we are to succeed, it needs all of us - Government, Opposition, trade unions, employers and all the people of this country also - to give it a go."

Subject

CONFIDENTIAL

c. Sir Robert Armstrong
Mr. Wolfson
Mr. Hoskyns

Ind Pol.

copied to: 1) Master Set
2) Nat Ind - Steel - Pt 4
3) Ind Pol - Legislation - Pt 2

NOTE FOR THE RECORD

Sir John Methven called on the Prime Minister at 1145 today. David Wolfson, Clive Whitmore and I were also present.

Steel Strike

Sir John referred to the ISTC threat to withdraw safety cover. He said that the threat should not be taken too seriously because it had come from an ISTC official and, at least in England, the safety work was carried out by blast-furnacemen. BSC did not believe that the blast-furnacemen would ruin their own plant. But in any case, even if they did refuse to carry out the work, it could still be done by BSC staff. The position in Scotland was more serious because the blast-furnaces there were manned by ISTC members. However, BSC's Scottish management ought to be able to cope with the situation.

Sir John went on to say that the CBI's latest assessment was that steel consuming industries could manage for another three or four weeks without suffering much damage. But BSC ought to make a major effort to settle the strike within the next two weeks. He had been in touch with Villiers and Scholey to make this point. After another two weeks, industrial opinion was likely to begin swinging in favour of a quick, costly settlement. The strike had had little effect so far because of large steel inventories and because successful of swopping arrangements (which the CBI had for obvious reasons not publicised). But the situation would change quite rapidly in another few weeks. It would then be hard for the CBI to hold their members behind the Government and BSC. If BSC had not been a member of the CBI, it would have been far more difficult to have held the membership: by keeping in close touch with Villiers and Scholey, and by enabling members to hear BSC's case at first hand, he had found it much easier than it would have been to keep them in line.

/The Prime Minister

CONFIDENTIAL

The Prime Minister asked why ACAS had not been more effective in dealing with this dispute. Sir John said that both ISTC and the blast-furnacemen were suspicious of ACAS. It was much more likely that Len Murray and other union leaders such as Moss Evans and David Basnett could help to conciliate. It was unfortunate that Len Murray had intervened prematurely early in January.

Employment Bill

Sir John said that the Employment Bill and Mr. Prior's proposal for reversing MacShane would outlaw tertiary action in all its forms, but would only outlaw secondary action in the form of picketing: in other words, sympathetic strikes, blacking and boycotting at first customer/first supplier would not be covered. He understood that, on tertiary action, the Department of Employment favoured a "territorial" test - which would expressly say that the scope of immunity was confined to employees of the party in dispute and employees of his first supplier or customer. The CBI favoured a "general objective" test on the lines used in the Court of Appeal decision on MacShane. Although this might offer less clarity, it might also - in certain cases - enable an injunction to be brought against secondary action. Both approaches were apparently included as options in the draft consultative document which Mr. Prior was planning to publish later in the week; he hoped that the Government would consider carefully before coming down in favour of the "territorial" test.

More generally, he felt that Mr. Prior's proposals went about as far as was possible in the present Bill. The objective must be to gain as much ground as possible and to make it stick. His recommendation was that the Government should push through the existing Bill with the additional clauses reversing MacShane and to follow this up with a Green Paper on all forms of secondary action and possible remedies with a view to legislating further in due course; alternatively, the Government might propose a 12 months inquiry. Before deciding to strengthen

/the Bill

the Bill either by removing union immunities or by outlawing secondary action , the following factors ought to be borne in mind.

First, consultation would be required, and - judging from the time it had taken to draft the presentation consultative document - this would take several weeks to get off the ground. All the more so since the idea of removing union immunities was a highly complex issue. It would be quite wrong not to consult with the unions and the employers on these matters, and to allow the necessary time for this would put at risk the passage of the Bill during the current session. Second, the union movement had been founded on secondary action - that was how traditionally they brought the most pressure on employers. Any further move by the Government against secondary action would therefore be bitterly opposed. Third, there were many problems in going down the union immunities route. In particular, it would often be difficult to decide when and where a union was responsible for action which had been outlawed. Before it would be possible for a plaintiff to attach union funds, it would be essential to identify this responsibility. For example, if one union official authorised unlawful strike action, while another official from the same union countermanded it, would the union be responsible? Furthermore, if employees took unofficial action against their union's instructions, this remedy would be ineffective.

Sir John said that he was not against going further: on the contrary he would in principle favour it. But it was crucial that the employers should support the Government's measures. If the Government were to announce more radical measures, he himself would support them; but he could not guarantee his membership. Their response was much more likely to be that the Government should confine any additions to the present Bill to reversing MacShane. As between outlawing all forms of secondary action and removing union immunities, he thought that the former would cause less trouble.

/The Prime Minister

The Prime Minister said that on tertiary action, the Department of Employment had indeed favoured the "territorial" test at first; but it now seemed that they were moving towards the "general objective" test favoured by the CBI. On the general question of whether the present proposals were adequate, she was more concerned than anything about the lack of adequate remedies. Recent events showed that trade unionists as individuals would not obey the law and would readily go to prison. This was why she strongly favoured making unions as institutions responsible for their members' actions. Sir John responded that there was no case in the last few years of trade unions or their members not sticking to the law. The Prime Minister commented that this was because there was, in effect, no law for them to obey. Sir John went on to say that, if there was a problem in preventing unlawful actions by individuals, the Government ought to consider making the act of picketing unlawful, just as he understood the act of squatting was unlawful. He had suggested this to the Department of Employment but they had rejected it. He understood that if an injunction were successfully brought against the act of picketing of a particular establishment, the police would then have the power to remove any pickets. The Prime Minister said that she doubted whether this was the case: since it would be a civil suit , she thought pickets would have to be removed by officers of the court.

As regards the timing of more radical measures, the Prime Minister said that there would always be a risk of confrontation with the unions. It seemed to her that it would be better to accept this risk in the coming few months rather than wait until next Autumn when the miners and others could cause the maximum disruption. It was a great pity, in her view, that the Government had not brought forward more radical proposals when the Bill was introduced: nine months had virtually been wasted in reached the present unsatisfactory juncture. The alternative to amending the existing Bill would be of course to announce that further legislation would be introduced, and to make this clear in the consultative document.

5 February 1980

TL.

CONFIDENTIAL

JS vcs

c.c. Mr. Hoskyns
Mr. Wolfson

Ind Pol.

10 DOWNING STREET

From the Private Secretary

14 December 1979

Copied to:
Master set
Industrial Relations (Legisn)
Econ Pol: CBI Ind. Trends

Dear Tom.

Sir John Methven called on the Prime Minister this morning, The following points which came up in discussion are worth recording.

The Business Climate and Publicity

Sir John said that the business community was still supporting the Government's strategy to a remarkable degree, notwithstanding the financial pressure particularly on smaller firms - caused by the increase in MLR. The vast majority of businessmen felt that "this was the last chance". It was all the more noteworthy that business support was continuing at a time when short-term expectations were becoming increasingly gloomy.

However, he was concerned that not enough was being done to put the Government's policies over. He accepted that the Prime Minister and the Chancellor were doing a good deal on this front, but he felt bound to say that more was needed. The CBI were themselves doing a great deal to put over the Government's message. He would find it easier to hold his members' support when the business climate got tougher in the coming months if senior Ministers could speak out more. He was not so much concerned about projecting the message to the community as a whole, but rather with providing moral support to employers to enable them to see out the recession.

Public Expenditure

Sir John said that the CBI Council would be considering a draft letter on public expenditure at their next meeting. This would argue the need for further public expenditure cuts, and he hoped to send it to the Prime Minister in early January.

Employment Bill

Sir John said that the CBI completely supported the current Bill, but they thought it would be wise to include an amendment

/at Committee

CONFIDENTIAL

at Committee stage to restore the legal position to what it was before the McShane judgement. He felt it would be a mistake to include amendments aimed at removing the immunities in respect of commercial contracts. Although it might be desirable in principle to remove these immunities, there was a real risk that this would be going too fast. The legislation would be useless unless employers could be persuaded to enforce it. If too big a step was taken, it was all too likely that they would not support it. There was also the danger that to remove the commercial contract immunities would bring a real breach between employers and Government on the one hand, and the unions on the other.

The Prime Minister said that the Government would certainly include an amendment at Committee stage of the Bill to deal with the McShane judgement. She noted what Sir John had said about immunities in respect of commercial contracts but commented that in her view these immunties must at some stage be removed.

Pay

Sir John said that the CBI Data Bank showed that big variations in pay settlements were emerging - ranging from as little as 5 per cent to over 25 per cent. This was all for the good, since it indicated that pay bargaining was beginning to take into account the ability of firms to pay. None the less, the average rate of settlement was still running too high. The main factor behind this was the continuing influence which the RPI had on union claims. But opposite factors were beginning to have an effect: these were the immediate threat of redundancies, and the realisation that excessive pay can jeopardise employment in the future.

CBI Surveys

The Prime Minister said that recent CBI industrial trends surveys had provided the Government's critics with a lot of ammunition. She wondered whether the presentation of the survey results could not be more balanced. Sir John replied that he would look into this, and in any case he would ensure that Ministers were given greater warning when the survey results were likely to cause particular difficulty.

I am sending copies of this letter to Ian Ellison (Department of Industry), Ian Fair (Department of Employment), Richard Prescott (Paymaster General's Office) and Martin Vile (Cabinet Office).

Yours ever,

Tim Lankester.

A. M. W. Battishill, Esq.,
H.M. Treasury.

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

13th December, 1979

Prime Minister

1/ The CBI pay summary is worth looking at (Flag A)

2/ On publicity, Clive and Bernard mentioned to you that they were thinking about how this can be better organized. Firm proposals will be with you for the weekend.

TL 13/12

Dear Caroline,

In your letter of 11th December you asking for briefing for Sir John Methven's call on the Prime Minister tomorrow.

The following are the more important issues in our field which could arise and background briefing is provided in the notes attached;

- Pay, and pay publicity
- Monetary policy and the company sector
- National Economic Development Council/economic forum
- CBI mutual insurance fund

Copies of this letter go to Ian Ellison (DOI) and Ian Fair (Department of Employment), though without the annexes to the brief on the first item which are rather bulky.

Yours,

Tony Battishill

(A.M.W. BATTISHILL)

Miss C. Stephens,
10, Downing Street

PAY

1. Whilst the broad level of settlements remains higher than hoped (and higher than implied by the Government's monetary policies), there are some encouraging signs that a greater sense of reality is beginning to enter at grass roots level - the miners' ballot (even though the settlement was still a very high one), acceptance of the closure of Corby (even though the ISTC is pursuing a hopelessly unrealistic line in relation to the BSC pay offer), the return to work by Shell tanker drivers (although the dispute is not about pay and may not be resolved until the New Year, it is seen by the union as closely related to the current pay negotiations). Further it is clear that a patternis developing of a wide dispersion of pay settlements, though this is not publicly as clear as it might be - both because the Press tend to concentrate on the high settlements, and because employers who settle at realistic levels are generally not anxious to publicise the fact for fear of pressures to reopen.

2. The CBI have done much through their publicity over the last fortnight or so to help influence attitudes. The release of information from the CBI Databank (Press release at Annex A) has done much to counteract the impression of uniformly high settlement levels, in spite of reservations about the accuracy of its methodology (see Department of Employment note at Annex B). Further, the recently released survey of workers' views commissioned by the CBI from ORC (contained in the latest CBI circular to members at Annex C) shows that, in spite of their unrealistic attitudes on the levels of pay that employers can afford, workers are prepared to reconsider their attitudes if the realities are put to them forcibly enough by their employer. You may wish to welcome these initiatives by the CBI and encourage Sir John Methven further in this direction.

3. The Government's overall message on pay remains unchanged:

i) the Government's monetary and fiscal policies will exert firm pressure on companies, and thus upon wage settlements. If wage negotiators seek to ignore those pressures and reach settlements which cannot be justified by the financial position of a company, then the results will be horrendous in terms of unemployment and bankruptcies, and thus for the economy as a whole. But there is clear evidence that the majority of employees, if faced with hard facts, will recognise the situation and be prepared to respond;

ii) companies, looking at past history, may be banking on the Government changing course when the going gets rough, and are therefore conceding settlements beyond what they can afford, rather than face disruptive strikes. If so, they are going to face a rude awakening, because the Government is not going to relax its fiscal and monetary policies;

iii) the Government as an employer is taking a full part in restoring a sense of realism in pay bargaining. The use of cash limits means that public expenditure will not exceed the limits of what the taxpayer can afford - excessive pay awards cannot be accommodated by increased cash limits;

iv) given the gloomy economic outlook, improvement of our lamentable productivity record is essential if we are to achieve economic revitalisation. The Government is doing its part to increase efficiency in the public services, through financial pressures and directly through Sir Derek Rayner's work. Industry must respond similarly: increased productivity will allow not only economic growth, but increased earnings and profits as a result.

None of this will be new to Sir John Methven, who has been bringing out a similar message in recent speeches. You may wish to express appreciation for his help.

<u>Pay Publicity</u>

4. There has been some criticism from the CBI that the Government has not been doing enough in this field. They have been slow to appreciate the limitations under which the Government must work - non-intervention in the details of pay bargaining (which we think the CBI warmly welcome) means both that it is in general inappropriate for the Governmnt to comment on the outcome of particular negotiations, and that its information on pay bargaining across the board is insufficient to give a detailed picture. The Government's role (and we understand this to be the Paymaster-General's view) must in general be limited to ramming home the general message. We believe that this is now accepted by Sir John Methven, who has expressed appreciation in particular of the way you and the Chancellor have

repeatedly restated the Government's policies. The CBI's role should include the complementary one of providing the detailed evidence and support - which is why their work in recent weeks is so valuable.

ANNEX A

Confederation of British Industry
News Release

21 Tothill Street London SW1H 9LP Telephone 01-930 6711 Telex 21332

P.80.79

NOT TO BE PUBLISHED OR
QUOTED BEFORE 22.00 HOURS
ON SUNDAY 2 DECEMBER, 1979

SIGNIFICANT VARIATIONS IN PAY SETTLEMENTS

NO SINGLE "GOING RATE", SAYS CBI

There have been significant variations in pay settlements reached since 1 August, according to information collected by the Confederation of British Industry and published today (Sunday 2 December). "For this reason it is misleading to speak of a single going rate", says the CBI. "These variations are expected to increase as employees' awareness of the serious financial position of many firms grows."

The CBI has received information about settlements covering some 2 million employees. Nineteen of the settlements are national agreements and wages council awards, and provide for increases (in most cases in minimum rates of pay) of between 9.1 per cent and 27.3 per cent. The impact of these rates on actual earnings varies considerably. Company settlements show a similar range - from 5.5 per cent to over 20 per cent. The majority of settlements are in the 12 per cent to 16 per cent range.

*Further details are attached.

A

CONFEDERATION OF BRITISH INDUSTRY

PAY SUMMARY

1 Although previous years' experience shows that claims are a poor guide to the level of settlements, claims are following the same pattern as last year. The majority are for pay increases of between 20 per cent and 30 per cent. A limited number include demands for some form of indexation. In addition, nearly all include demands for a shorter working week.

2 There is a significant variation in settlements reached since 1 August. The CBI has information about settlements covering some two million employees. Nineteen of the settlements are national agreements and wages council awards, and provide for increases (in most cases in minimum rates of pay) of between 9.1 per cent and 27.3 per cent. The impact of these rates on actual earnings varies considerably. Company settlements show a similar range - from 5.5 per cent to over 20 per cent. The majority of settlements are in the 12 per cent to 16 per cent range.

3 Managers report that three factors are having a major influence on the level of settlements - cost of living, state of the labour market and the company's ability to pay. The interaction of these factors explains why some settlements are above the current rate of price increases and some below.

4 In the CBI's pay Databank survey, a random sample of managers who have made settlements since 1 August reported that in just over half the settlements the cost of living, and in nearly a third the need to recruit/retain labour, were "very important"factors exerting an upward pressure on the level of pay rises. For factors exerting a "very important" downward pressure, in just over a third of settlements it was the level of profits, in another third it was the company's inability to pass on a substantial part of the pay increase in higher prices, and in about a sixth it was the threat of redundancies if high increases were awarded. This reinforces information being supplied to the CBI from a number of sources - that while the cost of living is exercising a predominant influence on settlements, market forces are encouraging variations around the RPI.

...../cont

5 For this reason it is misleading to speak of a single going rate for pay settlements. The variations are significant - a trend which we expect to increase as employees' awareness of the serious financial position of many firms grows. It would also be wrong to assume that the present general level of settlements will continue, or even rise over the coming months. Several negotiations reported to the CBI have been influenced by the fact that employees who settled at a relatively modest figure last year have been seeking to catch up with those who settled later for larger amounts. Thus it is possible that the pattern of settlements in 1979/80 may prove to be a reverse of the pattern in 1978/79 - instead of starting low and getting higher, they may be higher at the start than later, especially if public understanding of the serious economic situation grows.

6 A significant number of settlements contain elements designed to raise productivity. A small proportion make some commitment to reduce the number of hours at work, and about a third provide for longer holidays. The majority of settlements are for periods of 12 months or more.

* * * * * *

ANNEX B

BACKGROUND NOTE

Current Level of Settlement

1. The average settlement in the pay round that started on 1 August was estimated in mid-November to be 19½% (21½% in the private sector and 15½% in the public sector). This was reported by the Secretary of State for Employment in his monthly pay brief.

2. These figures are not made public (unlike practice under the previous Administration) partly because pay settlements are not now monitored in detail and partly because publicity would lend credence to the dangerous concept of the "going rate".

3. With each settlement, the aim is to estimate the average increase in earnings in the 12 months after the settlement date compared with the previous 12 months. It is often necessary to make this estimate on the basis of incomplete data or of data - such as changes in the minimum or basic rates or in the pay bill - which needs to be converted. Evaluation of individual settlements is thus open to a significant margin of error. It follows that estimates of the average level of settlements are also liable to such error. Moreover, these averages tend to understate the likely increase because they do not reflect such factors as settlement periods of less than 12 months and indexation and re-opener clauses.

CBI Estimates

4. The Times and Financial Times have reports today (3 Dec) about figures issued by the CBI on the level of recent pay settlements. These reports are based on a News Release (copy attached) by the CBI. This Release includes a pay summary but contains no detailed backing up information.

5. Although these reports accurately reflect a statement in the CBI note that "The majority of settlements are in the 12% to 16% range", they do not make clear, what we believe to be the case, that these figures relate only to company settlements and not to the generality of settlements (including industry-wide settlements).

6. The 12% to 16% estimate is based we believe on some 40/50 company settlements notified to the CBIs Databank. A full list of these is not given in the CBI note. Nor is it clear as to whether those settlements bear out the estimates. Without full details of the reported settlements it is not possible to judge whether the estimates are reasonable.

7. There are other difficulties in evaluating these estimates:-

(1) It is not clear whether the size of the pay groups has been reflected by weighting the figures;

(2) It is not clear whether the figures relate to earnings, pay bill, basic rates or minimum rates;

(3) It is not clear whether the CBI's estimates relate to all settlements since 1 August (ie including some left over from the old round) or are confined to new-round settlements - as are the Department of Employment's estimates given in para 1 above.

(4) It is possible that the CBI's figures for settlements reflect differences in the experience of small pay groups compared with the major groups monitored by the Department of Employment, where there could be more union militance.

(5) They may also reflect a bias in favour of low settlements, since the companies concerned seem more likely to have reported these "good" settlements than companies that may feel they have let the side down by conceding large increases. However, the Economist (1-7 December) records that the CBI say this bias has been corrected.

8. We believe that despite the 12% to 16% estimate, companies are reported to be expecting settlements in the 15% to 20% range.

9. The estimate does not reflect the tendency this produces to understate the average settlement.

10. On the details available, it is not possible to test the figures given for the range of national agreements etc (9.1% - 27.3%) or the range for company settlements (5.5% to over 20%). It seems possible that the 5.5% figure relates to the Talbot settlement. If so, the 5.5% relates to basic rates only. / This compares with an estimate of 13½% increase in earnings by the Department of Employment. What is certainly clear is that there is a wide spread in the level of settlements, and that it is therefore not sensible to talk of a "going rate" average about which most settlements are clustering.

11. The number of private-sector settlements so far in this round is higher than that for last year - 40 (870,000 workers) compared with 24 (517,000 workers). (The corresponding 76/77 figures were 22 settlements and 660,000 workers) It is known that around this time last year a number of groups were holding back in the expectation that the 5% policy would collapse

12. The CBI note says it is possible that during this round the pattern of settlements may be the "reverse" of last year's and, therefore, lower in the later part of the round. They base this on the belief that the early settlements this round include groups which last year settled for modest increases before the collapse of the 5% policy (whose numbers will decline as the round progresses) and on the possibility that the public understanding of the serious economic situation will grow. The view that groups due to settle later in the round will moderate their demands in the light of last year's increases is based largely on conjecture. It remains to be seen whether the fear of unemployment will substantially moderate settlements in the remainder of the round.

Confederation of British Industry

From the Director General Sir John Methven
To the Managing Director or Chief Executive

21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
Telex 21332
Telegrams
Cobustry London SW1

7 December 1979

Dear Hamby

I am writing to you again, as we now have some useful information about the pay scene from our Pay Databank: and also we have prepared two more leaflets in our Business Briefs series.

THE PAY DATABANK

We now have the first results from our Pay Databank for this year. Although experience shows that claims are a poor guide to the level of settlements, claims are following the same pattern as last year. The majority of claims are for pay increases of between 20% and 30%. Additionally, a limited number include demands for some form of indexation. Nearly all include demands for a shorter working week.

Settlements since 1 August, directly covering two million employees, show that those covered by national agreements and wages council awards provide for increases in minimum rates of pay of between 9.1% and 27.3% while company settlements range from 5.5% to over 20%. The majority of company settlements, however, are in the 12% to 16% range, and a significant number include elements designed to raise productivity. A small proportion make some commitment to reduce the number of hours at work, and about a third provide for longer holidays. The majority of settlements are for periods of 12 months or more.

A sample survey of those companies which have settled since 1 August shows that in just over half the settlements the cost of living, and in nearly one third the need to recruit or retain labour were "very important" factors in pushing up the level of pay rises. Important reasons restraining pay increases included:

- The level of profits (just over a third of settlements).
- The company's inability to pass on the increase in prices (also a third).
- The threat of redundancies (a sixth).

This demonstrates that, while the cost of living is a predominant influence on settlements, market forces are encouraging a wide spread in the level of settlements, with the majority below the current Retail Price Index.

With these significant variations it is not true to say that there is a "going-rate". As awareness grows of the serious financial position of many companies, variations in settlements can be expected to grow.

A recent opinion poll by Opinion Research and Communications revealed that:

- Although a substantial minority of workers would settle for 10% or less, the majority are seeking wage increases ranging from 15% to more than 25%, and they think their companies can afford it;

- But, more importantly, if a company can demonstrate to its employees that the outlook for business is bad, then 7 out of 10 employees would reconsider their pay claim.

I enclose a summary of the findings of this most important opinion research, with some of our own comments.

BUSINESS BRIEFS : "INVESTMENT ABROAD" AND "PRODUCTIVITY & COMPETITIVENESS"

I am enclosing with this letter two more leaflets in the series of Business Briefs - No 2 : "Investment Abroad" and No 3 : "Productivity & Competitiveness".

"Investment Abroad" is not directly related to the crucial issues of pay and productivity; but it will be useful as an aide-memoire of the reasons why freedom from exchange controls should be beneficial to companies and employees both in reducing upward pressure on the exchange rate, which affects our ability to sell abroad, and in creating new markets overseas and so jobs at home. "Productivity & Competitiveness" goes to the heart of our problems. The calculations give stark evidence of the need for radical improvements.

It may be useful if I remind you briefly of the other material the CBI has produced in the last few months designed specifically to try to help you in your pay negotiations:

Talking Point 37 : "Pay and Taxes"
(Reasons why the RPI should not be accepted as a measure of changes in living standards)

Talking Point 38 : "Economic Background to the 1979/80 Pay Round"
(Summary of prospects for growth, profits, competitiveness and inflation, which has been expanded and brought up-to-date in the form of a Slide Kit).

Business Brief 1 : "Pay, Profits and Jobs".
(The need for increased profitability and its implications for jobs and investment).

Business Realities : Practical do's and dont's for communicating with your work force.

(All these leaflets are available from CBI Publications Sales at £3.00 per hundred to cover print and postage. The slide kit "Economic Background to the Pay Round 1979/80" costs £15.00 plus VAT).

The CBI's fortnightly Members' Bulletin is sent to each company in membership; and you are probably a reader. We are in the process of making a number of changes to the Bulletin. We are going to place greater reliance on it as a key way of giving you information to help you, amongst other things, in pay negotiations. I do hope that you will ensure you see the Bulletin over the coming months.

I have said that we must not allow ourselves to be distracted from our objective of reversing our economic decline. Success lies, in my view, in explaining boldly the realities and prospects for each individual business in a difficult world market and, indeed, in a domestic economy which is going through some fundamental but necessary changes.

Yours sincerely,

Terence Beckett

Confederation of British Industry

21 Tothill Street London SW1H 9LP Telephone 01-930 6711 Telex 21332

December 1979

KEY FACTS FOR CURRENT PAY NEGOTIATIONS

Below are key findings from an up-to-date survey of workers' views by Opinion Research and Communication*, with the CBI's comments.

What emerges from its survey is that the mood of most workers in the present pay round is more unhelpful than at any time for the past three years.

However, the findings make clear that it is possible, given the right response, to change employee attitudes and achieve realistic pay settlements.

FINDING NO 1

55% of workers are looking for wage increases this pay round, ranging from 15% to more than 25%, though 32% want 10% or less. (See Table 1).

Comment

*Unless productivity is increased dramatically, the effect of the higher pay increases would be a further drop in our export competitiveness and lead to even greater inroads into the home market by imports. Bankruptcies and lay-offs must follow. (See CBI Business Brief No 2 – Productivity & Competitiveness.***

FINDING NO 2

72% of workers believe their companies can afford their particular claims. (See Table 2). 50% of workers believe that companies, in general, are earning good profits. (See Table 3).

Comment

*Companies are not making enough profit to maintain investment at this year's level. With high pay settlements, we are bound to see an even greater fall in investment plans than the up to 5% already expected for manufacturing companies in 1980. (See CBI's Business Brief No 1 – Pay, Profits and Jobs).***

FINDING NO 3

41% of workers believe they are entitled to a bigger increase this round because of the Budget's switch to VAT from Income tax. (See Table 4). Half of workers believe that inflation is not a problem, as long as incomes keep up with the cost of living. (See Table 5).

Comment

Taking the case of a married man with two children who got a rise to £4,500 in November last year (roughly the average pay for a man at that time) – his real net income will only have fallen by 10.5% if the RPI has risen 17.5% since then.

* ORAC is launching the new CBI Business Attitudes Guide which will monitor pay round attitudes each year. Further information on the Guide and the survey referred to in this Summary are available from ORAC: 2 Wesley Street, London W1.

** CBI leaflets are all available from CBI Publication Sales, 21 Tothill Street, London SW1H 9LP.

However, 72% of workers say they would reconsider their pay claim if the business outlook for their company was pretty bad, while 60% would reconsider if their claim would substantially cut future growth and investment.

If profits were cut substantially by the claim, then the result is more evenly balanced, with 41% saying they would reconsider, while 36% would press ahead with their claim. 74% would reconsider if the claim would bankrupt the organisation. (See Table 6).

Comment

*The more a company explains its business prospects, the better the likelihood of getting a pay deal the company can afford. (See CBI's "Business Realities – practical steps for explaining them to people at work" and CBI's "Communication with People at Work").***

TABLE 1

Increases workers say they would settle for

% of Workers	Nov 1977	Nov 1978	Oct 1979	Nov 1979
Less than 10%	6	45	15	11
10%	54	29	25	21
Over 10%, and under 15%	4	3	6	5
15%, under 20%	10	7	27	29
20% or over	17	10	23	26

TABLE 2

Ability of employers to pay increases workers are now expecting

Question : From what you have seen and heard do you think your employer is doing well enough to be able to pay an increase of the size you have just mentioned? (See Table 1)

	(All those able to give % figure of increase)	
Employers	Aug 1979	Oct 1979
Employer can afford to pay	71	72
Employer cannot afford to pay	13	15
Don't know	16	13

TABLE 3

Question : Would you say that, in general, most companies are or are not making good profits at the moment?

Position of profits	% of Companies
Are making good profits	50
Are not making good profits	19
It depends on industry	19
Don't know	12

TABLE 4

Question : The cut in income tax means that people will take home more of what they earn, but the increase in VAT will mean that the price of some things they buy will go up. Do you think that this will leave you better off or worse off than before or do you think it will make little difference?

Financial Position	% of Findings
Better off	11
Worse off	41
Makes little difference	48

TABLE 5

Question : Inflation is not a problem as long as incomes keep up with the cost of living?

Agreement/Disagreement	% of employees questioned
Agree very strongly	20
Agree fairly strongly	30
Neither agree of disagree	12
Disagree fairly strongly	22
Disagree very strongly	12
Don't know	4

TABLE 6

Factors likely to make workers moderate pay expectations

Question : Suppose you and your fellow workers were negotiating a pay claim with the management at your place of work. Would you still press ahead with the claim or would you reconsider it if you knew:

	Would still press ahead	Would reconsider	Don't know Not applicable
That the future outlook for business was pretty bad	11	72	16
That the claim would substantially cut the organisation's profits	36	41	23
That the claim would substantially cut future growth and investment	15	60	25
That the claim would probably bankrupt the organisation	4	74	22

THE CURRENT SITUATION

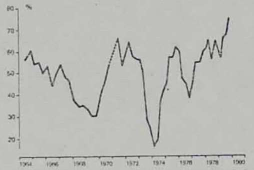
★ The UK's competitive position is now very worrying.[4]

Chart 3 gives a picture of the degree to which exporters see their prices in international markets as a major constraint on their business. The position has never been worse.

CHART 3

CBI Industrial Trends Survey

Q15 Is the price of your exports (compared with those of overseas competitors) a factor likely to limit your ability to obtain export orders over the next four months.



The position is particularly worrying in view of the gloomy prospects for world trade. Trading conditions are likely to be very depressed and competitiveness exceptionally important.

THE ECONOMIC REALITIES

As past experience has shown devaluation is not a real answer. In any case in the current situation it is probably not even an option. With North Sea oil and the need for strict monetary policies we cannot expect to postpone the necessary changes by devaluation.
The position is quite straight forward —

★ Unless productivity is improved and matched by realistic pay settlements, markets will be lost and company closures and redundancies will follow.

Notes (1) Labour costs include items such as employers' contributions to employee welfare schemes, as well as wages. (2) The UK figure appears to have been artificially reduced by the temporary pick-up in output in the second quarter of 1979 following the industrial disruption in the previous quarter. (3) This is equivalent to an increase of about 25% relative to the position in 1975. (4) Since the third quarter of this year sterling has weakened slightly but this appears to have been largely offset by the continuing under-[illegible] relative labour costs, and the position today (30 November) is about the same as it was in the third quarter.

[illegible] questions on the sources and calculations the table and charts or any other comments on the [illegible] please contact:
[illegible] P W M [illegible], Economic Directorate, CBI, 21 Tothill Street, SW1H 9LP.
[illegible] Further copies of this leaflet are available from CBI Publications Sales.

3

PRODUCTIVITY AND COMPETITIVENESS

1. Past experience shows that:

   ★ The competitiveness of British products has been reduced by excessive pay settlements and poor productivity.

   ★ Devaluation is not a real answer. It has made inflation worse and postponed the necessary changes.

2. We have still not solved our underlying problems. Our competitiveness continues to be eroded by poor productivity and excessive pay settlements. It has also been worsened by the recent strength of the pound.

3. The UK's competitive position is now very worrying — particularly with the gloomy prospects for world trade.

4. Unless productivity is improved and matched by realistic pay settlements, markets will be lost; company closures and redundancies will follow.

PAST EXPERIENCE

As Table 1 makes clear, during the 20 years to 1976:

* Productivity growth was very poor.

Output per man hour in manufacturing industry rose more slowly in the UK than in every one of our main competitor countries.

* We over-paid ourselves to a greater extent than our competitors.

Our wage increases were excessive — much higher than could be afforded given our productivity performance.

* So we had the fastest increase in wage costs per unit of output.

Table 1 Annual growth rates (%) in Manufacturing Industry 1956-1976

	Japan	Italy	France	Germany	USA	UK
Output per man hour	7.9	5.6	5.6	5.3	3.8	3.5
Hourly earnings	13.7	11.6	10.2	8.6	5.0	9.6
Wage costs per unit of output	5.1	5.8	4.2	3.2	1.2	6.6

The dotted red line in Chart 1 shows how our competitiveness was reduced by the faster increase in the labour cost[1] of production in the UK. It shows that from 1966 to 1976 this had increased by about 50% more than our main competitors.

The solid green line shows how the pound fell 40% against our main competitors' currencies. Initially each fall reduced the relative cost of UK products in world markets (see the solid red line), making our products more competitive — abroad and at home. But each fall in the pound added to our inflation and thus worsened the problem of our excessive pay settlements.

* The only real answer is to solve the underlying problems of poor productivity growth and excessive pay settlements.

RECENT EXPERIENCE

Table 2 shows that, since 1976

* We have still not solved these problems.

CHART 1

UK relative to competitors

a) Exchange rate relative to main competitor countries in Table 1
b) UK unit labour costs in sterling relative to competitors' unit labour costs in their currency
c) relative unit labour costs — UK relative to main competitors — after adjustment for exchange rate changes

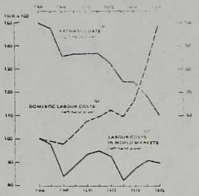


Table 2 Annual growth rates (%) in Manufacturing Industry 1976Q4-1979Q2

	Japan	Italy	France	Germany	USA	UK
Output per man hour	6.5	6.1	5.0	4.3	2.7	2.0
Hourly earnings	5.4	19.2	12.1	6.5	8.6	13.3
Wage costs per unit of output	−0.4	11.8	7.2	2.0	6.1	11.8[2]

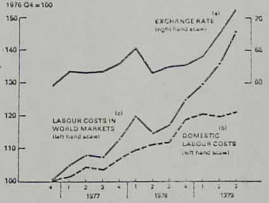
* Our competitiveness has been seriously reduced.

The labour cost of production in the UK (including the National Insurance Surcharge) has risen about 20% more than our main competitors' (see the dotted red line in Chart 2). But because the pound has strengthened at the same time, the labour cost element of our products in world markets has actually risen *40% more* than our main competitors'.[3]

CHART 2

UK relative to competitors

a) UK effective exchange rate
b) UK unit labour costs in sterling relative to other OECD countries' unit labour costs in their currency
c) relative unit labour costs — UK relative to other OECD countries — after adjustment for exchange rate changes



(1) For footnotes see back page

* Sometimes they have to invest in local markets abroad simply to stay in them - one survey showed that about a quarter of overseas investment went to markets which impose restrictions on direct British exports.

* These foreign activities by UK companies, keeping them healthy in world markets, can produce extra cash to be brought home - *and* the healthier the companies, the stronger the likelihood they will not have to cut back their UK operations.

THE WIDER WORLD

There are other points which may appear less obvious but which are equally important:

* Our standing in the world must improve when it is seen we are not using artificial props to bolster up our currency and that we are trying to make provision for the day our oil earnings run down.

* Greater freedom of movement of capital will further the development of the world economy as a whole - including the developing countries - and this must lead to higher living standards all round.

Above all, it has to be remembered that investment abroad is seldom an alternative to investment in the UK. The way to increase investment in British industry is by making investment worth while - through greater efficiency and lower production costs.

Exchange controls impeded foreign investment. *Investment abroad helps to create British jobs not destroy them.*

For [illegible] information on the contents of this Business Brief please contact: Economic [illegible]ate, CBI, 21 Tothill Street, SW1 H 9LP. Tel: 01-930 6711. Further copies of this [illegible] available from CBI Publications Sales.

2

INVESTMENT ABROAD AND JOBS AT HOME

1. Investing abroad is *rarely* an alterative to investing in Britain - cutting down on the first seldom increases the second.

2. Foreign investment by UK companies *creates* jobs in Britain.

3. The way to secure more investment in British industry is to increase real profits (See Business Brief N°1) by greater efficiency and lower production costs.

4. Lifting exchange controls removes an artificial interference with the value of the £ abroad when most British exporters would benefit from a free market level. So would British companies competing with foreigners in the UK market.

5. Capital outflow builds up assets, giving us future income from abroad, without which we shall be that much poorer when North Sea oil begins to decline.

6. Lifting all exchange controls removes from British companies - particularly small ones - a heavy burden of form filling and bureaucracy.

WHY ABROAD?

Companies mostly invest abroad either to spread their risks or expand their business to secure worthwhile returns on a particular project. They can very rarely just switch these investment plans to projects in the UK. The alternative to overseas investment is often no investment at all.

Investment abroad does not reduce the funds available for investment in the UK. There is no general shortage of funds for this purpose - if the expected profitability is attractive enough. This was a finding of the Committee, set up under the chairmanship of former Premier Sir Harold Wilson, to review the functioning of financial institutions.

The results of a CBI survey, presented in evidence to this Committee, showed that out of 160 investment schemes abroad which were examined, only four could have involved the investment of the money in Britain.

★ **Money being invested abroad is seldom money which would be invested in Britain.**

CONTROLLING THE FLOW

The effect of removing altogether the exchange controls which (until Oct 24, 1979) had existed in one form or another for 40 years has still to be assessed in detail. What is certain, as the Chancellor said in the Commons on Oct 23, is that the controls had 'outlived their usefulness'.

While they rarely stopped companies from investing overseas, since many, for example, were allowed to borrow abroad for this purpose, they did distort the pattern of financing and loaded companies, particularly small ones, with administrative burdens and form-filling. Some small companies actually lost commercial opportunities because of delays in processing exchange control permission.

Whatever the original reasons for imposing controls, the £ does not now need an artificial prop to maintain its value. This is true even though the strength of sterling may owe more to North Sea oil than to the overall efficiency of British industry.

★ **Removing exchange controls is of definite value to British trade and industry.**

★ **In time, any capital outflow will be offset by the money sent back to Britain from the foreign investments made.**

This will be of great value when our income from North Sea oil begins to decline.

THE BENEFITS

We have seen that companies seldom have the simple choice of just switching a sum of money from a planned foreign project to the UK. But how can Britain's economy - and Britain's workers - actually benefit when it goes abroad? There are a number of ways:

★ **Foreign investment can create jobs in the UK.**

Investment in overseas distribution networks can be expected to stimulate exports and, thus, jobs in Britain. Often, building a factory abroad can mean increased sales of British capital goods for its construction and equipment. And once it is in operation, a continuous flow of British components, spare parts and - in some cases - expertise - can follow. Setting up a local subsidiary can often convince foreign buyers that it is safe to continue 'buying British' - the British company is on the spot to cope with problems.

★ **Foreign investment produces extra income for this country which helps us to pay for imports of food and of materials used in our factories.**

★ **Sometimes companies need to invest abroad to secure their sources of raw materials.**

MONETARY POLICY AND THE COMPANY SECTOR

Background

There is clearly a difficult short term outlook for the company sector. The share of profits in total incomes in already exceptionally low(perhaps about 6% for non-oil companies) and has recently been adversely affected by continued cost pressures and falling activity. The cushion of liquidity built up by companies in 1977 and 1978 has been severly depleted. The financial deficit of non North Sea companies is unlikely to be as high as a proportion of GDP as it was in 1974 ($4\frac{3}{4}$%) but could come close to it over the 12 months to mid 1980. Difficult trading conditions are likely to continue next year reflecting weak demand at home and abroad and unfavourable competitiveness. But the pressure on companies will be eased somewhat in the course of 1980 as they cut back on stockbuilding and investment. Such cutbacks, which are to some extent a response to financial pressure and a tight monetary situation, will contribute to the expected fall in the level of economic activity. But both the immediate outlook for the sector and the prospects for future years depend crucially on future pay bargains.

Positive

1. Our first objective must be to bring down the rate of inflation. This is crucial to create the right conditions for investment and future growth. To relax our monetary policy would risk a surge in inflation which would be much more damaging to output and employment than tight monetary conditions.

2. The CBI recognised the 15 November package as a necessary part of the Government's determination to bring money supply and hence inflation under control.

3. The impact of tight monetary policies depends on how both sides of industry respond. If pay bargains are reasonable, inflation will come down faster and any substantial loss of output and jobs will be avoided.

Defensive

1. Future interest rates depend crucially on progress in reducing monetary growth and inflation.

2. Providing pay bargains are reasonable, there should be room within the monetary target and SSD scheme guidelines for necessary industrial finance.

3. Interest rates, of themselves, are not an important determinant of investment. The prospects for the economy generally are much more important. A lower rate of inflation is crucial; this would also allow lower interest rates.

4. There are objections of practice and principle to schemes of two-tier rates, sheltered finance for industry, etc. No sector of the economy can be wholly isolated from the effects of high interest rates; that would only undermine our policies.

5. Small firms face other difficulties, and we are looking at what might be done to relieve this.

6. We accept that "monetarism is not enough". Productivity needs to be improved as one element of a programme to improve the supply side of the economy.

NATIONAL ECONOMIC DEVELOPMENT COUNCIL

Sir John Methven may offer some thoughts about the discussion of UK economic performance and prospects at the December meeting of NEDC, and the conclusions to be drawn for future similar discussions. He may also express an interest in the January meeting, at which the Prime Minister will take the chair, where the main item for discussion will be/Employment Trends and/ Technological Change, Industrial Adjustment - Employment

December meeting

2. We believe that this was a modest success. There was a fair measure of agreement about the immediate economic prospects, though probably little closing of the gap between the TUC and the Government positions. At the very least, however, all parties seemed to have found the discussion useful, and the way is open for a similar discussion in a few months time. The Chancellor was also able to draw out a number of more specific issues to which the Council could return over the months ahead, including trade policy, industry support, small firms, the relationship of financial institutions to manufacturing industry, and the effectiveness of the tripartite Sector Working Parties in stimulating action at company and plant level.

3. The Chancellor has not yet had the opportunity to consider with his colleagues the timing of a further general economic discussion in NEDC. This would probably, however, be in three or four months time, though would not necessarily mean taking up the whole of a Council meeting. Sir John Methven has indicated a strong preference for the next such discussion to be held before the Budget. There would be much to commend this - ie in terms of influencing the presentation of the Budget, and the Budget Speech, even though there may not be much room for influencing the substance of the Budget itself.

4. Though the CBI have been pressing for a national economic forum - implicitly if not explicitly concerned with pay - all parties at the December meeting seemed to accept that whilst the Council would need to come back to the question of pay, tripartite discussions at this stage would be premature. /The Chancellor will shortly be discussing the future of the tripartite machinery generally with

the Secretary of State for Employment, with regard in particular to the slightly longer term aim of being in the position, as a result of discussions about the economy in NEDC (and elswhere), to influence attitudes and behaviour in the next pay round.7

Line to take

5. The Prime Minister might say that the December meeting was very much a first step towards getting a wider understanding about economic realities. The Government is feeling its way forward, and did not want to push the TUC in particular too far or too fast. The meeting was a modest success, and the way is open for further general economic discussions, as well as for follow-up on some of the more specific issues which came out of the meeting. However, all parties seemed in agreement that it would be premature to have tripartite discussions specifically on pay. We need, therefore, to see what more can be achieved by further discussions in NEDC before considering the need for, and likely success of, some new national economic forum.

January meeting

6. Discussion on the main agenda items will probably be grouped, conveniently, around three main headings:

(i) employment trends over the longer term;

(ii) technology (particularly micro-electronics) and employment;

(iii) work being done by the Sector Working Parties in this area as a whole.

The Government's aim will be to underline the fairly extensive common ground which exists between all the main parties, both about the positive potential benefits of new technology for jobs and living standards, but also about the danger of jeopardising future prosperity if we fail to adapt and innovate quickly enough and keep abreast with our competitors. The Government will acknowledge its own role both in getting a greater awareness of new technology, and in easing the process of adjustment for those whose jobs are lost as a result of technological change. An important theme of the discussion will be the importance of consultation between management and workforce about the introduction of new technology, and the Government hope that the CBI will be able to agree with the TUC on a joint approach to this. (For example, the CBI might join with the TUC in monitoring and publicising cases where new technology has been incorporated successfully as a result of full consultation and co-operation between management and employees.)

7. Another theme will be the need for people to learn new skills and new work methods as firms adopt the new technologies. The Government will reiterate its view that, whilst the activities of the Manpower Services Commission are important in steering the nation's training system towards meeting the skill needs of microprocessor technology, the prime responsibility for training must remain with employers, who can best perceive their individual needs. Again, therefore, the Government hope that the CBI will underline their own endorsement of this view.

8. If the opportunity arises, the Prime Minister might also ask Sir John Methven for his views about possible and desirable outcomes for the meeting.

MUTUAL INSURANCE FUND

1. The attached press cutting from The Daily Telegraph is the fullest recent account for public consumption of what is happening on this front. We imagine that if the subject is raised, Sir John Methven will wish to do most of the talking by bringing you up to date and filling you in on the background. Formally the CBI regard the fund as very much a matter for themselves, and have not discussed it with Government. However, the subject did come up at the CBI's working dinner with the Chancellor at the end of October: although the Chancellor considered such a fund essential to redress the balance of power between employers and unions, he did have very serious doubts about the possibility of the fund being located in a tax haven.

INVESTMENT & BUSINESS

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Jobless will reach 2·25m say brokers

By CLIFFORD GERMAN

UNEMPLOYMENT is likely to rise particularly quickly next year and go on rising until it reaches a post-war peak of 2·25 million or about 10 p.c. of the labour force, according to Mark Fulton, an economist at stockbrokers James Capel.

The cost of extra unemployment benefit would then add about £850 million to the public sector borrowing requirement in 1980-81 and £2,000 million in 1981-82.

The cost includes the loss of Income tax revenue and National Insurance contributions and the extra cost of unemployment and Social Security benefit, although the tax lost depends on the kind of worker who loses his job.

The extra cost of benefit depends on whether working wives lose their jobs, how many unemployed men lose benefit [illegible] are still at [illegible] the propor- [illegible] unemployed [illegible] next [illegible] to be [illegible] 1975, it [illegible] with [illegible] the [illegible] in [illegible] the

CBI aims for £50m strike insurance fund

By MICHAEL BECKET

THE Confederation of British Industry is aiming to build up a fund of between £50 million and £100 million within a year or so of starting its insurance scheme to reimburse members for the effects of strikes.

The mutual insurance fund, now entering its final planning stage, would need that sort of sum behind it "to seem credible" says C B I director general Sir John Methven. If it failed to get the right level of backing from the start, the scheme would not begin, he added.

He also wants a proper spread of risks. Some people have been sceptical, Sir John concedes, "but they want the balance of power altered" so what other way is there, he asks.

Over the next couple of months the five insurance brokers devising the scheme with the C B I will be "test marketing" it with some 30 large companies. This is to see whether they would join on the present terms.

A major factor to be tested is the acceptability of the cost. It must be compared with other insurance premiums and with provisions many companies already make for disruptions both within their own organisations and at suppliers and customers.

The premium is being determined by a large number of criteria, including size of workforce, location of plant, number of unions involved (and which ones), past strike experience, and vulnerability to knock-on effects.

Each factory is rated separately and employers can select which to insure, but all policies cover direct and knock-on losses.

Another question companies are being quizzed about is whether the scheme has the right "excess" (degree to which insured carries own loss) and limits. The draft plan suggests insurance be triggered after 10 days of strike and cease after 60 days, but both are flexible in general and may be altered to suit individual circumstances.

It is also expected to be "co-insurance" — the companies would have to bear part of the cost even within the insured period. The present recommendation is for companies to pay 25 p.c. of the insured cost.

After this initial survey, the terms will be altered in response to suggestions, and then in February put to a series of meetings of some 150 companies. This is to get the opinion of a cross section of C B I membership.

That will produce the "fine tuning" as Sir John calls it. The brokers then go out into the market around next April to start selling it properly on a provisional basis. The schedule is to get the scheme passed by the April meeting of the C B I council.

Sir John hopes to get the plan underway by August 1 next year. At the latest he wants September 1 as the starting date. There is a lot to settle before then. But the C B I is still not certain whether the insurance legislation may be applied to the scheme.

If so, the regulations would be so onerous—not being framed for such funds—that the scheme may have to be set up overseas in perhaps Lichtenstein, the Channel Islands or Bermuda, though Sir John would prefer it on-shore.

A separate company would have to be set up either way, owned by the C B I but run by the five brokers. Finally a group to check on the claims has to be recruited though auditors would be asked to certify the amount of the losses claimed.

Ladbroke's licence optimism 'misplaced'

By BARBARA CONWAY

[illegible] Ladbroke Group [illegible]

THE discussion paper on new techniques of monetary control being drafted by the Bank of England is almost complete. It should be in Whitehall in the next week or so.

Given the crucial importance of monetary control to the Government, however, and the scaring experience of the latest rise in interest rates, there could be a good deal of debate before a final version is released to public view. That is now more likely to be after Christmas than before.

It is no secret that there are many shades of opinion about controlling the monetary base both within the Bank and the Treasury ranging from almost complete scepticism to enthusiastic support.

But it is already clear that switching to control of the monetary base is far from solving all Britain's problems in controlling the money supply at a stroke. Anticipation has tended in some quarters to exaggerate what a change in the system can achieve.

Monetary base control is unlikely to keep interest rates any lower than they would otherwise have been and will probably make them more volatile, both up and down. It does not relieve the Government of the need to pursue a responsible fiscal policy or to fund its borrowing requirement by selling gilts.

In some versions it may remove the temptation for banks to evade the controls but only at the cost of relinquishing discretionary control over interest rates. Finally it does nothing to underpin the theoretical basis of monetarism that there is a stable relationship between the demand for money and national income.

The likely benefits from changing the system are first, to reduce the overwhelming reliance on the gilt-edged market for monetary control which has kept the market in a state of varying tension *vis à vis* the authorities for the last few years and made steady sales of gilts unnecessarily difficult.

The second aim is to replace the banking "corset" which reduces competition between the banks and distorts the financial system and the statistics on which policy is based. A third aim is to speed up the response of interest rates to monetary conditions.

Tramp ship rates rise

RATES for tramp ships are showing another significant rise, the General Council of British Shipping reports in its monthly [illegible]

N

Secretary of State for Industry

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13 December 1979

Martin Hall Esq
Private Secretary to the
Chancellor of the Exchequer
HM Treasury
London SW1

Dear Martin

Caroline Stephens copied to us her letter of 11 December to Tony Battishill requesting briefing for the Prime Ministers meeting with Sir John Methven tomorrow.

I enclose a brief on points of interest to this Department suggested by our officials. This has not been cleared by the Secretary of State due to lack of time.

I am copying this letter to Caroline Stephens (No.10) and Andrew Hardman (Employment).

Yours

Bernard Dodwell.

B C. DODWELL
Private Secretary

BRIEF FOR MEETING ON 14 DECEMBER BETWEEN THE PRIME MINISTER AND SIR JOHN METHVEN

1 INDUSTRY BILL/NEB

The CBI gave their views on the Industry Bill when they saw the Secretary of State on 3 December. In general they welcomed it, although the Director General expressed strong concern about the power in Clause 6 for the Secretary of State to nominate the NEB's Chief Executive. The Secretary of State is now following this matter up with the Scottish and Welsh Ministers. It is unlikely however that the CBI's concern about this would become public.

2 RESIGNATION OF "NEB BOARD"

Following the resignation of the NEB Board, after a decision to hand Rolls Royce back to the Department of Industry, Sir John Methven requested a meeting to discuss the Department's plans for NEB and Rolls Royce.

During discussions in late November with Sir Peter Carey, Sir John expressed unease about the wider implications of the Rolls Royce decision, but indicated that he could see the sense of the argument that there was an inherent inconsistency in having the Board at RR supervised by a separate Board of equal stature. When Sir Peter indicated the names to be announced by the Secretary of State Sir John showed that he was favourably impressed. In discussions about the implications for the TUC, Sir John said that he intended to contact Mr Murray to try and pour oil on troubled waters. This offer was welcomed.

In subsequent talks within the NEDC, the TUC took the line that the old Board had been shabbily treated by the Government and it was for that reason that there was no trade union representatives on the new Board.

3 COMPANY LIQUIDITY

The CBI have expressed concern about the forecast worsening of company liquidity. Industrial and commercial companies are estimated to have had a financial deficit of £2.4 billion, seasonally adjusted, for the first half of 1979, compared to £2.2 billion for the whole of 1978. Most forecasts suggest a deficit of between £4 billion and £6½ billion in 1980, the CBI's forecast being £5-6 billion. It is estimated that the North Sea sector has now moved into surplus, hence the deficit for the non North Sea sector could have been £3-3½ billion in the first half of 1979. If North Sea activities are

RESTRICTED

RESTRICTED

excluded from the forecasts for 1980, the top end of the range of forecast deficit for industrial and commercial companies could be reached, and could approach the previous peak of 1974 (about £3.8 billion) in real terms.

It is generally expected that the increased financial deficits will shortly start to be reflected in deteriorating company liquidity. This is supported by the CBI's six monthly survey of company liquidity (as part of their 'Trends' survey) which indicated a 'significant worsening in liquidity between October 1978 and October 1979'. This was particularly marked among the larger companies. A further deterioration is anticipated. The Bank of England's monthly survey for October, based on contact with industry and banks, manifests a good deal of concern about prospects for profitability, but less anxiety about liquidity than is reflected in the CBI's survey.

12 December 1979
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KS

10 DOWNING STREET

From the Private Secretary

11 December 1979

BF ~~13.12.79~~

Sir John Methven has requested a short meeting with the Prime Minister and he is to see her at 1000 a.m. on Friday 14 December.

I would be grateful for a brief on any of the points the Prime Minister should be aware of.

I am sending a copy of this letter to Ian Ellison (Department of Industry) and Ian Fair (Department of Employment).

CS

Tony Battishill, Esq.,
H.M. Treasury.

GB

CONFIDENTIAL

Ind Pol. 2

Prime Minister

Worth reading

cc Mr Wolfson
Mr Ingham

Copies to each:-

CHANCELLOR
CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (C)
MINISTER OF STATE (L)

SIR FRED ATKINSON
SIR DOUGLAS WASS
SIR LAWRENCE AIREY
SIR ANTHONY RAWLINSON
MR LITTLER
MR F JONES

MR MONCK
MR UNWIN
MR DIXON
MR LOVELL
MR BUTT
MRS HEATON
MR P G DAVIES

PS/Inland Revenue

MR RIDLEY
MR CROPPER

PS/Secretary of State for Industry
PS/Secretary of State for Trade

PS/Paymaster-General

Mr Lankester)
Mr Duguid) No.10.

WORKING DINNER WITH THE CBI

I attach a note on last Monday's meeting, with apologies for the delay in circulation. The discussion was on a very frank and private basis, and I should, therefore, be grateful if the confidentiality of the record could be respected.

M. A. HALL
2nd November 1979

CONFIDENTIAL

RECORD OF DISCUSSION AT A WORKING DINNER WITH THE CONFEDERATION OF BRITISH INDUSTRY: 21 TOTHILL STREET, MONDAY, 29TH OCTOBER, 1979

Present:

Sir John Hedley Greenborough K.B.E.(Host)	Chancellor of the Exchequer
Sir Raymond Pennock	Secretary of State for Industry
Sir Adrian Cadbury	Secretary of State for Trade
Sir Arthur Knight	
Mr. H. A. Whittall, C.B.E.	
Sir John Methven	
Sir Donald MacDougall, C.B.E.	
Mr. Richard Dixon	

After dinner, Sir John Greenborough welcomed Ministers, and proposed a semi-structured discussion based on the agenda in his letter ... of 19th October (attached). He opened the discussion by outlining the themes he intended to pursue at the CBI's Annual Conference the following week. He would say that the CBI supported the broad thrust of the Government's policies; and that he accepted that the ball was now in management's court. But the perennial problems remained. Reality must be faced without defeatism. It was not just Trades Unionists who had yet to adjust to the new freedoms. He hoped that the Conference would provide the backcloth to a broad and thorough discussion. A main objective would be to help management to explain the relevance of the Government's policies to their shopfloors. The other main issue would be the fundamental problem of righting the balance of power between management and unionised labour. The CBI's idea of a mutual insurance fund would be launched.

2. Sir John Methven said that the CBI's extended data bank suggested that pay settlements in the private sector were running at or above levels reached last year. Although the Government's approach to economic policy was undoubtedly kindling a new spirit, this was not manifested in day-to-day negotiations on the shopfloor. In his view, it would be cause for relief if settlements could be

contained to the range 13 - 16 per cent, however distressing the sentiment may be. Picking up Sir John Greenborough's point, he regarded the central problem as enabling individual companies to get across to the shop floor the dangerous consequences of settlements at unrealistic levels. He observed that over the past year the public sector had in fact led the private sector; at least the latter had been de-manning. The Clegg Commission was a further complication, and the Government was still conceding pay increases in the public sector which were incompatible with their broader policies. In short, he himself was very anxious about the progress of the present pay round.

3. Sir Geoffrey Howe agreed with Sir John Greenborough that reality must be faced. There was little point on this occasion in ranging over the now familiar problems of world economic stagnation and the UK's relatively poor performance. It was a policy of despair to suggest that our problems could be escaped by progressive depreciation of the exchange rate. He too was concerned about settlementsin the public sector. The Treasury was faced with acute problems in this area. Its role was to forecast as accurately as it could the cash resources which would be available, and then to fix cash limits; if these were unrealistic they were over shot; if they were set realistically, they influenced expectations elsewhere, with damaging effect. He had been struck in discussion earlier that day with the Welsh TUC how the union side had seen no connection at all between the future of the steel industry as a whole, and the problems at Hunterston/Ravenscraig. Clearly the whole tone of the public debate needed to be changed; he confessed to a quandary, in that his own speeches were criticised equally severely, on grounds either of excessive pessimism or undue euphoria. On the balance of industrial power, the Government was trying to redress the position as far as it judged sensible. He thought that most

CBI members would think the Government was going far enough; but were they really stopping short of what was necessary?

4. Sir John Methven said that everyone was against inflation, but that no one saw his own pay claim as fuelling it. There was a need for ingenuity in establishing this link in peoples minds. Managers on the shop floor must be armed with the right arguments. Institutions tended to concentrate on the macro economy; not enough effort was being put into the problem at micro level. The Chancellor commented that in the public sector there was no such discussion at shop floor level at all. Sir Keith Joseph thought that this was a bit harsh; the nationalised industries were making real efforts to eliminate their losses. He thought that a major problem was the perverse effects of redundancy payments. Because of the cushion these provided, individuals no longer felt a stake in the survival of their employers. Mr. Dixon commented that arrangements in the UK were no more generous than elsewhere; the fact that unemployment had lost its sting was a fact of life, to which management must adjust.

5. Sir John Greenborough said the importance of communication within the firm could not be overstressed. Managers had to turn themselves into communicators. The Chancellor thought it was essential that the Government should not underplay the vital message on pay. Specific examples should be quoted - e.g.Hunterston and the firm of ship repairers in Mr. Nott's constituency which had been forced out of business by the engineering strike. Sir John Methven said the CBI supported the Government's broad economic policy to the hilt. But the battle would be lost unless victories were won on the pay and public expenditure front. There was no sign that the Government was adopting new methods of getting its message across. The CBI on the other hand, was experimenting in many ways:- regular letters to member companies; tapes for managers; preparation of talking points; invitations to

trades unionists from Germany etc. Sir Raymond Pennock agreed that the Government could not escape its responsibility to put across the argument at national level. But management too was failing by conceding in individual battles over wages. The Government should say, and say soon, what the country can afford by way of wages. If it did not act decisively, events over the next six to eight weeks would result in an outturn of 17-20 per cent settlements for this year.

6. The Chancellor commented that the burden of this message would have to be that on average there would have to be a decline in real living standards. But such a stark message would have to be presented as positively as possible. Mr. Dixon thought that if this really was the message, neither the Government nor the CBI had yet begun to explain it. Sir John Methven disagreed. The CBI had not ducked the issue; even againstthis sombre background, where a firm improved its productivity, it was possible to concede pay rises above the general level of inflation. Sir Raymond Pennock accepted this as fair comment in a free economic climate. There were certainly companies that could afford generous pay rises. But the way in which companies' results were presented gave a highly misleading impression. For example, on a historic cost basis ICI's third quarter results were excellent; but they represented only a 3.3 per cent real return on assets. No company could in fact afford wage rises at or above the level of the RPI. This was another aspect of reality which needed to be exposed.

7. Mr. Whittall commented that the Chancellor was a lone voice; other Ministers had not hammered home the economic message.

8. Sir Adrian Cadbury then outlined the CBI's view of the immediate future. There was already a squeeze on profitability and liquidity, which would intensify. But there was no real evidence that either member companies or their bankers had taken aboard the

full consequences of the Government's monetary policies. The message he would try to put over in Birmingham was that companies must look to their cash flow, and take appropriate action. The CBI had no alternative but to produce a gloomy forecast. Economic discomfort in the short term future was unavoidable if growth was to be resumed. And the Government's policies offered the only route to growth. The Chancellor agreed that the message was uncomfortable. But maintaining monetary disciplines as a perimeter fence implied that some firms would go to the wall. There was no escape from this conclusion. Successful companies could be found, and they would survive the storm; but the weaker firms caused real concern. Sir Keith Joseph agreed with Sir John Methven that the liquidity position was in no way as serious as it had been in 1974-5. The present corporate sector deficit of £4-5bn would be as high as £9bn. if 1974/5 conditions obtained.

9. Sir John Methven said his discussions in Whitehall during the summer had revealed no new Government thinking on propagating the message. Outsiders must be brought in, just as the CBI had recruited the services of Brian Redhead. Sir John Greenborough thought that detailed analysis was needed of precisely who should try to influence whom; e.g. at which audience were Ministerial speeches directed?

10. The Chancellor observed that at least in private sector enterprises the market was a strong influence on decisions; this was absent from the public sector. Sir Raymond Pennock commented that it was cold comfort to companies paying wages beyond their means that things were even worse in the nationalised industries. Sir Keith Joseph said that the Chancellor's policies were in fact leading to a reduction in the proportion of resources absorbed by public sector. The number of people working in it was falling, and a better competitive base for the nationalised industries was being established.

11. Sir Donald MacDougall thought that it would be counter-productive to suggest that people should settle for a reduction in their standards of living, even if this were true. It was better to argue in terms of getting both wages and prices down. Sir Keith Joseph thought most of the public debate was misguided. Money supply was growing at an annual rate of some 11 per cent as compared with an inflation rate of say 17 per cent. The difference between these figures was the crucial factor. Sir John Methven thought this message lacked intelligibility and immediacy to the shop floor. His concern was to avert, by whatever means of communication he could muster, as many bankcruptcies as he could. If unemployment rose to very high levels, he was deeply concerned about the social consequences. Sir Keith Joseph pointed out that it took time to reduce the level of inflation by firm monetary policies. Instant remedies were not available.

12. The Secretary of State for Trade thought that the CBI and the Government would help their own case by ceasing publication of forecasts. Events would sort themselves out, given time. The removal of controls had set the Government well on the way to solving the fundamental problems; the basis of a self regulating system was now installed. Sir Arthur Knight commented that the new freedoms had come very quickly. It was up to employers to insist on real productivity improvements in exchange for generous pay settlements. This was possible where companies negotiated separately; but they lost control where settlements were made nationally.

13. Sir John Methven said that the next eighteen months would be a testing time. Good communications were the only way of keeping CBI members on the Government side when the going got rough.

14. Mr.Nott reverted to his earlier theme. We were all obsessed with crystal gazing. He would willingly free the Government from its commitment to publish the "Bray" forecast

by tacking an amendment on to one of his Bills in thepresent session. He took pride in the paucity of statements about statistics made by his Department. The Chancellor said there was no doubt that monthly examination of the entrails was unhealthy. But, like corporate finance directors, the Government had to produce a cash framework within which the economy could work. It could not avoid being drawn into detail where the nationalised industries were concerned. Sir Raymond Pennock said that the Government would have to explain its policies carefully; otherwise it would be voted out. Mr. Nott thought the tone of the evening's discussion was unduly pessimistic. Pessimism was self-fulfilling. It, rather than the lack of clear explanations was the real root of present problems. Sir John Methven disagreed. Ordinary people tended to take sensible decisions - e.g. in the various referenda - provided they were given a well argued choice. There was no downward risk in attempting to clarify Government policy. The Chancellor deplored the lack of informed commentators in the media. It was particularly difficult for the Government itself to get the message home to the shop floor. Mr. Dixon commented that the Government disposed of by far the largest information machine in the country. It should work on the more influential interviewers.

15. The Secretary of State for Trade thought that the one major area still to be tackled by the Government, and possibly the most difficult, was employment protection. The Opposition were disorganised, and now was the moment to act.

16. The Chancellor of the Exchequer raised the question of the CBI's mutual insurance fund (MIF). He thought such an instrument essential in the "balance of power"; but he was distressed at reports that the CBI was contemplating locating the fund in a tax haven. Sir John Methven said that this was certainly not the CBI's objective. But in order to be able to base the fund in the UK, certain conditions needed to be met:(a)premiums must be deductible

for tax purposes. (b) Taxation levels on investment income must be kept low. (c). Premiums paid e.g. by companies like Plessey should be includable for Government contracts. He hoped Ministers could help the CBI over these conditions; his advice was that at present location outside the UK would be advantageous from the taxation point of view. Mr. Dixon added that a further complication was that the fund would have to be established for six months before it could function, if it were set up in the UK.

17. The Chancellor said that any savour of tax evasion would make the fund markedly less attractive, and would cause positive harm to the CBI. Mr. Nott said he agreed; but that if there was anything he could do to help through Bills now on the stocks, he would gladly do so. The CBI should contact officials in the Department of Trade. The opprobium attaching to measures helpful to the CBI on this would be less than the damage done by an offshore fund. Sir John Methven said the timetable was tight. The scheme must be put together by December, and sold to member companies during December to March. A small number of participant firms would suffice; but the risk would have to be spread.

18. The Chancellor said that CBI must accept political reality. Their scheme must be compatible with the UK tax system, and the Government could not be expected to adjust the law in order to accommodate it. Nor could the CBI expect their scheme to be taken seriously if in order to work it had to be established in Lichtenstein. It may be that accommodation through legislation would be necessary; but the CBI should do its utmost to fit it to existing UK law.

19. Mr. Dixon said the advantages of going off shore were overwhelming. The CBI were well aware of the presentational disadvantages.

20. Sir Raymond Pennock said it was essential not to lose sight of the main point. The important thing was to rectify the balance of power; the right means must be found. Mr. Nott thought the Chancellor had stated the case too starkly. The "deemed strike pay" provisions, for instance, were no more politically difficult than adjusting the law to accommodate such a scheme. He would much rather do this than let the fund go offshore. The Chancellor said he very strongly supported the CBI's objective; but he remained strongly opposed to an offshore fund.

21. Sir John Methven expressed disappointment at the Chancellor's view. The fund was not even off the ground; it risked being still-born. The Chancellor had placed a major roadblock in the way of the scheme. This was a great pity, since it would make a very major impact on the industrial scene. Mr. Whittall commented that it would be embarrassing to CBI, not the Government; the latter could always disown the fund. The Chancellor said the CBI and the Government were fighting the same battle. Neither could disown the other.

22. Sir John Methven said he personally now accepted that an offshore fund was politically unacceptable. The fund however was vital; it must be got off the ground by September 1980; and the Government's help was needed. The CBI would, therefore, let the Chancellor and Mr. Nott have a memorandum on the scheme within two weeks. To meet the CBI's own deadlines, cast iron solutions would be needed by mid-January 1980.

MAH

M. A. HALL
2nd November 1979

Industrial Policy MFS
cc DM

10 DOWNING STREET

THE PRIME MINISTER

30 July 1979

Dear Sir John,

Thank you very much for your letter of 25 July in which you report on the two conferences which you have recently held on the 1979/80 pay round.

I was most interested to hear about the points which were raised at these conferences, and I am sure they will have strengthened employer determination to stand firm against excessive pay claims in the coming round.

Yours sincerely

Margaret Thatcher

Sir John Hedley Greenborough, K.B.E.

10 DOWNING STREET

PRIME MINISTER

This is a letter from the President of the CBI reporting on two recent conferences on the next pay round which the CBI mentioned to you that they would be holding. These appear to have been quite helpful in stiffening employer resolve. I attach a draft reply.

T..

MA

26 July 1979

Confederation of British Industry

From the President:

Sir John Hedley Greenborough KBE

21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
Telex 21332
Telegrams
Cobustry London SW1

25th July 1979

Dear Prime Minister,

You will remember that at our meeting on 9th July I mentioned that we were planning to hold two Conferences of Chief Executives and Industrial Relations Directors to seek employers' assessment of the manner in which the 1979/80 pay round is likely to develop; how they can help to establish the right climate for sensible and economically effective pay bargaining; and their individual attitudes and potential responses to the claims made on them.

The Conferences were held last week and I thought you might be interested to receive a brief report on them. They were attended by some 130 very senior representatives from the largest CBI member firms (including the Nationalised Industries), the major employer organisations and the smaller firms.

There was total agreement that main bargaining will take place at a critical time with low real profitability in much of industry, tight liquidity, declining international competitiveness, a sharp rise forecast in the cost of living, and the likelihood of increasing unemployment. It was recognised that the gravity of the situation placed a particularly heavy responsibility on employer and union negotiators.

The Conferences identified the pressures likely to be faced in the forthcoming round - in particular, demands for pay increases at least as great as movements in the RPI, for increases based on comparability rather than on companies' ability to pay, and for a reduced working week without loss of pay. Participants, however, saw some possibility that responsible trade union negotiators would show greater realism than in the recent past.

/...

The chastened mood of many trade unionists, following the disruption of last winter and the defeat of the Labour Government, together with the implications for employment of large pay increases at a time of strict control of the money supply, were cited as giving some hope towards such realism.

The outcome of the next pay round clearly depends very much on the way expectations develop. In this context, both Conferences emphasised the importance of the Government stressing publicly, and repeatedly, its determination to achieve its monetary targets and to stick to its cash limits. It is also most important for your Government to make it absolutely clear that you have no intention during this pay round of introducing any form of pay freeze. This was recommended to discourage union negotiators from pressing home excessive demands in order to get in before the "boom is lowered". Although it was recognised that managers would be unrealistic to attempt to bargain about net rather than gross pay, those attending felt that negotiations would be helpfully influenced if employees were regularly reminded, not only by their employers but particularly by Government, of the benefits they had received from the direct tax reductions in the Budget. It was stressed that in this way, and more generally by bringing to public attention, frequently, the economic realities surrounding pay, the Government could do much to influence expectations.

But we can't absolutely rule it out. T.

It was of course accepted that ultimately the responsibility for ensuring a realistic level of settlements lay with the employers themselves. There was widespread determination by companies' representatives to convey their own particular circumstances to their employees by effective in-house communication, to encourage their managers at all levels to stand firm against excessive claims, and specifically to resist demands for a reduced working week. A desire to strengthen the position of employers by improving employer liaison and, where possible, by mutual support, was clearly expressed. The need for well informed, confident, and determined management was stressed repeatedly.

A great sense of urgency was apparent at both Conferences. It was essential to start taking action now to influence expectations in the period ahead and for Government, employer organisations and companies to bring home the same consistent message.

The Conferences showed great appreciation for what the Government has done so far and voiced strong determination to do everything possible to seize the opportunities which lie ahead. The road will not be an easy one.

/ ...

The candid and unrestricted exchanges of view at both Conferences were, I am sure, born from my assurance that the confidentiality of the meetings would be respected.

I am sending copies of this letter to the Chancellor of the Exchequer and to the Secretary of State for Employment.

Sincerely,

John Greenborough

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister,
10, Downing Street,
London, SW 1.

25 JUL 1979

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10 DOWNING STREET

From the Private Secretary

10 July 1979

I enclose the record of the Prime Minister's meeting with the CBI yesterday.

I am sending copies of this letter and enclosure to Andrew Duguid (Department of Industry), Ian Fair (Department of Employment), Tom Harris (Department of Trade), Richard Prescott (Paymaster General's Office) and Martin Vile (Cabinet Office).

TL

A.M.W. Battishill, Esq.,
H.M. Treasury.

CONFIDENTIAL

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CONFIDENTIAL

cc. Messrs Gow, Wolfson, Hoskyns, James, Whitmore.

JS

/c Master Set

RECORD OF A MEETING BETWEEN THE PRIME MINISTER AND THE CBI AT 1545 HOURS ON MONDAY 9 JULY 1979

Present:

Prime Minister
Chancellor of the Exchequer
Secretary of State for Industry
Secretary of State for Employment
Secretary of State for Trade
Mr. Ian Gow
Mr. David Wolfson
Mr. John Hoskyns
Mr. Henry James
Mr. Clive Whitmore
Mr. Tim Lankester

Sir John Greenborough
Sir Adrian Cadbury
Mr. Fiennes Cornwallis
Sir Francis Tombs
Mr. H.A. Whittall
Sir John Methven
Sir Donald MacDougall
Mr. Richard Dixon

* * * * * * * * *

Welcoming the CBI delegation, the Prime Minister thanked them for their warm welcome to the Budget and to the Government's overall economic strategy. The strategy consisted of two key elements: improving incentives and returning power and responsibility to the private sector. The Government depended upon the private sector to make the strategy succeed.

Sir John Greenborough said that the CBI were pleased to have the opportunity to express their views to the Prime Minister directly. The CBI were indeed very pleased with the Government's strategy, and this was reflected in the letters which they had sent out to their members. He and Sir John Methven had found that the response of many employers was encouraging. Industry was committed to accept the challenge which the Government had provided. It would be important to monitor progress.

Against this generally encouraging background, the CBI wished to discuss with the Prime Minister two main policy areas: first,

/ the exchange

the exchange rate, exchange controls and interest rates; second, the coming pay round. On the latter, Sir John Greenborough said that the Prime Minister's speech in Cambridge the previous Friday had struck just the right note.

Sir Adrian Cadbury said that the CBI's view on the short-term economic prospect was similar to the Government's. The main problems facing industry were high interest rates, declining competitiveness and low profitability - for the first quarter of 1979, profitability in real terms had been only 2.9 per cent, and the CBI were forecasting only 3 per cent for the rest of the year. The CBI fully supported the Government's efforts to economise on public expenditure, but they felt it important - for the sake of the construction industry and for the country's infrastructure - that the cuts should not be concentrated on the capital side. As for interest rates, they accepted the overriding need to reduce the rate of inflation, but they were concerned about the effect of high interest rates, especially on small businesses. High interest rates were also putting upward pressure on the exchange rate. They therefore hoped that the MLR would be reduced as early as possible, consistent with keeping the money supply under control.

The CBI's latest survey showed that 67 per cent of respondents regarded prices as the major factor constraining exports; and even where export performance was being maintained, the high exchange rate meant that profitability was being reduced. A study carried out by Mr. Oppenheimer for the CBI in 1978 showed that many firms were worried about becoming uncompetitive because of the rising pound; the recent appreciation only underlined this concern. The CBI appreciated that there were certain advantages of a high exchange rate - in particular, the discipline which this imposed and its effect on inflation. But the speed and magnitude of the recent appreciation, and uncertainty over sterling's future course, were causing difficulties. The CBI hoped that the Government would abolish the remaining exchange controls as soon as possible: this would remove any artificial

/ boost to the

boost to the rate and would encourage the building up of assets abroad against the eventual decline of North Sea oil.

The Chancellor replied that the Government and the CBI appeared to be in close agreement on objectives. The Government disliked high interest rates, but against the background of accelerating inflation and excessive monetary growth, it had had no alternative but to increase MLR. Unfortunately, there was no evidence as yet that monetary growth was slowing, even though the authorities had achieved heavy sales of gilts since the Budget. The main problem was the very high level of bank lending to the private sector. Sir Adrian Cadbury agreed that it would be a mistake to reduce MLR prematurely before the money supply was firmly under control again, but asked that in reaching a decision on timing the Government should take into account the heavy cost which industry was having to pay as a result of high interest rates.

The Chancellor went on to say that he had made clear in his Budget speech that he intended to move to the progressive dismantling of exchange controls. The trade union response to this had been muted because they seemed to understand that an excessively high exchange rate was likely to threaten jobs. But after forty years of controls, it was only sensible to move step by step. Although he could not say what was a desirable level for sterling, it was clearly right on merits to relax exchange controls. The CBI's point that there should be early relaxation was well taken. But the extent to which the Government could influence the exchange rate was limited: industry might have to live with a relatively high rate and improve its trade performance through better non-price competitiveness.

Mr. Whittall commented that many companies had been forced to take on fixed-price export contracts because of tough competition, and this - particularly in the capital goods field -

/ was causing

was causing problems. Mr. Cornwallis said that small companies were especially vulnerable to the high level of interest rates. Their priority at present was to reduce their overdrafts, rather than expand their businesses. They were also badly affected by the uncompetitive pound, and were more likely to give up exporting than were larger companies. Sir Adrian Cadbury said that, more generally, industry was likely to be facing a liquidity squeeze by the end of the year: although it was vital that the Government should maintain its policy of monetary discipline, industry's requirements could not be altogether neglected.

Turning to pay, Sir John Methven said that the next round was not going to be easy. However, the pay climate was already rather different from what it had been the previous year. The CBI were doing all they could to strengthen employer solidarity: they were planning two major conferences on pay and they would be circulating to all their members "pay talking points" which were intended to provide employers with advice on how they should set about negotiating in the coming round; for example, they would spell out the tax cuts in the Budget and the prospect that inflation - after peaking at 16 to 17 per cent - would thereafter be falling.

The CBI were thus doing their best to create the right climate for pay negotiations. It would be helpful if the Government could do more itself. It was especially important to influence trade unionists over the next two months when they would be at their annual conferences. The Prime Minister had projected the message very well in her weekend speech, but it needed to be spelt out again and again - and not just by the key economic Ministers. The message would only get home if it was repeated frequently. Sir John Greenborough added that he hoped that Ministers would consider carefully this whole communication aspect.

Sir John Methven went on to say that the CBI were keen to pursue the idea of a public discussion on the economic prospects. Neither the CBI, nor the Government, nor the trade unions, wanted a pay norm, but there appeared to be increasing support for the idea of a wider discussion of the choices ahead. In their view, it was important that such discussion should get under way if the economic realities were to be brought home to people. In particular, every effort must be made to disconnect the likely peaking of the rate of inflation from next year's pay claims.

The Chancellor said that the Government would do all they could to communicate the strategy, and create the right climate, as Sir John Methven had suggested. The Secretary of State for Employment pointed out that it was not always easy for Ministers to put the message across: in some ways it was easier for industry itself. The Government had an important role to play in influencing claims in the public sector, but its influence on private sector bargaining was likely to be fairly limited. The private sector would have to bear the brunt of claims early in the round. The Prime Minister said that Ministers would find it helpful, in communicating the strategy, to have a list of "success stories" in industry. Sir John Methven said that the CBI did keep such a list, and they would be glad to provide Ministers with examples: it was much easier to get publicity for them if Ministers, and preferably the Prime Minister, mentioned them.

As for the CBI's proposals for a wider economic discussion, the Prime Minister said that the Government were considering the proposal to set up a Forum. If such a Forum were established, it would be important that small businesses should be represented on it.

Sir John Methven then referred to the latest exposure draft on inflation accounting. The sooner progress could be made on inflation accounting, the sooner there would be a clearer understanding of the real level of profit in companies. He hoped that the Inland Revenue would clarify their approach to the fiscal aspects. The Chancellor replied that this work was in hand.

Thanking the Prime Minister for the meeting, Sir John Greenborough said that he hoped that she would be willing to meet the CBI regularly; he suggested a further meeting in the latter half of September. The Prime Minister said that she would be willing to meet regularly.

Finally, Sir John Methven said that in speaking to the press after the meeting he would only tell them what the delegation had told the Prime Minister; they would not indicate what Ministers' response had been.

The meeting closed at 1645.

10 July 1979

Distribution:

Private Secretary to the Chancellor of the Exchequer
Secretary of State for Industry
Secretary of State for Employment
Secretary of State for Trade
Sir John Hunt
Paymaster General

Original in GIR

L P O

cc HMT

10 DOWNING STREET

THE PRIME MINISTER

9 July 1979

Dear Sir John,

You may by now know that alas I cannot accept your very kind invitation to address the CBI Annual Dinner on 16 May, 1980. I know that Caroline Stephens spoke to you on the telephone this morning explaining that I had three major political speeches to make over that period and if you agreed I would be most grateful if, for 1980, you could see your way to inviting the Chancellor of the Exchequer.

I must apologise for bringing you this disappointing reply but I know you will be the first to understand.

Perhaps we could negotiate a date for 1981 that did not coincide with the Party commitments that I have around that time.

Yours sincerely

Margaret Thatcher

Sir John Hedley Greenborough, K.B.E.

PRIME MINISTER

c. Mr. Hoskyns
Mr. James

Meeting with the CBI at 1545 on Monday 9 July

The CBI delegation will consist of the following:

Sir John Greenborough	President, CBI
Sir Adrian Cadbury	Chairman, CBI Economic and Financial Policy Committee
Mr. Fiennes Cornwallis	Chairman, CBI Smaller Firms Council
Sir Francis Tombs	Chairman, Nationalised Industries Chairmen's Group
Mr. H.A. Whittall	Chairman, CBI Employment Committee
Sir John Methven	Director General, CBI
Sir Donald MacDougall	Chief Economic Adviser, CBI
Mr. Richard Dixon	Director of Social Affairs, CBI

Sir John Methven has told me that they will wish to focus mainly on two policy issues:

i) the exchange rate and competitiveness and the related issues of high interest rates and exchange controls; and

ii) the pay scene

Sir John has subsequently written to say that he may wish to raise the issue of competition policy. The CBI are unhappy with the powers which Mr. Nott is proposing for the Director General of Fair Trading. They think - unjustly in my view - that these powers are going to be excessive and arbitrary. There has been correspondence between Sir John and Mr. Nott on this matter, and Mr. Nott wrote to him yesterday setting out the arguments for what he is trying to do. This letter should have helped to assuage the CBI; but I understand they may still raise it in passing. I think it would be unwise for you to get involved in any detailed discussion on this, but in case they do press the matter, I have taken the liberty of inviting Mr. Nott to the meeting. Other Ministers who will be coming are: The Chancellor, Sir Keith Joseph and Mr. Prior.

/ I attach

I attach:

Flag A	Treasury briefing on the exchange rate, exchange control, etc., and pay issues. (The pay papers for E Committee are of course highly relevant.)
Flag B	Department of Trade briefing on competition policy
Flag C	A note by John Hoskyns
Flag D	Detailed background material on the competition policy issue (though I do not think you need bother with this).
Flag E	A letter from Sir Arthur Knight arguing the case for a lower exchange rate. (He wants a meeting with you; can I assume that you will not want to see him?)
Flag F	Recent correspondence between you and the CBI.

R

6 July 1979

PRIME MINISTER

CBI MEETING

Here are one or two points which you may like to consider for your agenda with CBI on Monday.

1. What are their views of the likelihood of serious industrial unrest this winter?

2. How much effect do they think our proposed union reforms will have in redressing the union-management bargaining balance?

3. Union officials have lots of time to think about bargaining etc, while managers have other things to worry about. Does the CBI invest any effort, centrally, in giving its members the benefits of its accumulated experience on negotiating (which is a skilled business)?

4. What is the present position on the feasibility of an employers' strike fund?

5. Methven is planning to urge his members to respond positively to our Budget. It would be interesting to know whether there are any hard-edged proposals emerging or whether there will be simply vague undertakings to "try harder, do better". Politically, they ought to think of accompanying any initiative on a central strike fund with other initiatives like reducing management perks in line with cuts in taxation. I believe Methven is already suggesting some action on perks.

6. They are bound to raise the question of the exchange rate, though there seems little we can offer.

JOHN HOSKYNS
6 July 1979

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Tim Lankester Esq
10 Downing Street
London SW1

6 July 1979

Dear Tim

COMPETITION BILL: BRIEF FOR PM's MEETING WITH SIR JOHN METHVEN

As requested I attach a short brief for the Prime Minister's use on Monday should Sir John Methven raise the Competition Bill in a way which requires discussion. The brief is self-contained but the issues are amplified in Sir John Methven's letter of 3 July and Mr Nott's reply of 5 July. It deals only with the question of anti-competitive practices. Mr Nott will be able to deal with any other points that are raised.

I am copying this letter and attachments to Andrew Duguid (Industry), Ian Fair (Employment), Richard Prescott (Paymaster General's Office), Tony Battishill (Treasury) and Martin Vile (Cabinet Office).

Yours ever,

Tom Harris

T G HARRIS
Private Secretary

B

BRIEF FOR PRIME MINISTER'S MEETING WITH SIR JOHN METHVEN

COMPETITION BILL

1 Sir John Methven sent the Prime Minister a copy of his letter of 3 July to the Secretary of State for Trade complaining about the new powers on anti-competitive practices. Mr Nott replied fully in his letter of 5 July to the points made by Sir John Methven. Sir John may nevertheless raise the question with the Prime Minister in passing.

2 The powers on anti-competitive practices will enable the Director General of Fair Trading (DGFT) to mount a quick investigation (subject to Ministerial veto) of any firm which he suspects of engaging in an anti-competitive practice. He will publish his findings indicating whether if he has found an anti-competitive practice he intends referring it to the Monopolies & Mergers Commission (MMC). If he refers the practice to the MMC (this can be vetoed by Ministers) the MMC must find the practice against the public interest before it can be condemned. A firm can offer an undertaking to the DGFT as an alternative to a reference to the MMC if it so prefers. There will be a minimum size (£5m p.a. turnover) below which a firm cannot be investigated unless it has more than 25% of a market. (Although the CBI know there will be a lower limit this figure has not been announced).

If Sir John does raise this issue the Prime Minister may wish to draw on the following points:

i The new powers for selective investigation and control are an integral part of the Government's decision to abolish the Price Commission and strengthen competition policy.

ii There are safeguards built into the process at all stages (two vetoes, publication of the DGFT's findings, and order-making powers resting with Ministers). There is to be a minimum cut off to the size of firms to be investigated.

iii In order to meet the CBI's concern the DGFT will be required to say whether he thinks it appropriate to refer an anti-competitive practice he has found to the MMC to determine whether it is against the public interest.

iv The resources available to the OFT for this purpose (45 extra staff) are very small by comparison with the number of staff in the Price Commission (530). The number of investigations that can be carried out is thus clearly limited.

v Although the <u>definition</u> of anti-competitive practice is wide, the <u>system</u> involves selective investigation and control, not outright prohibition as is common in the EEC and elsewhere.

vi If the DGFT could only investigate firms with a market share above a certain size, this would represent little or no strengthening of competition policy by comparison with the present Fair Trading Act powers.

CP1
6 July 1979

With the Compliments
of the
Chancellor of the Exchequer's
Private Secretary

Treasury Chambers,
Parliament Street,
SW1P 3AG

MR M A HALL

c PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (L)
PS/Minister of State (C)
Sir Douglas Wass
Sir Lawrence Airey
Mr F Jones o.r.
Mr Byatt
Mr Hancock
Mr Unwin
Mr Butt
Mr P G Davies
Mr St Clair
Mr Prescott
Mr Ridley

R
4/7

ADVICE FOR THE PRIME MINISTER

In your minute of 29 January, you asked for advice on a number of topics, of which the first was whether the Prime Minister should see the President's Committee of the CBI to ask them what they could do to secure a better export performance.

2. Since then we have been briefing for a meeting between the Prime Minister and the CBI on 9 July, and trade performance (in the light of exchange rate movements) has been covered. The team which will be coming to see the Prime Minister is not the full President's Committee but, as usual with the CBI, a smaller group, including some members of the President's Committee and staff support, specially selected for the occasion. Maybe this covers the point I was asked to advise on. But in case it is useful, let me add the following.

3. The President's Committee itself consists of about two dozen leading industrialists, including the Chairmen of a number of the CBI's specialized committees and Regional Councils. It does not normally perform representational functions collectively; but it did have drinks with the Conservative 1922 Committee and also met the Press at Brighton. Whether there would be value in the Prime Minister seeing the Committee would depend on whether there were messages to get across to a wider audience than the smaller group seeing her on Monday - two-way discussion is likely to be easier in the smaller group. This is something she might like to bear in mind on Monday if the discussion points up the need for a further meeting.

/4. As to

4. As to what the messages should be, my own view is that export performance alone is too narrow. With a rising exchange rate, it is becoming equally difficult and important for manufacturers to compete successfully in the home market. Perhaps (following yesterday's NEDC) what we used to call "productivity" - the efficient use of all factors of production - is the key. But probably even more crucial is the need for managers to appreciate what the new monetary climate (including its exchange rate aspect) implies for what firms can afford by way of pay settlements. To the extent that the deceleration of inflation implied by monetary policy is based on a reduced rate of pay settlements, profitability and employment will be protected: otherwise the counter-inflationary lesson will be learnt only at the cost of severe damage to the economy as well as to individual firms and employees. It is worth trying to promote a climate in which this understanding is diffused.

5. This takes one into the whole question of how to get a better public understanding of the economic facts of life, the "Forum" etc. Regardless of decisions on an institutional framework for this, it is obviously important meanwhile to take such opportunities to influence the climate as arise, subject to the important constraint that it would be easy for Ministers to get into a false position of appearing to adopt an incomes policy.

6. In sum, I think there could be value in the Prime Minister's having contacts with the management side of industry across a broad front - British Institute of Management and Institute of Directors as suggested in your minute as well as CBI, though the CBI alone is represented on the NEDC and is likely to be the Government's main channel for discussion and negotiation of specific issues. It would of course be important for such a pattern of contacts not to get out of balance and to appear to be concentrated only on the management side of industry.

7. I suggest that the question of further contacts with the management side of industry be considered again after the Prime Minister has seen the CBI. It is possible that the Chancellor also might wish to extend his contacts (I gather

/that he

that he declined a meeting with the BIM on the "Forum").

8. I will deal separately with the other questions in your minute relating to the NEDC.

PVD.

P V DIXON
5 July 1979

A

CONFIDENTIAL

BRIEF FOR PRIME MINISTER'S MEETING WITH CBI ON 9 JULY

The CBI have indicated that they would like to focus discussion at this meeting on two areas: the exchange rate (together with the related issues of competitiveness, interest rates and exchange control) and the pay scene. They have not suggested any general discussion of the economic outlook or of the effects of the Budget on industry but the Prime Minister might care to glance at the material supplied in Annex A as background. The Department of Trade will be briefing separately on whether the issue of competition policy is likely to arise at the meeting.

STRUCTURE OF THE MEETING

The CBI have given the Budget a warm public welcome and the Prime Minister might express her appreciation for their support at the outset of the meeting. She sees the revival of private industry as the key to our future economic prosperity. She was therefore much encouraged to note the recent CBI Council resolution recognising that the success of the Government's economic strategy "will hinge to a large extent on the ability of managers and employers throughout business to respond to the challenge and incentives it provides" and to learn of the positive action which individual firms have already taken in the light of the Budget.

The Prime Minister might then invite the CBI to unfold their views on the exchange rate. The ensuing discussion of competitiveness will lead naturally to talk of pay.

EXCHANGE RATE, COMPETITIVENESS, INTEREST RATES
AND EXCHANGE CONTROL

LINE TO TAKE

The Government is committed to controlling the money supply. This is vital to tackling inflation. The recent changes in the exchange rate and in interest rates need to be seen in that context.

2. The exchange rate has risen significantly since the Budget. This has owed much to the continued rise in oil prices which has increased the attractiveness of sterling to international investors. The high UK interest rates which have been necessary to restore monetary control have also played a part. But it seems possible that the recent euphoria in the exchange markets has been somewhat excessive. However, the exchange rate is determined by market forces and a Government committed to monetary targets has only limited scope for influencing it directly.

3. We realise that the present strength of sterling will in the short-term make it more difficult for industry to compete in both domestic and world markets. We would like to hear the CBI's views on how different sectors may be affected. But both sides of industry must recognise that the main cause of uncompetitiveness is excessive domestic cost increases and that devaluation is not a cure for these: indeed it gives a further upward twist to inflation. A high exchange rate reduces the cost of the raw materials and components which we import and so helps to reduce the rate of inflation more generally. As these effects feed through to the whole of the economy the problems arising from a short-term loss of competitiveness will diminish.

4. For the benefit to inflation to be felt quickly it is vitally important for companies to play their part by negotiating responsible pay settlements that take account of changes in import prices and of the competitive pressures in world markets and that, above all, are related firmly to increases in productivity. Failure to do so will certainly reduce competitiveness and threaten profitability, export markets and jobs.

5. High interest rates are not welcome. As inflation is brought down and as we reduce public expenditure and borrowing, interest rates will come down. But the Government inherited a situation in which the money supply was getting out of control. In order to regain control it was necessary to take immediate action in the Budget, including a rise in MLR.

6. The Government intends progressively to dismantle exchange controls: they cause unnecessary costs and distortions. But the effect on the exchange rate and competitiveness of relaxing exchange controls is very uncertain; in the short-term it might even be perverse. Our exchange control relaxations must be seen as part of a long-term policy of freeing the economy from costs and distortions and of building up overseas assets to provide income when the oil runs out. We are, of course, giving careful consideration to when and what the next steps in our programme of relaxations should be.

BACKGROUND NOTES

Background notes are attached on :

(i) The exchange rate and competitiveness.

(ii) The consequences for industry of the loss of competitiveness.

(iii) Interest rates.

(iv) Exchange controls.

EXCHANGE RATES

A graph showing exchange rate movements since the start of 1978 is attached. For the first half of 1978 the rates declined both in effective terms and against the dollar. In the second half of 1978 it recovered fast against the dollar, touching $2 at the end of the year, but this reflected the weakness of the dollar rather than the strength of sterling. Sterling recovered a little in effective terms but ended the year at 63 - 3 points lower than at the end of 1978.

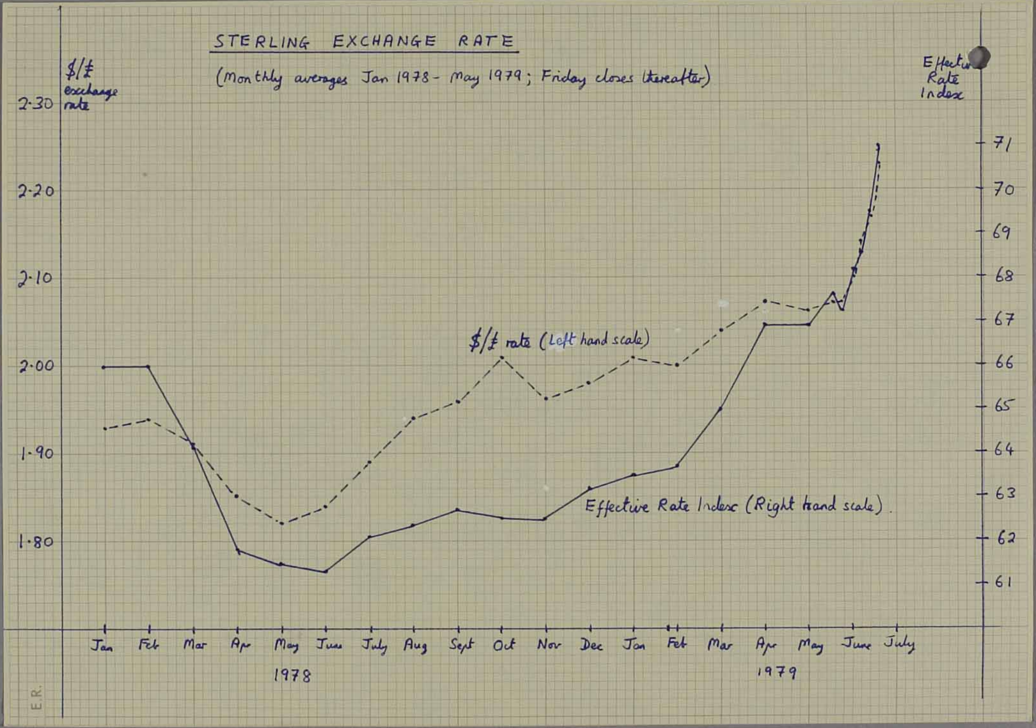
2. Apart from the odd episode of selling, sterling has consistently appreciated this year, gaining over 10% in both effective terms and against the dollar. The movements against the dollar relative to other currencies have reflected the recovery in the dollar in the early part of this year and then, more recently, some renewed weakness in the dollar as a result of the oil price rises.

3. The day before the Budget (11 June) sterling closed at 67.3 and 2.07. By the close of Budget day (12 June) the effective was up to 68.3 and the rate against the dollar to 2.08. With the occasional odd reverse sterling has climbed since then steadily. The current effective level of around 71 is the highest since the present effective index was introduced in 1977 while the present dollar rate of around $2.23 is the highest for over four years.

INTERNATIONAL COMPETITIVENESS

4. There is no unique way of measuring international price or cost competitiveness and none of the measures available are entirely satisfactory. The two most common measures used are relative normal unit labour costs and relative export prices. The table attached gives figures and definitions for both these series.

5. As is apparent from the table, we have lost competitiveness substantially over the last year as prices and costs in the UK have risen rather faster than those in other countries while the exchange rate has appreciated. By the second quarter of this year we were probably less competitive in terms of our costs than at any time since the early 1970s. The table also includes a rough estimate of what our competitive position might be if the effective exchange rate remained at 70 throughout the third quarter: this reveals a considerable additional loss of competitiveness.


STERLING EXCHANGE RATE
(Monthly averages Jan 1978 - May 1979; Friday closes thereafter)
$/£ exchange rate
Effective Rate Index
2·30
2·20
2·10
2·00
1·90
1·80
71
70
69
68
67
66
65
64
63
62
61
$/£ rate (Left hand scale)
Effective Rate Index (Right hand scale).
Jan
Feb
Mar
Apr
May
June
July
Aug
Sept
Oct
Nov
Dec
Jan
Feb
Mar
Apr
May
June
July
1978
1979
E.R.

MEASURES OF COMPETITIVENESS

Index Numbers 1975 = 100

		Relative Normal Unit Labour Costs (c)	Relative Export Prices (d)
1970		100.2	104.5
1971		103.6	106.7
1972		103.7	106.6
1973		92.6	97.8
1974		96.6	96.3
1975		100.0	100.0
1976		92.6	98.0
1977		88.8	102.8
1978		93.8	107.6
1977	Q1	88.8	98.7
	Q2	88.1	102.1
	Q3	88.1	103.4
	Q4	90.2	107.0
1978	Q1	94.7	110.3
	Q2	92.2	104.1
	Q3	94.1	107.2
	Q4	94.3	108.7
1979	Q1	98 (a)	112(a)
	Q2	106 (a)	115(a)
	Q3	110 (b)	

N.B. For both series an increase means a loss of competitiveness

Notes (a) Rough estimates based on Treasury forecasts

(b) An illustration of what might happen if the effective exchange rate were to average 70 during QIII.

(c) Defined as unit labour costs in manufacturing in the UK relative to those in other countries adjusted for exchange rate changes and for cyclical variations in productivity.

(d) Defined as the unit of value of UK exports of manufactures relative to those of our competitors, adjusted for exchange rate changes.

THE CONSEQUENCES FOR INDUSTRY OF THE LOSS OF COMPETITIVENESS

One of the most significant features of the April CBI Industrial Trends Survey was the continuing decline in optimism about export prospects and the large number of firms worried about export price competitiveness. The proportion of firms citing price competitiveness as a factor likely to limit new export orders rose from 58% in the January survey to 67% in April: although similar to the level reached in the April and October 1978 surveys, this was the highest figure recorded since the question was first introduced in 1974. The latest CBI Economic Situation report and the Financial Times Business Opinion survey confirm that industry is becoming increasingly worried about the erosion of its competitive position in both home and overseas markets.

2. The CBI themselves have in the last couple of years taken a fairly balanced view about the implications of the high exchange rate. They have, as in their recent Economic Policy and Budget Recommendations, acknowledged the value of a high and stable exchange rate to counter inflation policy but have also (with increasing force in recent months) pointed to the problems created by the resulting loss of competitiveness.

3. The immediate prospects for trade,particularly in manufacturing, were shown in the forecasts given in the Financial Statement and Budget Report and are extremely poor - mainly as a result of worsened competitiveness. A fairly flat path is predicted for export of manufactures, whilst imports continue to rise. This results in a forecast of falling manufacturing output and low profitability in the non-oil sectors. Sectors most likely to suffer from price/cost competition are basic chemicals, metal manufacture, mechanical engineering, textiles, clothing, footwear and timber and furniture.

4. A high exchange rate increases domestic costs in relation to overseas competitors' costs, but has a beneficial effect on the cost of imported raw materials and, eventually, on domestic labour costs. Research suggests that it could be several years before the beneficial impact on UK costs fully compensates for the initial loss of competitiveness. Export performance also depends heavily on non-price competitiveness - eg quality, design and reliability. There is much evidence to suggest that the long-term fall in the UK share of world exports of manufactures is associated with a fall in the relative quality and sophistication of UK exports.

INTEREST RATES

1. Since the adoption of monetary targets in 1976 UK interest rates have reflected the importance attached to restraint of monetary growth, as well as external considerations. But the relationship between interest rates and the rate of monetary growth is complex, and much depends on market expectations about such things as future inflation and public sector borrowing. A table showing movements in both short and long term interest rates over the last year is attached.

2. In the autumn of 1977 interest rates, especially at the short end, were very low reflecting the previous Government's policy towards intervention and the exchange rate at that time. Since then there has been a general upward movement in rates as funding of the PSBR and monetary control have assumed paramount importance. The timing of changes has reflected expectational factors to a considerable extent, however. Between April and June 1978, for example, the rise in interest rates largely reflected worries in the market about the implications of the prospective level of the PSBR for 1978-79, and in the early part of this year concern at the prospects for wage settlements and also the likely level of the PSBR in 1979-80 resulted in an upward movement in rates which was eventually followed by the MLR rise to 14% on 8 February.

3. Between February and the June Budget interest rates fell back as market expectations became more sanguine about the outlook for 1979-80. But concern about the underlying rate of monetary growth, and in particular about the very rapid growth of bank lending to the private sector, prompted the Chancellor to announce an increase in MLR of 2% in his Budget speech. After the Budget gilt-edged stocks also rose; although there was an immediate burst of gilt sales, the market was generally weak until the latter part of June when substantial gilt sales were achieved and yields again fell back.

INTEREST RATES

%

	MLR	Clearers' base rates	3 months' interbank	5 year* gilts	20 year* gilts
9 June 1978	10	9	10 1/16	11.20	12.46
10 July 1978	10	10	9 15/16	11.72	12.66
9 August 1978	10	10	9 9/16	11.19	12.50
8 September 1978	10	10	9 5/16	11.74	12.69
9 October 1978	10	10	10⅛	12.14	12.82
10 November 1978	12½	11½	12⅜	13.15	13.24
8 December 1978	12½	12½	12 5/16	12.68	13.14
9 January 1979	12½	12½	12 5/16	13.14	13.52
9 February 1979	14	12½	13⅞	14.00	14.40
9 March 1979	13	13	11 9/16	11.08	12.25
6 April 1979	12	12	11¼	10.68	11.80
9 May 1979	12	12	11¾	11.10	11.97
11 June 1979	12	12	11 15/16	11.27	12.21
14 June 1979	14	14	13 11/16	12.65	12.85
2 July 1979	14	14	14	11.88	12.51

*Yield curve rates as calculated on the nearest convenient date.

EXCHANGE CONTROLS

A substantial first step in dismantling exchange controls was taken on 12 June concentrating (as the CBI suggested in their Budget representations) on outward direct investment - (£5m ration of official exchange per project per year; no restriction on reinvestment of profits; repayment of foreign currency borrowing over 5 years). Controls on individuals were also eased, - in particular those on private property purchases overseas, and private and business travel. Only two minor steps were taken on portfolio investment, mainly to simplify the control. Sterling finance was reintroduced (w.e.f. 5 July) for UK merchants engaged in third-country trade (but not to banks because of the potential size and volatility of outflow involved).

2. The CBI are expected to press strongly for an abolition of the remaining controls: there have been several press reports to this effect. The Chancellor is intending to introduce a further package before the recess which would lift all restrictions on direct investment and make a substantial start on portfolio. The CBI cannot be told this yet but can be assured that the Government is actively considering when and how soon the next step in relaxing controls should be taken.

3. The CBI may argue that with sterling at its present levels there can be no justification for not relaxing all controls immediately. The response might be that the Government will certainly take the present strength of sterling into account when deciding on the next step in its programme. But exchange controls have been in force for forty years and no-one can predict what might happen if they were abolished overnight. It is right to continue with a step-by-step relaxation, although the intervals between the steps might be shortened.

PAY AND THE PRIVATE SECTOR

Tactics

The CBI are likely to place their primary emphasis in discussion on publicity and communication. They will describe their own efforts in this area and may argue that the Government are not doing enough. However, their criticism of lack of Government effort seems to stem in part at least from a misunderstanding of the Government's role in this field. Since the Government require the full support of bodies like the CBI in order to secure a favourable pay outturn in the private sector, we suggest that the Prime Minister might take the initiative in explaining politely but firmly how the Government see their role and how the CBI can help to further their objectives.

Background

The CBI policy, as set out in their recent booklet "Pay: The Choice Ahead", is broadly in line with the Government's view, subject to some difference of emphasis. Thus the CBI place less weight on monetary policy - which they regard as a necessary but not a sufficient condition for success - and more stress on changes in collective bargaining procedures. This is hardly surprising, since the latter is a field in which the initiative ought to rest with employers not the Government (except on trade union legislation). Again, the CBI support a national economic forum but would give it a role rather beyond that which the Government at present have in mind.

The CBI have already shown Treasury officials informally a draft copy of their "Talking Points" brief which they intend to circulate to their members advising them on points to use in pay negotiations. The draft stresses that in principle, pay negotiations should be flexible, taking into account factors such as company profitability, labour market conditions and productivity. But it accepts that in practice negotiators are likely to use the increase in the RPI over the past year as a base for their bargaining positions. They therefore rightly remind employers of the way in which the Budget tax cuts have broadly offset the rise in prices stemming from last month's indirect tax increases; but they then come close to advocating a 10-12 per cent pay norm by not explicitly ruling out negotiating in terms of real take-home pay (strictly, real family income). We think this is potentially damaging, and senior officials have pointed out the dangers to Sir Donald MacDougall who has agreed to look again at the presentation of the material.

Points to make

i. The Government's view of private sector pay bargaining is that firms should negotiate settlements based on what they can afford in the light of current monetary policy. If they settle too high, they will have to suffer the consequences; there will be no one to bail them out. This cannot be stressed too often, but it is for individual firms to work out what this means in any particular case: there is no general solution and there is little more that the Government can given in the way of specific guidance.

ii. The Government will certainly continue to stress the way in which the direct tax cuts in the Budget broadly offset the effects of the indirect tax increases and they have already pointed out that movements in the Retail Prices Index will therefore not be an appropriate guide to changes in real living standards over the months ahead. Indeed, the Government are already giving consideration to an index of real living standards to supplement the RPI.

iii. But strictly speaking, neither movements in the RPI nor changes in real living standards are relevant to the level of pay settlements. These must be determined by what firms can afford, taking full account of the economic context in which they are operating. If a firm cannot provide sufficient pay increases to maintain real living standards, then its workforce must either increase their productivity or accept some decline. Unions will inevitably use RPI movements as a basis for pay claims and there may be circumstances in which firms will wish to dispute the facts. But in general, it would be wiser to keep out of this area completely. Detailed arguments about movements in real incomes, as contained in the draft CBI brief, or worse still, any specific suggestion of a percentage increase needed to maintain real living standards, implies both that RPI movements are relevant to pay bargaining and acceptance of the concept of a pay norm which can all too quickly become a floor for negotiation. The Prime Minister will wish to stress to the CBI that it would be most unhelpful for their advice to members to concentrate on the maintenance of living standards.

iv. The CBI will be on stronger ground in giving advice to their members on how they should negotiate. As a result of years of pay policy, management have in many cases forgotten how to bargain effectively. They need to relearn this skill. The CBI should also advise their members on what they can really afford - often negotiators do not know. Frequently they look only at their cash flow position and not at the longer-term consequences of their decisions or even at the wider market context. The draft CBI advice contains some very useful information on, for example, the low real return on capital for most British firms, but more needs to be said to punch the message home. Unless industry is prepared to adopt a new approach, the outcome must be disaster, given the Government's commitment to a strict monetary policy. The CBI should see it as their central task to put that lesson across clearly and effectively.

The national forum

The CBI will have noted the Prime Minister's remarks in the House on 19 June that the Government propose to set up a national forum "wider than the TUC and CBI" to discuss economic issues. They themselves have advocated the establishment of a national economic forum with Parliamentary links, perhaps through a Select Committee, in their booklet on the future of pay determination. They foresee four main functions for the forum:

i. to produce a regular economic analysis;

ii. to spell out the likely scenarios for the year ahead on various economic assumptions, including pay;

iii. to act as an authoritative source of facts and figures;

iv. to educate the public on economic issues.

However, they stress that the emphasis of the forum should rest with providing information, not fixing rigid norms.

Ministers will be considering these issues in due course and no decisions have been taken as yet. While, therefore, it is important to keep options open, there is probably little more that the Prime Minister can add at this stage. She will presumably not want to raise the subject herself at this meeting. If the CBI do so, she could refer to her earlier statements and indicate that Ministers had not yet been able to consider together the appropriate form that any forum might take. She would, of course, be glad to hear any views which the CBI themselves might have.

ANNEX A

BACKGROUND NOTE: THE BUDGET AND INDUSTRY

The Economic Outlook: General

1. The economic outlook to 1980 (incorporating the effects of the Budget itself) were set out in the Financial Statement and Budget Report 1979-80. The prospect is for economic activity to decline slightly over the next year or so; there will be rather little change in real personal disposable incomes, a small fall in the level of total output, and a rather larger fall in manufacturing output reflecting adverse overseas trade movements. The retail prices index is forecast to be 16% higher in the third quarter of 1979 than in the third quarter of 1978 - although it should be only around 13½% higher a year later. The adverse trend in British competitiveness is likely to continue though the current account is likely to remain approcimately in balance.

The Economic Outlook: Manufacturing Industry

2. The published forecast shows a 2½% fall in manufacturing production from the first half of 1979 to the first half of 1980. The overall picture is very serious for manufacturing industry - a sharp setback is envisaged from a situation which industry regards as already depressed. The main features of the forecast are as follows:-

a. output

Manufacturing output is expected to decline about 1% this year and 2% next year.

b. international trade

The outlook for manufacturing trade is particularly depressed. While exports are virtually unchanged in volume between 1978 and 1980, imports rise by a sixth. This is partly caused by an adverse competitive position in which UK unit labour costs rise more than 10% relative to those of our competitors.

c. employment and productivity

With the decline in manufacturing output, employment prospects are poor even though productivity growth this year and next is expected to be rather worse than last year's. Manufacturing employment is forecast to be more than a quarter of a million lower in 1980 than in 1978.

d. manufacturing investment

The poor prospect for output, adverse profitability and high interest rates combine to produce declines in manufacturing investment and stock levels from now on. The prospect is for the level of private investment in manufacturing in 1980 some 10% below that for 1979.

e. <u>profitability and finance</u>

The reduction in investment and stock building expenditure holds the non-oil industrial and commercial companies' financial deficit down to a little over £4 billion this year and next, ie about 2½% of GNP. This is a high level, though not disastrously high, by comparison with previous periods; the worrying factor however is that it occurs at a time of low profitability and low investment, and therefore may be more difficult to finance than if the climate were an expansionary one.

4. The position for manufacturing industry is therefore an uncomfortable one. Two further qualifications are however necessary; one which would exacerbate the position and one which would ease it. On the negative side, industry will bear the brunt of a squeeze between tighter monetary policies and high exchange rate on the one hand // and the pressure of wage costs on the other. The Treasury model suggests that the net effect of the budget package on wage settlements will be small. If this assessment underestimates the increase, the long term prospects for manufacturing output and employment will be gloomier still.

5. On the positive side, it has not been possible to make an allowance in the forecast for any dynamic effects on the supply side of the economy resulting from improved incentives given by the Budget. Although these dynamic effects may not add up to much in the relatively short period ahead covered by the forecast, to the extent that they do exist the prospect for economic and industrial activity may be less gloomy than implied by the forecast.

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Tim Lankester Esq
Private Secretary to the Prime Minister
10 Downing Street
London, SW1

5 July 1979

Dear Tim

I refer to your letter of 3 July about Sir John Methven's correspondence on the Competition Bill. As you will see from the attached letter, my Secretary of State has given a full and detailed reply to the points in Sir John's latest letter.

My Secretary of State feels that the proposed policy is very close indeed to what Sir John Methven advised himself whilst they were in opposition and Sir John has discussed the proposals twice with the Secretary of State since the election. It may be that he is under some pressure from certain of his members to adopt a more formal approach. My Secretary of State feels that it would be very damaging to the credibility of our whole approach if we were seen to be yielding further to CBI pressure.

My Secretary of State thinks that his letter deals with the points raised by the CBI, and hopes that you will be able to persuade Sir John not to raise the question with the Prime Minister on Monday. As I mentioned to you, if Sir John does insist on raising the issues, my Secretary of State would wish to be present.

I also attach previous correspondence from the Secretary of State which Sir John did not copy to you.

I am sending copies of this letter and attachments to Andrew Duguid (Department of Industry), Ian Fair (Department of Employment), Richard Prescott (Paymaster General's Office), Tony Battishill (Treasury) and Martin Vile (Cabinet Office).

Yours sincerely
John Symes
J M D Symes
Private Secretary

5 JUL 1979

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Sir John Methven
Director General
Confederation of British Industry
21 Tothill Street
London SW1

5 July 1979

Dear John.

Thank you for your letter of 3 July. I am glad to note that you accept that an effective competition policy is necessary.

As you know we felt, with you, that the effect of the Price Commission Act has been damaging to jobs and investment while having a negligible effect on inflation. This arose for a number of reasons including the Price Commission's powers to freeze prices during an investigation but also because it was never altogether clear whether the Price Commission was intended to promote competition or to reduce inflation. We therefore decided (and you welcomed our decision) to abolish the Price Commission, but at the same time we regard it as essential to ensure that competitive conditions should be promoted in industry. We therefore decided that we must, at the same time as abolishing the Price Commission, take steps to strengthen our existing approach to competition policy. This, as you know, is a two-pronged approach designed to promote competition but to do so recognising that other factors need to be taken into account in arriving at the public interest. The new powers on anti-competitive practices which we propose to take are designed to follow this approach.

The objective is thus clear and unambiguous (unlike the objective of the Price Commission Act). Anti-competitive practices will be defined in terms of their effect on competition, and although this definition

contd/......

is wide, it is by no means novel (compare for example Articles 85 and 86 of the Treaty of Rome) and unlike the systems in many European countries, the EEC itself, and in the United States, a practice will not be banned per se, but only after an investigation has shown it to be anti-competitive - <u>and</u> it is contrary to the public interest - in the circumstances in which it operates. As you know, in many other systems, violation of the per se prohibition can lead to heavy fines.

The power we propose to take is one of selective investigation by the Director General and possibly subsequently by the Monopolies and Mergers Commission and as I have already explained, there will be the power of Ministerial veto at both stages. The act of investigation itself, although unwelcome to the firms being investigated, will not, in contrast to the powers under the Price Commission Act, be accompanied by the freezing of prices or any other sanction. Order making powers will only be available if the MMC condemns the practice, though a firm may offer the DGFT an undertaking earlier if it prefers to do so.

When we met on 21 June I said that, in order to meet your concern, I would consider further the extent to which the Director General should, in his published report, take account of the public interest. In deciding the approach to adopt on this I have had in mind the situation on mergers where the Director General offers me advice as to the course of action to follow, and I have to decide whether to refer the merger to the MMC to investigate. As you know, the reference to the Commission does not indicate that the Government or the Director General think that the merger is against the public interest, but rather that there are matters relevant to the public interest which need to be investigated further before a decision can be taken. Accordingly I am proposing to include a provision to give effect to a procedure of this sort. The Bill will thus require the Director General not only to publish his findings as to whether what he has investigated is an anti-competitive practice, but also whether he considers that the course of conduct is such that it is appropriate for him to make a reference to the MMC to determine whether it operates against the public interest.

contd/.....

If I went further and required the Director General actually to make public interest findings, he would not only need to have the power to summon witnesses for public interest hearings but this would inevitably lengthen his own investigation and would add considerably to the burdens on industry. I have in mind also that one of the principal beneficiaries of these new powers will be smaller firms trying to establish themselves in new markets.

I have written to you separately about the other two points in your letter. On confidentiality I explained that the Price Commission records will be subject to the Public Records Act 1958 and that it would be a draconian measure to provide that their files should be destroyed or otherwise not made subject to the Act. I have also explained that it is not my intention to allow the Price Commission's material to be made available before 30 years have elapsed, and that I intend to announce publicly my undertaking to consult the CBI if any change is contemplated. As to the powers in section 2 of the Prices Act, I have explained that the provision is currently being used to prevent the diversion of EEC subsidies and to regulate the practice of repricing food which has been displayed.

I would like to close by saying that I was surprised at some of the remarks in your letter which seem to be based on a misunderstanding of our proposals. You refer to the Director General being given authority "effectively to control business practices", and that he is "to an extent independent of normal judicial and parliamentary processes". Neither of these points is correct. His only power of initiative is to mount investigations into suspected anti-competitive practices. He is subject at the initial stage to Ministerial veto, and again at the point where he makes a reference to the MMC. Although he will be able to accept undertakings as an alternative to the latter reference, order making powers, which are vested in Ministers and subject to Parliamentary control, only arise following adverse findings by the MMC.

contd/....

You refer also to firms being subjected to "long and costly Monopolies and Mergers Commission investigations". Again, as I have explained, it is a central part of our proposals that the MMC investigations into anti-competitive practices should be carried out much more speedily than has been the case for full-scale monopoly references and their investigations will be directed only at limited questions. Moreover the initial investigation by the Director General, which is subject to a Ministerial veto and from which no sanctions flow at all, is specifically designed to prevent any undue burden on industry by an unnecessary reference to the Monopolies Commission. If I were to give the DGFT precisely the same powers as the Monopolies Commission it could involve industry in two full investigations on the same reference.

Yours Sincerely
John Nott.

JOHN NOTT

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Sir John Methven
Director-General
Confederation of British Industry
21 Tothill Street
LONDON
SW1H 9LP

29 June 1979

Dear Sir John,

At our meeting on 25 June, I promised to give further thought to the question of access to the Price Commission's commercially confidential material over the next thirty years.

You rightly pointed out that before thirty years had elapsed, it would be possible under section 5(4) of the Public Records Act 1958 for me or my successors to allow access to these files on an individual basis, and that officers of the Office of Fair Trading could be granted such access. As I indicated in my letter to you of 19 June, it is not my intention to allow the Commission's commercially sensitive material to be made available to the public - or to the Office of Fair Trading - before thirty years have elapsed. I can also confirm that it is not my Department's intention to requisition any of these files for their own purpose, or to let other departments requisition them. If exceptionally these arrangements needed to be modified, the CBI would be consulted beforehand.

As you pointed out at our meeting, no administration can bind its successors. However, I intend to announce in the House, during the progress of the new legislation, my proposals for preserving the confidentiality of the Commission's files over the next thirty years, *From the Secretary of State*

and I shall certainly include in this statement the undertaking to consult the CBI if any change in procedure is contemplated. While I suppose it is conceivable that a future administration might wish to modify the procedure, I do not think it is realistic to imagine they would do so without at least informing the CBI of the change. This would warn the CBI that scrutiny of files was at least a possibility and would open the way to representations and public pressure.

In the light of these proposals, I see no need to make further provision in the legislation for protecting the confidentiality of the Commission's commercially sensitive information. I hope, however, that the arrangements meet most of your worries.

Also, you raised the question of the consideration of the public interest in relation to the reports of the Director General's investigations into anti-competitive practices. I asked my officials to look again at this question and I hope to be able to write to you shortly.

Yours Sincerely,

T. Allan

pp. JOHN NOTT
(Approved by the Secretary of State, and signed in his absence)

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

From the Secretary of State

Sir John Methven
Director-General
Confederation of British Industry
21 Tothill Street
London, SW1H 9LP

19 June 1979

Dear John.

ABOLITION OF THE PRICE COMMISSION

Thank you for your letters of 31 May and 8 June about the new competition legislation.

We have considered carefully whether the existing powers over food prices in section 2 of the Prices Act 1974 should be abolished. I recognise the concern of your members about the retention of general powers, but the provision is currently being used to prevent the diversion of EEC subsidies and the regulate the practice of repricing food which has been displayed. We feel therefore that the powers are useful and should be retained.

On the question of confidentiality, I do very much appreciate the fears of industry about the future of data collected by the Commission under their information-seeking powers. However, the Price Commission are already subject to the Public Records Act 1958 and it would be a draconian measure to provide that their files should be destroyed or otherwise not made subject to the Act. Moreover, when the National Board for Prices and Incomes was wound up, its files became subject to the Thirty Years Rule along with most other categories of public records and I do not think there are compelling arguments for treating the Price Commission differently. There is of course no question of the Commission's commercially sensitive information being made available to the public before thirty years have elapsed, but thereafter it seems unlikely that disclosure could harm the firms concerned. I can also confirm that the material will not be made available to the Office of Fair Trading. I hope therefore that this will set your members' minds at rest.

In your letter of 8 June you referred to the provisions for dealing with anti-competitive practices. While I note your remarks in favour of retaining the 25 per cent market share statutory monopoly criterion such a limitation would not be consistent with our general approach to these practices which can be used to limit competition wherever there is an abuse of market power. I have noted the two other points you have made on anti-competitive practices and will certainly bear them in mind in formulating the detailed proposals.

I have also noted your remarks about the criteria of the Fair Trading Act. Unfortunately the Bill will not provide a suitable opportunity for amending the criteria of the Act, but we will, as part of our wider review of competition policy, be considering whether the criteria should be amended and we will take your remarks into account in that context.

Yours ever
John.

JOHN NOTT

cc Front Door

Ind. Policy

Confederation of British Industry

From the President:

Sir John Hedley Greenborough KBE

21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
Telex 21332
Telegrams
Cobustry London SW1

5th July 1979

Dear Mr. Lankester,

I am writing to let you know that those attending the meeting now scheduled for 3.45 p.m. with the Prime Minister on Monday July 9th at 10, Downing Street, are as follows:

Sir John Greenborough	President, CBI
Sir Adrian Cadbury	Chairman, CBI Economic and Financial Policy Committee
Mr. Fiennes Cornwallis	Chairman, CBI Smaller Firms Council
Sir Francis Tombs	Chairman, Nationalised Industries Chairmen's Group
Mr. H.A. Whittall	Chairman, CBI Employment Committee
Sir John Methven	Director General, CBI
Sir Donald MacDougall	Chief Economic Adviser, CBI
Mr. Richard Dixon	Director of Social Affairs, CBI

Yours sincerely,

Beatrice Calpin

Personal Assistant to
The President

T.P. Lankester Esq.,
Private Secretary to The Prime Minister,
10, Downing Street,
London, SW 1.

Ind. Policy

10 DOWNING STREET

PRIME MINISTER

CBI meeting next Monday 9 July
at 1500

Would you be happy that the Chancellor of the Exchequer, Sir Keith Joseph and Mr Prior should attend on our side?

C.L.

Yes MT

3 July 1979

Please file. C.L.
4/7

10 DOWNING STREET

From the Private Secretary

B/F 6.7.79.

3 July 1979

I enclose a letter which we have received from Sir John Methven about competition policy. I would be grateful if this could be covered in separate briefing for the Prime Minister's meeting with the CBI next Monday. It would be helpful if this could reach me by midday on Friday so that I can tell Sir John whether we think the issue has been resolved; or whether it is something the CBI could raise with the Prime Minister on Monday.

I am sending copies of this letter and enclosure to Andrew Duguid (Department of Industry), Ian Fair (Department of Employment), Richard Prescott (Paymaster General's Office), Tony Battishill (HM Treasury) and Martin Vile (Cabinet Office).

C.P. LANKESTER

T.G. Harris Esq
Department of Trade.

Confederation of British Industry

21 Tothill Street
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From the Director-General: Sir John Methven

3 July 1979

Dear Mr Whitmore,

We will be coming to see the Prime Minister on Monday 9 July. Obviously we would wish, if the Prime Minister agrees, to talk mostly about the economic and pay scene. But there is one area where we are in danger of getting locked into an unnecessary conflict on competition policy with the Department of Trade: and that is over the proposed power to give the Director General of Fair Trading the power to investigate anti-competitive practices. We believe that there should be some reasonable limit on that power: and the best way to make my point is to send you three documents, which I enclose.

If we have not got this point resolved this week, I would hope that it might be possible to raise this point on competition (and this point alone) with the Prime Minister. It might help you to know that I have done the Director General of Fair Trading job and consider the powers he is being given in its present form unreasonably wide.

Yours sincerely

Jane Fingland

ft Sir John Methven.

PS Incidentally, I shall from Wednesday to Saturday of this week be in Edinburgh hosting a three day Conference of all my equivalents from Europe. But I can be got at the Caledonian Hotel (Tel No: 031-225-2433). If you want me, please do not hesitate to ring.

C Whitmore Esq
10 Downing Street
London
SW1

PROPOSALS FOR THE PROMOTION OF COMPETITION

The Government has announced its proposals, as part of its new approach to economic policy to strengthen Competition. It will, soon after the Whitsun recess, introduce a short Bill to strengthen the powers of the Director General of Fair Trading and the Monopolies & Mergers Commission. Powers will also be taken to abolish the Price Commission. This note deals with the Government's proposals to strengthen competition.

The Government's intention is to strengthen the power of the Director General of Fair Trading and the Monopolies & Mergers Commission to deal with practices which limit competition and to provide a new procedure for enquiry into questions relating to prices to determine whether the level of prices is affected by a limitation of competition.

ANTI-COMPETITIVE PRACTICES

The Government's proposals on this point follow the recommendation (in paragraph 1.12 recommendation No 14) outlined in the recent Green Paper "A Review of Restrictive Trade Practices Policy" Cmnd 7512). Chapter 6 and paragraphs 7.28 to 7.40 of the consultative document deal with anti-competitive practices. In accordance with the proposals of the Green Paper we propose to give the Director General of Fair Trading (DGFT) a power to carry out a quick investigation where he has reason to suspect that a firm or firms are engaging in a practice (other than a registered agreement under the Restrictive Trade Practices Act) which has the purpose or effect of restricting or distorting competition. He will be given powers, much on the lines of those already available to the MMC, to gather information and he will be required to publish his findings (but not to make a full report). If following such investigation he reaches the prima facie conclusion that the practice is restricting competition he will (subject to veto by the Secretary of State) be able to refer the practice by a particular firm or firms to the Monopolies & Mergers Commission (MMC) for investigation and report. The Commission will then be required to report within a specified time whether the firm or firms concerned is or have been carrying out the practice specified and whether that practice restricts or distorts competition, and if so whether it operates or may be expected to operate against the public interest. In determining the public interest the Commission shall take account of section 84 of the Fair Trading Act 1973. The MMC will submit a report to the Secretary of State, and the usual provisions about excisions and publication will apply on the lines of the Fair Trading Act.

If the MMC's report is adverse, the Secretary of State will then have the power by order to require the firm or firms to desist from the practice or, if that would be inappropriate, to regulate their prices (as provided for in Schedule 8 of the Fair Trading Act). Alternatively, as with a monopoly report the Secretary of State may instruct the Director General to negotiate suitable undertakings and then to monitor them.

In addition, as an alternative to making a reference to the MMC following his initial investigation, the DGFT will be empowered to accept undertakings from firms and to monitor those undertakings. The sanction for breach of such undertakings would be the power to make a reference to the MMC.

These new powers on anti-competitive practices will apply equally to nationalised industries and to the private sector.

PRICES

The primary means of dealing with excessive prices will be by tackling the limitations of competition that give rise to such prices, that is:-

a either by making a reference to the MMC under existing powers where monopoly conditions prevail. This will enable the Director General to deal with cases where competition is limited by the structure of the market, and, as is already the case under monopoly reference powers, such a reference can be limited to particular aspects of behaviour including pricing; or

b by following the procedures outlined above for dealing with anti-competitive practices.

Thus the DGFT's powers to act on his own initiative will arise only where he has reason to consider that competition is limited in one or other of these ways.

The Secretary of State will in addition have power to request the Director General to investigate a price which he considers to be of major public concern. Such a request will give rise to the same powers of investigation for the Director General as in the cases described above, but he will be required to produce a full report on the question. This report will be submitted to the Secretary of State, who will have responsibility for publication and for excision of any matters that should be kept confidential. The only powers which will flow from the report however will be the possibility of a reference to the MMC as described above if the report disclosed a limitation of competition ameanable to such action. There will be no requirement to pre-notify price increases or to freeze prices during an investigation, though, as described above, in the event of an adverse finding by the MMC, regulation of prices might be appropriate.

NATIONALISED INDUSTRIES

Anti-competitive practices carried out by nationalised industries will be subject to the same scrutiny as those of private industry. In addition the Director General of Fair Trading will be given greater power to refer nationalised industries to the MMC where there may be an abuse of monopoly power, which at present can only be done by Ministers.

INSTITUTIONS

To enable the DGFT and the MMC to carry out their enlarged functions effectively and as speedily as possible, the Government is considering, in conjunction with the organisations concerned the staffing, resources and procedures of the institutions which will require some strengthening. There will however be a substantial overall saving in public services man power when the abolition of the Price Commission is taken into account.

GOV/TRA/1

3 July 1979

At the end of our meeting on Monday, I promised to let you have a note of our principle recommendations relating to your proposals on competition policy. Let me at the outset say that we believe that an effective competition policy is necessary. What we are concerned to ensure is that the proposals are balanced and fair. To that end, there are three points which I wish to repeat to you.

First, we take strong exception to the present proposal on anti-competitive practices which would be a uniquely wide and dangerous power - particularly when compared with the approach to this problem in other EEC countries. Experience with the Price Commission illustrated the danger of giving an independent agency wide powers and an imprecise objective. We, therefore, see grave dangers in your proposal to give DGFT authority to investigate and, effectively, to control business practices without there being any statutory indication of the intention or focus of that authority. We believe it is a totally inadequate argument to say that such practices are hard to define or may change through time so that the power has to be flexible.

On the contrary we regard it as necessary discipline on the authorities to require that the purpose of such powers is specified, particularly when the agency concerned is to an extent independent of normal judicial and parliamentary processes. Otherwise the result will be uncertainty and damage to business confidence and will be interpreted as showing that the Government has not appreciated the strong objections that business has in principle to this type of regulation - and indeed to which we thought that your Government itself was opposed.

/....

One way to secure a clearer definition of the power would be to have a market share criterion. But, if you reject this approach, an alternative method - and one I strongly urge you to adopt - is to require that DGFT does not merely consider the narrow competitive effect of a practice but is required also to report publicly with reasons, whether he considers that there is a prima facie case the practice has, or may be expected to have, an adverse effect on the public interest.

The central argument for this suggestion is that it is quite possible to consider that many business practices have an anti-competitive effect, although they are quite desirable for other reasons - for example long-term business contracts. It would be needlessly worrying for UK business if such practices were thought to be open to scrutiny, analysis and possible prohibition, and that the only way through to vindication was through a long and costly Monopolies Commission investigation.

So I ask you to reconsider your position on this. I must make it clear that this is an issue of principle and that if the Government fail to meet us on it or provide a satisfactory explanation why that is not possible, CBI members will wish us to use every means at our disposal to achieve a change that we believe is reasonable and necessary.

We also attach considerable importance to the question of the future of Price Commission papers. We have your assurance that OFT will not be given access to them during the 30-year period, but this cannot bind any future Government. It would be a significant deterrent to possible misuse of the power of access if authorisation had to be publicised, and it would not prevent access for any legitimate purposes. I ask that you adopt this proposal.

Finally, I was disappointed at your decision to retain the power to restrict the prices of products which are the subject of regular purchase provided by Section 2 of the Prices Act 1974. Your Bill will refer, as I understand it, to at least three other Acts and I doubt whether a reference to another piece of legislation would appreciably intensify the debate on the principle of price controls. You must know that if the Government are ever forced to use the power we will oppose it wholeheartedly.

Rt Hon John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
LONDON
S W 1

ORIGINAL
signed by
The Director General

GOV/TRA/1

8 June 1979

Since we last wrote to you regarding your proposals on the Price Commission and competition policy, we have been able to consult more widely and give fuller consideration to the changes you intend making. The purpose of this letter is to record the points that we hope you can include in the forthcoming Bill.

Anti-competitive practices

The proposed new power to enquire into anti-competitive practices is causing some worry because, as I mentioned in my earlier letter, it provides the DGFT, with an ill defined remit to investigate wide aspects of the behaviour of trade and industry. Such a novel and complex nww procedure does not appear to be justified by the incidence of the practices recorded in the Green Paper "A Review of Restrictive Trade Practices Policy". You will understand that business is inevitably suspicious of a power which extends beyond the identified deficiencies in present law and procedure.

In this context there is therefore a strong argument for retaining the 25% market share statutory monopoly criterion. The CBI has for long supported this criterion on the basis that it provides some reassurance to business about the extent to whichthe wide-ranging powers embodied in the

/legislation

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legislation could be used and that any cases falling outside its scope are unlikely to have anti-competitive effects of any major significance. We would hope therefore that you will reconsider the decision not to apply the present market share criterion.

We should also like to see the adoption of two other changes which would not unreasonably limit the remit of the DGFT's power to initiate enquiries.

First, the concept of a "restriction to competition" is very vague and imprecise and could be seriously misleading for the authorities and bu iness. Thus many practices restrict competition but are wholly desirable: for example; price-cutting may increase market share and hence the market power of a company, but it is hardly undesirable. To make the objective of enquiries and references more precise, we believe the DGFT should be required to consider not only whether a practice is, prima facie, restricting competition, but in addition whether there is prima facie evidence that the practice has, or may have, an adverse effect on the public interest.

The DGFT is already obliged to consider the question of the effect on the public interest in his consideration of merger references (and, de facto, in considering monopoly references). Our proposal would therefore require him to answer a question with which he is familiar under present procedures.

A second type of change would remove from the scope of the legislation very minor instances of anti-competitive practices. We understand that you may be considering an exemption for small firms; and my officials have already suggested that the DGFT should be required to assess whether the practice is having an adverse effect to an economically meaningful or significant extent. Both of these amendments would beof value.

Finally on the proposal on anti-competitive practices, we note that it is suggested that the order-making power following an adverse MMC enquiry of an anti-competitive practice should include provision for the regulation of

/prices

prices "where this is appropriate". There has been some concern expressed that, as a price enquiry may prompt an MMC enquiry if a restrictive practice is discovered, an effective system of price regulation is being preserved. We hope that the order-making power will only provide authority to require amendment or cessation of the practice referred. If an analysis were to suggest that a practice was leading to high prices, then removal of the practice would force the price down, so a power to regulate the price directly would be superfluous.

International competition

UK business today operates in a highly competitive EEC and world market and there is always concern that national competition law may be too parochial in its assessment of the constraints on business. We suggest therefore that you take this opportunity to amend the public interest criteria in the Fair Trading Act to include a greater obligation on the authorities to have regard to the need for UK industry to have the resources to be able to compete in the world market. Such a move would be seen by industry as a welcome recognition that the new government appreciates the realities of international trade and competition.

Finally, the points in this letter are in addition to those contained in my letter to you dated 31 May.

ORIGINAL
signed by
The Director General

Rt. Hon. John Nott MP
Secretary of State for Trade
Department of Trade
1 Victoria Street
London SW1

cc HMT
Industry
Employment
Trade
Paymaster General
Cabinet Office

TLA Ind. Pol top copy to S/pore

Confederation of British Industry

21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
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From the Director-General: Sir John Methven

GOV/PM/1

28 June 1979

Dear Prime Minister,

In the letter to you of 21 June, the President said that we would be writing to all CBI members urging them to respond to the new climate that you and your Government created by the Budget.

I now enclose a copy of the letter which I have just sent out. We shall be publicizing individual examples of actions taken by companies and management in the new climate. I have mentioned R T Z Wheal Jane in the letter to members and I also enclose a copy of the letter that I have had from Bob Thornton, Chief Executive of Debenhams, which arose from a conversation which I had with him and to which, I am sure that you will agree, he has responded in the fullest fashion.

We will also be publicizing shortly a note which should help managers to resist wage claims based on the RPI: and I will send that to you, if I may. I am sure that you will agree that it is absolutely essential that we all get over to the public in every possible way over the next two months the fact that people really will have more money in their pockets and that excessive wage claims pushed through by the unions, will, in the absence of much higher productivity, only lead to higher inflation and further loss of jobs. I hope that you will agree that we might discuss this information problem as one of the topics at the meeting on 9 July.

Yours ever

John

The Rt Hon Mrs Margaret Thatcher MP
Prime Minister
10 Downing Street
LONDON S W 1

Confederation of British Industry

From the Director General, Sir John Methven
To the Managing Director or Chief Executive

21 Tothill Street
London SW1H 9LP
Telephone 01-930 6711
Telex 21332
Telegrams
Cobustry London SW1

28 June 1979

Dear Member,

Over the last three years, I have written to all of you on a regular basis, explaining in my own words what I believe that the CBI had achieved and the objectives I thought we should be striking out for.

I had intended to use this letter as a normal report to you all. But that I now think would be wrong. This letter needs to be straightforward and to the point; and I would ask you all to read it and then discuss it with your colleagues throughout your organisation. My reason for asking this is as follows.

Every one of us knows that we are entering a crucial period in the UK. We have a Government which, in its Budget, has set out to do many of the things that on the personal incentives front we have so long argued for. They have taken risks, but they have been bold and courageous. They have been bold in dealing with the Price Commission. I believe too, that they intend to move firmly on the Industrial Relations front. If they don't, they will get pushed very sharply by the CBI!

So at last we have a Government which is intent on giving us - managers, employers and shopfloor - many of the conditions for which we have asked: and they are going to ask us all - as they are entitled to - how <u>we</u> are going to respond.

How can we - each of us - respond? At its meeting on Wednesday last week the CBI Council responded by passing the following resolution (and the CBI Council very rarely passes resolutions!):

> 'This Council fully supports the strategy and the direction of the Budget and recognises that its success will hinge to a large extent on the ability of managers and employers throughout business to respond to the challenge and the incentives it provides. The CBI Council therefore calls on all CBI member firms to do everything in their power through the efficient and competitive management of their enterprises to ensure that the policies, which the CBI has long advocated and which are now being pursued by the Government, lead to higher productivity, higher living standards, more jobs and a more successful economy, in the interests of the British people as a whole.'

The CBI, as I well know, has no power or right, of its own initiative, to make promises on behalf of its membership. It is not something I would ever attempt. But we have learned to act and fight together over the last three years when it was really necessary - over Bullock, on Government contracts, on sanctions: and I thank you for that.

Now what I ask you to show on an individual and company basis is that you recognise that we have a new climate for business and that we can and will respond to it.

How? For example, by responding as RTZ did, when they decided to re-examine the possibility of acquiring and re-opening Wheal Jane, the tin-mine in Cornwall, without Government aid: by fighting to obtain moderation in wage levels in the coming months and above all by getting real productivity increases: by showing, publicly, by individual example after individual example, that we - as managers as employers - are responding to the new climate by specific actions on the investment front, on the wages and salaries front, on the productivity front and by explaining the facts of life to our work-force to a much greater extent than in the past - encouraging a much greater sense of involvement with the firm for which they work.

Those of you who are owners of independent small firms (and you comprise the vast majority of members of the CBI) have a special challenge. The way in which you respond to the encouragement of risk taking will be crucial to the success or failure of the Government's policy. I believe that now you have a real opportunity to do the job you should be doing - taking risks and creating prosperity as a result.

I do not pretend that the next 12 months, or even thereafter, will be easy. The world economic outlook is certainly difficult. Indeed it may be that the CBI will have substantial disagreements with the present Government, for example over what changes the Government should make in industrial relations legislation or over changes to competition policy. That is why the CBI is needed - to go on putting the business point of view, irrespective of who is in Government.

But that should not and, I believe, will not deter each and every one of us from responding to the new climate and doing our best (which means much better than in the past) to deliver a high output, high earnings economy which will enable us to create the free, prosperous and caring society in which we all believe.

If we fail in this new environment - when we are being given the sort of incentives we have asked for - we may never be believed again. We may never get such a chance again. And we shouldn't be surprised then if other, unpalatable, alternative strategies gain more attraction.

I can assure you that every one of the CBI staff in the Regions and in Tothill Street (not least myself) will be ready to help you. In particular I will be sending you shortly a note on inflation, pay and the changes in personal taxation which I hope that you will find helpful.

But please tell us specifically how you are responding to the new climate and what you are doing. We want to help to publicise it.

Yes, this is a call to arms. This is a call to be positive and to publicise what we are doing. This is a call to show that we believe in a market economy and that, when given the right conditions, we can make a market economy work for the benefit of the British people as a whole - even though it may take us some long time fully to succeed.

Yours sincerely,

John Methven

Confederation of British Industry

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From the Director-General: Sir John Methven

29 June 1979

Dear Bob,

Thank you very much indeed for your letter of 25 June 1979. If I may say so I was absolutely delighted to read it. I am taking the liberty of including a copy of your letter in a letter to the Prime Minister which I now enclose. I am sure that she will be as delighted as I am.

Are you going to publicise what you are doing? And, would it be possible for us to use the information provided that we do not in any way use your name unless you agree to it? I feel it is a question of getting a stone rolling: and what you have done should greatly help.

Yours,

Jo

R C Thornton Esq
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25th June, 1979

Sir John Methven,
Director General,
Confederation of British Industry,
21 Tothill Street,
London, SWIH 9LP.

Dear John,

I thought I would drop you a line and let you know something of the general feeling in the Debenham Group as a result of the new Budget.

First, and I am writing with restraint; there was a strong surge of patriotic feeling went through the senior management as the realisation sank in that here at last was a Government acting in the best interests of the country. With this came a determination to make the Budget work. Here are a few of the things we have decided to do as a result:-

1. The increase in V.A.T. has left us in some confusion about our sales, margins and stock planning for the future. The one point, however, which comes out most clearly is the grave danger of a drop in unit sales with resultant price increases throughout the Group. We have, therefore, as a matter of urgency, instituted a review of all our sources of supply to ensure that the axe falls most gently on the suppliers, particularly in the U.K., with whom we wish to have growing long term relations. This means, of course, a cruel blow to a number of fringe people; but we take the view that in any case one of our problems as a country is that we have too many fringe activities.

2. Although we regard ourselves as the lowest cost Department Store Group in the world, we have instituted another look at all our costs, particularly those associated with the bureaucracy, both our own and that of Whitehall which, as you know, imposes on us heavy demands for paper returns, etc. We are going to perform surgery with zest I look forward to the first confrontation with some Whitehall Department asking /

cont'd/

asking for returns that we are no longer going to send them. I should be glad if you would tell your friends in Government that this is going to happen and I will keep you informed of how the battle goes.

3. We have struggled here for a year or two with a number of fringe activities of our own and have probably been self-indulgent; we shall be closing down a number of these within a matter of weeks and hope to claw back £5m. of capital and put it to better use.

4. I am attaching an extract from the Financial Times of 15th June which gives you a clear picture of our investment programme and our optimism about the United Kingdom. It makes no mention there of the $40m. of sales we achieve in the United States. We intend to grow in that market from profits achieved there and without cost to the U.K. will build up a hard selling, high return asset.

5. We believe that the Chancellor means what he says about credit and therefore we are increasing our credit charges in order to damp down this method of selling and, incidentally, make more money.

6. We are looking again at fuel and distribution costs and, in particular, at company motor cars. We hope to come up with an idea for putting the choice back on the individual. We provide over 700 company cars and what we have in mind is to give staff the money instead. We think this will encourage them to be more frugal in their use of cars and fuel.

It was a pleasure to see you again the other day and, on behalf of my colleagues I want you to be assured, and pass the message on, that we intend to support the Government in its actions.

Yours sincerely,

B Thornton

Debenhams begins to benefit from earlier developments

15.6.79
FT

THE DEVELOPMENTS planned and started some years ago by Debenhams, retail distributor, are now coming on stream and the group is beginning to reap the benefits, says Sir Anthony Burney, the chairman.

As anticipated last year, the group opened two new stores during 1978 at Swansea and at Stockport. Both of these are showing good results and are coming fully up to directors' expectations.

In March this year the group opened the first phase of the redevelopment of its Ipswich store and Sir Anthony says the whole new store should be in operation by autumn 1980.

Progress on the Blackburn store is on schedule and it is anticipated that it will be completed by the autumn of this year. Work on the new stores in Cardiff and Edinburgh is proceeding and these should be open in autumn next year.

Detailed plans for the major reconstruction of the group's Croydon property have now been completed and it will shortly be entering into negotiations for the financing of this new project.

As reported May 19, bad weather and industrial unrest early this year trimmed pre-tax profits from [illegible] to £33.31m for the year ended January 27, 1979, on sales, excluding VAT, of £493.14m ([illegible]). Trading profit after cost of finance rose by 30 per cent to £21.73m, but the effect of lost turnover in January was to reduce profit by at least £1.25m.

The directors are confident that trading profit in the current year will show a further substantial advance.

On a current cost basis, pre-tax profits are reduced to £17.8m against £21.2m last time, after adjustments for depreciation of £3.2m (same), self-financed cost of sales £3.9m (£6.2m), less gearing of £1.6m (£2.3m).

The £74.83m surplus arising from a revaluation of the group's properties made in 1978, with retained profits, but less £8.8m written off goodwill, resulted in an increase in shareholders' funds from £170.78m to £246.48m.

At balance date, total borrowings amounted to £74.6m, representing some 30 per cent of shareholders' funds, compared to around 31 per cent a year earlier.

Group fixed assets rose from £150.86m to £241.8m and net current assets were up from £71.92m to £82.41m.

Registered in London (No 83395) Registered Office: 1 Welbeck St. London W1A 1DF

Ind Pol. JS
cc last para + Press
BF 6/7/79

10 DOWNING STREET

From the Private Secretary

28 June 1979

The Prime Minister will be receiving a delegation from the CBI at 1500 hours on Monday, 9 July. The delegation will probably consist of: Sir John Greenborough, Sir John Methven, Mr. Astley Whittall, Mr. Richard Dixon, Mr. Fiennes Cornwallis, Sir Adrian Cadbury, Sir Donald MacDougall and Sir Francis Tombs. Sir John Methven has told me that they will wish to focus mainly on two areas: the exchange rate and competitiveness, and the related issues of high interest rates and exchange controls; and the pay scene. On the latter, the CBI will want to tell the Prime Minister what action they are taking to impress upon their members of the need for a tough stance in the coming year's pay negotiations. They will also want to discuss the Government's own efforts in communicating the need for pay restraint, taking into account the income tax reductions in the Budget. Sir John tells me that, in the CBI's view, the Government is not doing enough on this front.

I should be grateful for briefing for the Prime Minister, to reach me by 1700 hours on Friday, 6 July. I expect the Prime Minister will wish the Chancellor of the Exchequer and the Secretary of State for Industry to attend the meeting; I will confirm this when the Prime Minister returns from Tokyo.

I am sending copies of this letter to Andrew Duguid (Department of Industry), Ian Fair (Department of Employment), Tom Harris (Department of Trade), Richard Prescott (Paymaster General's Office) and Martin Vile (Cabinet Office).

T. P. LANKESTER

A.M.W. Battishill, Esq.,
HM Treasury.

ALRM

Ind Pol 1.

PRIME MINISTER

Sir John Methven telephoned me today.

He was much concerned that your seeing Mr. Murray later this week had become pretty widely known and he was, in consequence, being taken to task by the senior members of the CBI for not having made contact with you on their behalf. It was being put to him, crudely, that one would expect a Labour Government to have an early and informal contact with the General Secretary of the TUC, and one could see the point of a Conservative Prime Minister having an early meeting with him, but surely the CBI ought to be given precedence.

No need

John Methven, who obviously felt embarrassed by this, answered his own problem by saying that, of course, he was aware that you already had a good understanding of the CBI's position and his own judgement had been that you did not need him to bother you at this stage simply to tell you what you already knew. Their Committee had last week been to see the Chancellor of the Exchequer about the Budget so they were in contact with the Government. Nevertheless he said it would be of great help to him in relation to the CBI membership if he could come to see you from time to time. He would like to be able to indicate that this would be your intention, although he himself is not pressing for an early meeting.

Agreed

Agreed in ?.

It is a pity that what was intended to be a private meeting with Mr. Murray has become fairly well known. The difficulty about having an early meeting with the CBI, whether it be John Methven alone or two or three of the President's Committee with him, is that as John himself would be the first to say, they have nothing particular that they want to put to you or that merits your attention at this stage. That is why he suggests he should make it clear that, while there is no immediate need for him to come and see you simply because you

/are seeing

are seeing Mr. Murray, you have said that you would see them periodically to keep in touch. Would you be content for him to let this be known?

Yes mt

KRS.

29 May 1979