Economic Strategy.
Pay and Prices Monthly. Economic Report.
The Economic Prospect.

PART 8.

ECONOMIC POLICY

Pt 1: May 1979
Pt 8: Jan 1981

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~9.1.81~~							
~~26.1.81.~~							
~~5.2.81~~							
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~~26.5.81~~							
~~2.6.81~~							
18.6.81							
PART 8 ENDS							

PREM 19/423

PART 8 ends:-

TPL to PM 10/6/81

PART 9 begins:-

C(81)29 12/6/81

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(81) 1	02/01/81
E(81) 15	03/02/81
E(81) 28	04/03/81
E(81) 38	31/03/81
E(81) 51	01/05/81
E(81) 61	01/06/81

The documents listed above, which were enclosed on this file, have been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES

Signed PWayland Date 15 March 2011

PREM Records Team

Econ Pol

PRIME MINISTER

The Chancellor forgot to mention to you this afternoon that he would like the Chief Secretary (in his absence) to say a few words at tomorrow's Cabinet about the economic strategy paper for next week. He would like him to give some rough idea of what the paper does and does not contain, and also to urge colleagues not to divulge its contents over the weekend.

If you are content for the Chief Secretary to do this, I would suggest the best moment would be just before the last item on local authority expenditure.

Agree?

10 June 1981

DRAFT OF 9 JUNE

D

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ECONOMIC STRATEGY

This paper is intended to help us to take stock of our first two years of office and to identify the key issues we need to face in the remainder of this Parliament and in preparation for the next.

2. Our objectives are clear

- We aim to break out of the circle of high inflation, low productivity, poor market disciplines and responses, poor management and progressive devaluation. These are all closely linked.

- Success in this is essential for a <u>sustainable</u> growth of output, employment and living standards.

  This means ......

- we must substantially improve the efficiency and the competitiveness of the economy. And ....

- we must bring inflation down and keep it down.

3. As we made clear in our Manifesto, bringing about the necessary fundamental changes - not least changes in attitude on the part of management and labour towards the disciplines of competition and honest money - is not easy. This is especially so given the years of neglect, the tougher world setting and the competition we face from economies overseas which are much fitter than our own. We have made significant progress already. We have to consider the next stage.

I Setting the scene

4. Throughout the industrial world inflation accelerated and growth slowed down during the 1970s. Almost everywhere this was accompanied by sluggish productivity and rising unemployment.

5. The second oil price shock (oil price $17 a barrel on polling day and [early June figure to come]) has seriously worsened the prospects for the world economy over the next few years. Growth prospects for the 1980s have been scaled down markedly. Earlier hopes that, once the first oil price shock had been absorbed, the world economy would regain the growth rates enjoyed in the 1960s have long since been abandoned. In most industrial countries there are doubts whether growth in the 1980s will reach even the level recorded in the 1970s. In short, the world setting

is much harsher than expected when we came into office.

6. The acceleration of inflation and slowdown in growth has been especially bad in Britain. Chart A shows how, through two decades, money incomes grew increasingly fast - much faster in fact, than in other industrial countries - while growth of real output slowed down. Between 1970 and 1980 output grew only 16 per cent. But money incomes increased by 335 per cent. In other industrial countries the increase in earnings over the period of the second oil shock was much more moderate than in the UK.

7. We are thus badly handicapped by a serious decline in our ability to compete. As Chart B shows, this is because our wage costs have risen much more steeply than those of our competitors and, to a much lesser extent, because North Sea oil has prevented them from being accommodated to the same extent as in former years by a continuously declining exchange rate. Chart C compares our performance on pay and productivity in manufacturing with that of other countries. If our productivity was up to French or German standards, we could have getting on for twice the output from our existing labour force.

8. As the decline in our ability to compete has gone on for a number of years, its causes are plainly deep-seated. We cannot therefore expect a speedy recovery from our industrial problems.

9. Britain, like other countries, has reacted to rising inflation by taking measures to limit the growth of total money expenditure; and to reduce inflationary expectations by persuading people to accept and adapt to the lower growth of money, especially in wage demands. This has included setting targets for the growth of the money supply. The effect is similar to establishing a cash limit for the whole economy, within which cash limits for the public sector are a natural consequence. The object must be to reduce from year to year the rate at which these cash limits grow until inflation is under control. Within that framework the total increases will be divided into the part taken by inflation and the part that represents real growth of output. Our task must, of course, be to reduce the former and increase the latter.

II Inflation

10. Control of inflation, which was the first task in our Manifesto, must then remain first:-

- Because, if not controlled, inflation tends to accelerate and lead to an economic "stop".

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- Because the attitudes which go with high inflation also produce poor productivity, poor management and loss of competitiveness, so reducing growth and employment.
- Because inflation is unjust and unpopular.
- Because our success or failure in reducing it is one of the main things by which we shall be judged.

11. Inflation was accelerating when we came in. We have reversed that trend. Inflation is now about 12 per cent, compared with about 22 per cent a year ago.

12. As Chart D shows, in the past year inflation has fallen much more quickly in Britain than in the rest of the OECD. And productivity has improved in some industries. But

- Our inflation is still above the OECD average and far too high.
- We must bring down our costs substantially, to help reverse our loss of competitiveness.
- The progress so far made will be hard to maintain.

13. This last point is important. Although most projections show inflation continuing to fall, there is a real risk of some temporary reversal, even if, by firm control of the money supply, we prevent any reversal from going too far. This could come about because of such factors as:-

- A faster rise in some world prices, as activity recovers.
- Pressures when our economy picks up, as profit margins recover and employers bid for skilled labour.
- The recent fall in the exchange rate and the possibility of further falls.

14. Some of these factors are inevitably beyond our control. So it is all the more important not to ease up on what we can do. We must take the expenditure and tax decisions that are necessary if we are to achieve our monetary targets and be in a position to help industry, for example on interest rates. We need also to lighten the burden of rates and taxes and to improve incentives.

15. In addition we must:-

- take all possible steps to secure a reduction in unit labour costs and in the cost of the public sector;

- maintain and strengthen expectations that inflation will continue to fall, despite short term difficulties.

III Output

16. To repeat, over the past 10 years prices have risen by 275 per cent and money incomes by 335 per cent, but real output by only 16 per cent. Since the first half of 1979 output has actually fallen by 5 to 6 per cent.

17. In part this recent fall in output reflects world-wide developments, as most major economies experienced recession following the oil price rises. Output in all the major countries of the European Community, for example, has fallen during the past year and is expected to remain roughly flat for the rest of the year.

18. But the recession has been deeper in Britain, reflecting:-

- The underlying weakness of our economy, much of it over-manned and uncompetitive.
- Excessive pay increases over many years.
- An <u>un</u>comfortable side-effect of North Sea oil, through the impact of the high exchange rate on some manufacturing industry.
- The need to bring down inflation by more than other countries have had to do.

19. Chart E shows that real industrial profitability has fallen from about 14 per cent to virtually nil in the past 20 years. The rate of new investment (after allowing for the replacement of old plant) has also fallen. Chart F shows the contrast in recent years between falling company incomes - down by 25 per cent - and rising personal incomes - up by 18 per cent.

20. There are signs that, with the rundown in stocks coming to an end, and retail sales high so far this year, we are nearing the end of the recession; a number of recent indicators suggest that the fall in output is levelling off and that in some industries activity is increasing. There are encouraging reports of improved productivity. Recent CBI and other reports offer evidence of some improvement in business confidence.

21. But as with our success on inflation the improvement here is fragile. If we are to have the basis for sustainable growth we must resist any temptation to relax. The world economic setting is unfriendly and intensely competitive.

22. In this difficult setting, any upturn in the economic cycle will take us only a small part of the way. Essentially it will be up to business and industry to create or win new markets and to increase market share, at home as well as abroad. Government must help and not hinder this process. We still need much wider understanding, above all in the public sector where several effective labour monopolies

exist, of the importance of combined effort in pursuit of better productivity. There are still too many obstacles to economic change and flexibility, probably above all in the labour market. But not only there.

IV Employment

23. Chart G shows the recent very sharp rise in unemployment, following a long upward trend.

24. Most of the actions required to improve productivity and competitiveness - cost cutting, removal of restrictive practices, increasing efficiency - necessarily increase unemployment at first. We face the consequences of years of over-manning. In the longer run improving productivity and so competitiveness leads to faster growth and more jobs. That is the clear lesson of, for example, the Japanese experience. It is in fact confirmed by the record of some successful parts of the British economy. The need is to bring our average performance nearer to what our most successful firms and industries have shown to be possible and at the same time to promote the expansion of real and sustainable new employment opportunities.

25. Nevertheless, we must recognise that, because of the big improvements needed in our competitiveness and of a growing labour force, unemployment is likely to continue to rise for some time yet, although at a slower pace. It will take a long time for business and industry to develop and exploit new markets on a sufficient scale.

26. There is another point. As Chart G shows, recorded unemployment has for some years been increasing out of line with other indicators of the pressure of demand for labour. Chart G also shows how over time each cyclical peak of unemployment is higher than the last. This implies that even when the economy recovers and the demand for labour improves, unemployment is quite likely to stabilise at a higher level than in earlier decades. We need to do all we can, without provoking renewed inflation, to speed the sustainable expansion of productive activity and real output. But we must also seek ways of containing unemployment meanwhile.

27. We need to consider the needs of particular groups, such as the young. But any such action cannot be allowed to jeopardise the need to control total public expenditure. Once again we see the need for more flexibility within the labour market. The higher the cost and the greater the difficulty of taking on new labour, the smaller will be the number of new jobs.

Tax and public expenditure

28. So far in our period of office the tax and public expenditure burdens have both risen, as Chart H shows. We have reduced the PSBR as a proportion of GDP - but only by covering higher public expenditure by even higher taxes.

29. Within the limits of the very tight fiscal situation we have been facing, we have made significant improvements in the tax system so as to encourage growth and enterprise: thus we have dramatically reduced the confiscatory top rates of income tax, and we have introduced an array of new incentives to promote the establishment and growth of small businesses. But nonetheless the tax burden has sharply increased since 1978-79:-

- Although some switch has been made from taxes on personal income to taxes on expenditure, both direct and indirect taxes are heavier than when we came to power. Excluding the effects of the North Sea, this year taxes (including National Insurance and rates) will take 39½ per cent of the nation's income compared with 35 per cent in Labour's last year.
- A married man on average earnings now pays 48½ per cent of his income in direct and indirect taxes and contributions compared with 45½ per cent when we came to office.
- We have made only moderate progress in easing capital taxes and in lightening company taxation.

Moreover, on the projections published at Budget time (based on our plans for declining public expenditure, as set out in the White Paper) the tax burden in 1983-84 would still be 38 per cent of GDP - 3 points above the level we inherited.

30. This falls well short of what is expected of us by our supporters and indeed by the country as a whole. For economic as well as political reasons we have to do better.

31. On public expenditure we set out to reduce the total substantially as a proportion of GDP. Business and industry still rightly regard this as an essential objective. We have had some success. We held the ratio steady for our first year in office. Expenditure during the current year is expected to be £5 billion less than our predecessors were planning, despite the additional costs of unemployment benefit and employment support due to the recession, for which their plans included no provision. For next year, our March plans represent expenditure nearly £10 billion less than they were planning. In achieving these reductions from previously planned levels, we have not shrunk from some very difficult decisions. But:-

- In 1980-81 the total as a proportion of GDP shot up - both because GDP fell and because expenditure was higher than we intended (less than half of this excess can be explained by the fact that the recession was worse than expected).

- This year the ratio could approach the peak reached in the early years of the last Labour Government. In cash terms expenditure by central and local government in 1981-82 is estimated to be about £6 billion higher than forecast a year ago.
- This represents an increase of more than 60 per cent between 1979-80 and 1981-82, compared with an increase in retail prices of 49 per cent.

32. Public expenditure must be paid for by the private sector, either through taxes or through the high interest rates that accompany higher borrowing. To improve the outlook for the private sector we have to reverse the growth of the public sector. Charts I and J show the present breakdown of spending. They demonstrate the programmes we shall have to look to for this. And because we want to do this without adding to inflation, the apparently easy option of further increasing public sector, particularly nationalised industry, prices beyond the levels currently envisaged is not open to us.

33. We have already recognised, and said publicly in the last public expenditure White Paper, that the present expenditure programmes are higher than we wish in relation to financial and economic objectives. Nothing has happened to invalidate that judgement. The need is clear to reduce the public expenditure totals for the years ahead below the equivalent of those in the last White Paper.

34. Yet there are already pressures for increases in certain programmes, notably for nationalised industries (relatively little for investment), for industry generally, and for unemployment related programmes.

35. There is a case for changing the composition of our spending programmes to create room for public sector investment which gives a good return and which would also improve the relative prospects for private sector output and employment. Within the total increase of 60 per cent in public expenditure between 1979-80 and 1981-82, fixed investment was static in cash terms. We should certainly do all we can to ensure that the public investments we undertake are those which will contribute most to making the economy more productive and competitive. The best way to finance profitable public investment is to cut out unprofitable public investment.

36. We could go further and increase public investment at the cost of current expenditure. But to the extent that we increase public expenditure on investment (or indeed increase any other programme) we have to forego the chances of lower taxes or lower interest rates which might otherwise result from cuts in other programmes. (This is discussed at more length in the note attached at Annex B.) There are already signs of a repetition of last year, with difficult reductions being required simply to hold the total against increases which we may find unavoidable, let alone to reduce it as we need.

37. As well as reducing the size of the public sector we must make every effort to contain costs. This year pay in the public services - but not in the nationalised industries - is in general rising less rapidly than pay in the private sector. We need to do better still - especially in the nationalised industries - and at least to ensure that we hold the improvements so far made.

38. To repeat, on present spending plans, even on optimistic assumptions about the growth of the economy, we shall enter the election with an overall tax burden much heavier than the one we inherited. Not only politically, but also economically, that is not tolerable.

VI The way ahead

39. Recovery is bound to be slow, unemployment will go on rising for some time yet - although more slowly - and the fight against inflation will grow harder, particularly since we may no longer have the benefit of an appreciating exchange rate. A sustained expansion of output and jobs will only be possible if we maintain progress against the deep-seated weaknesses of the economy - poor productivity and competitiveness, resistance to difficult changes, a large public sector and, perhaps above all, monopolistic [and selfishly used] power in pay bargaining.

40. What the Government can do directly is limited. It is a job for everyone, Government, management, unions and individuals. But we must go further towards creating the right climate for bringing about the needed changes. The need for perseverance over a relatively protracted period poses a formidable political problem.

41. What should we be doing? There are plenty of blind alleys. Thus:-

- Relax our money stance? An inappropriate cut in interest rates would lead to excessive monetary growth and even more inflation, and any effects on unemployment would be small and short-lived. And it would worsen the long-term problem of securing a proper balance between output and inflation.

- Formal incomes policy? We certainly need to ensure that the rate of growth of money incomes continues to fall. But experience shows that any success achieved by formal control is always short-lived and counter-productive when its distorting effects unwind.
- Import controls? For a major trading nation like ourselfs, retaliation would be inevitable, and any short-run benefits to output and employment would be purchased at the expense of efficiency and so of consumers and of higher inflation.
- Bring down the exchange rate? It has recently moved sharply down against the dollar, but remains much higher against the D-mark than when we came into office. Although it will help sales of UK exports in the US, the recent movement is bound to cause some anxiety about the effect of higher import prices on inflation.
- Putting North Sea revenues to "better" use? A North Sea Oil Fund perhaps? But North Sea revenues, which by 1983-84 are expected to amount to only about 6 per cent of general Government revenues (about half of annual defence spending and less than we are already spending on investment by publicly owned industries) are already helping to keep down the PSBR, and so interest rates. And in any individual year uncertainties over output levels, oil prices and the exchange rate affect actual receipts. Any new accounting device would at best be cosmetic and, given the uncertainties, could constrain our freedom of action.
- A straight increase in public expenditure? In order to prevent this leading to higher inflation, it would entail higher taxes or higher interest rates, neither of which would help the recovery of the private sector. This would be so even if the extra public spending took the form of capital investment. The effect would be to discourage private spending, including investment. Yet in the long run [private sector spending decisions OR private investment] would almost certainly create more wealth than extra public spending.

42. Clearly we must avoid the mistakes of the past and be willing to sustain the right policies for long enough to secure a lasting improvement in underlying performance. This certainly means maintaining firm control on the amount of

money available in the economy, the national cash limit. By making clear our determination to stick to this discipline we can sustain the change in expectations and attitudes within industry. There are encouraging signs. But we need to build on them and not risk dissipating them.

43. To repeat, the vital need, in economic terms, is to go on reducing the share of the rising national cash limit that is absorbed by inflation and to increase the share that represents real growth of output. I set out below some of the difficult areas where we need to concentrate our thinking.

Changing the patterns of economic behaviour

(a) How can we secure much wider understanding of the scale of our problems and of their real causes?

(b) What more can we do to convince people of the need - and of our determination - to maintain the fight against inflation, if unemployment is to begin to yield? And to secure a sustained change in the attitudes of pay bargainers, in public and private sectors alike?

(c) In particular what more can we do to create the climate for a moderate rate of pay increases, well down in single figures, [in the public sector] for pay settlements in the coming autumn and winter?

[FST suggestion]

Improving the supply side of the economy

(d) How should we continue increasing and improving opportunities for the private sector and, most of all, for new and expanding businesses?

(e) What more should be done to remove obstacles to mobility and efficiency, for example in the housing market and in the labour market?

(f) How do we handle the prospect of a continued growth in unemployment, particularly amonst the young?

(g) Should we be doing more to tackle monopolies and restrictive practices, whether in private or state industry or in the labour market? In particular, what more could we contemplate doing to tackle the problems of union power and union behaviour?

The balance of fiscal policy

(h) How do we make faster progress in reducing the size - and cost - of the public sector and so ensuring further progress towards lower interest rates and reducing the tax burden on the private sector?

(i) How much importance do we attach to securing significant cuts in the present tax burden? And how important are other commitments if we are to make room for tax cuts?

44. These are difficult questions for difficult times. Popular expectations remain high and people are (understandably) impatient for success. Yet we can restore the economy to health only if we are determined, for some time to come, to sustain the policies needed to achieve a fundamental change in attitudes and institutions.

VII CONCLUSIONS

45. I invite my colleagues to:-

(i) note the need to maintain the Government's present general approach to the economy;

(ii) offer their views on how best to promote the changes in patterns of economic behaviour and in the working of markets essential if we are to improve the performance of the economy; and how best to adapt our fiscal and other policies to contribute to these objectives.

G.H.

H.M. TREASURY
11 June 1981

CHART A

United Kingdom average annual growth rates

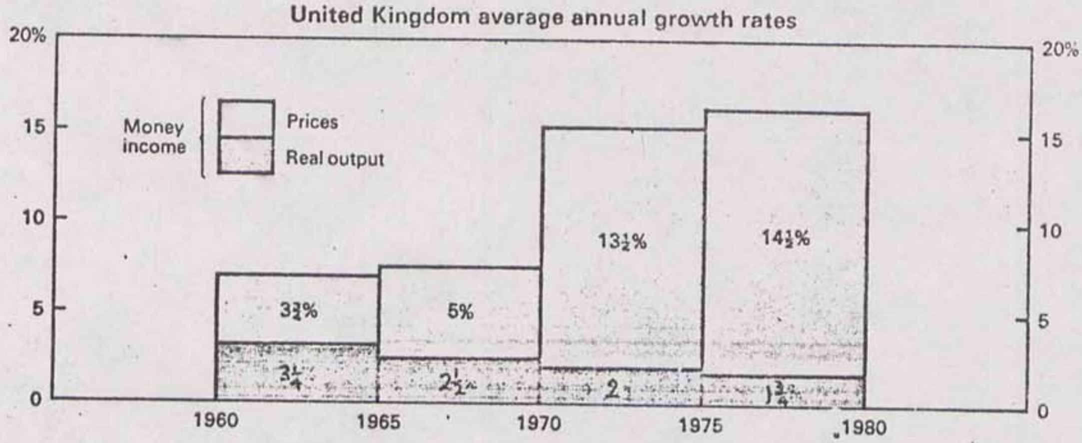


CHART B

Exchange rate, wage costs and competitiveness
1975 = 100

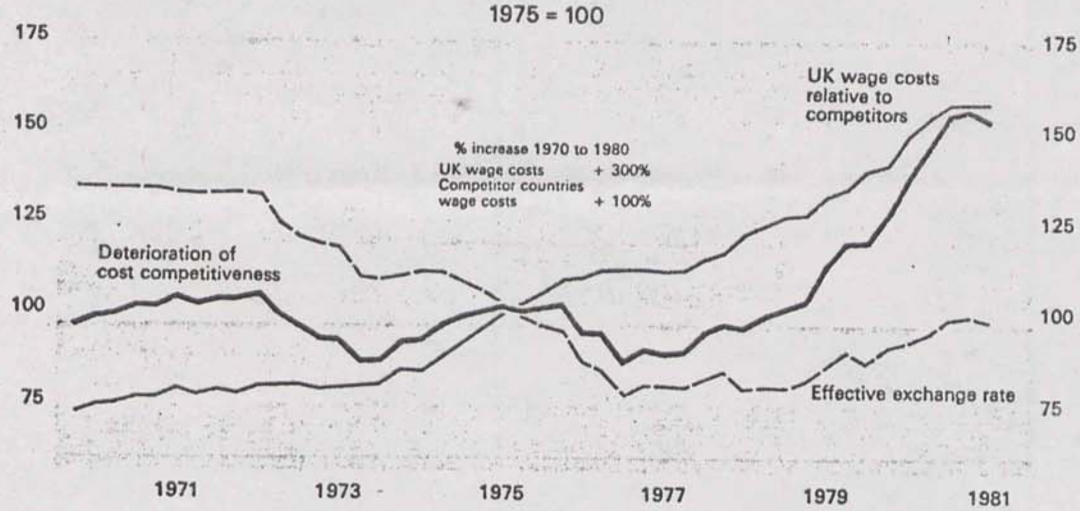


CHART C

Pay and productivity in manufacturing
Average annual rates of growth 1976 QIV — 1980 QIV

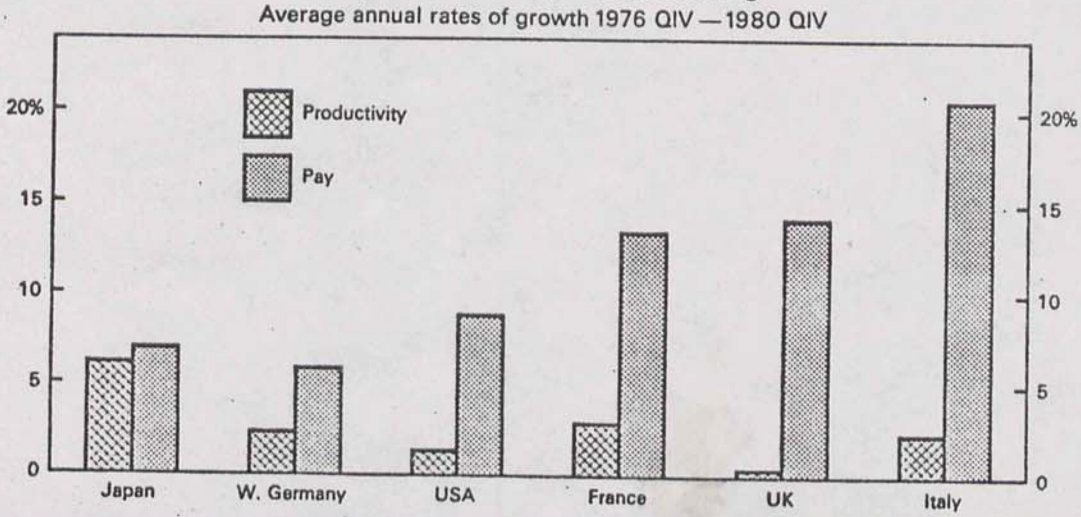


CHART D

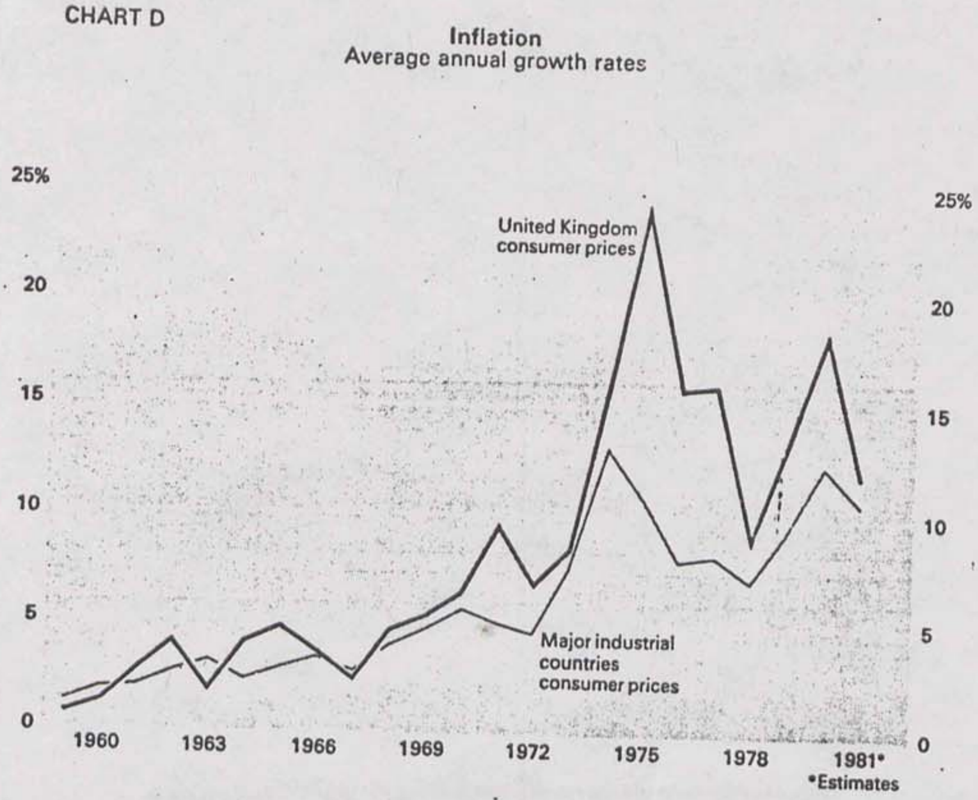

Inflation
Average annual growth rates
25%
20
15
10
5
0
United Kingdom
consumer prices
Major industrial
countries
consumer prices
1960
1963
1966
1969
1972
1975
1978
1981*
*Estimates

CHART E

Profitability ~~Probability~~ and Investment

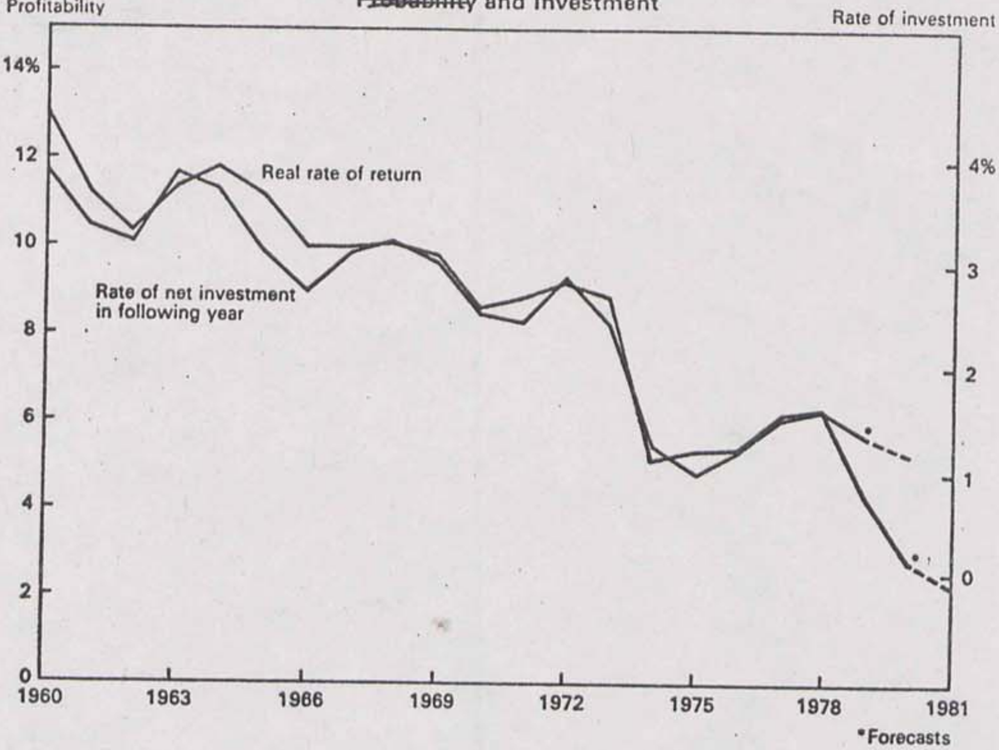


CHART F

Personal and company disposable income

£billion, 1975 prices

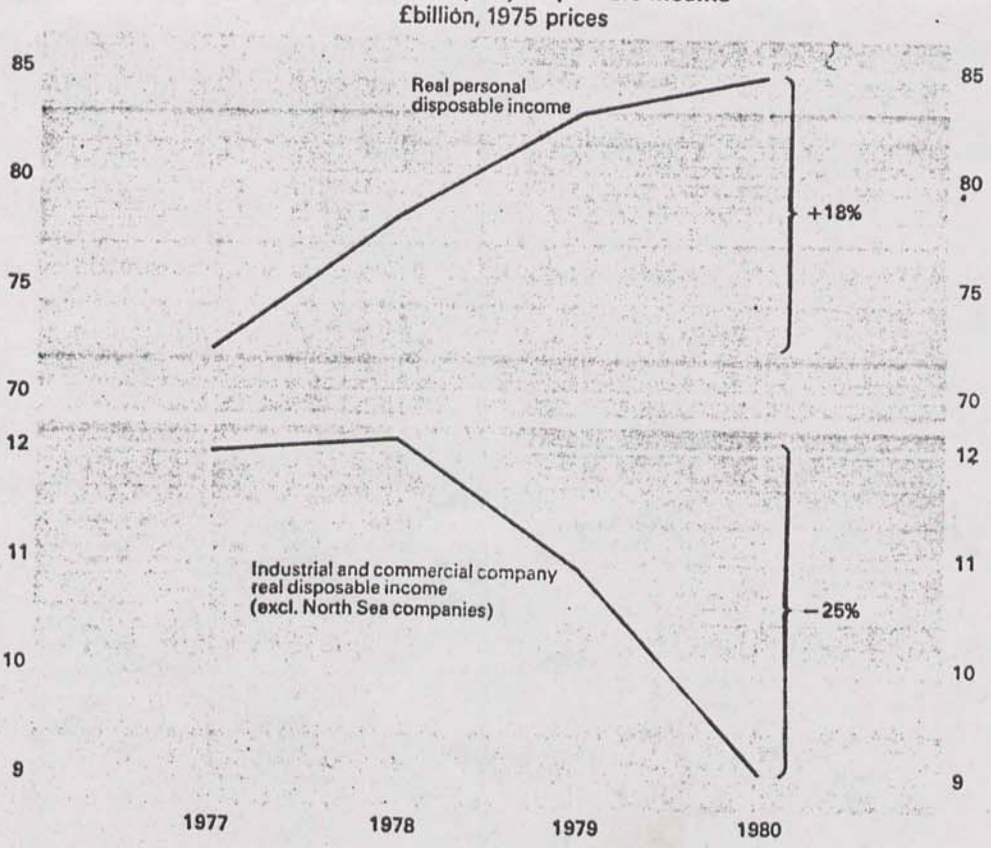


CHART G

Unemployment and skilled labour shortage

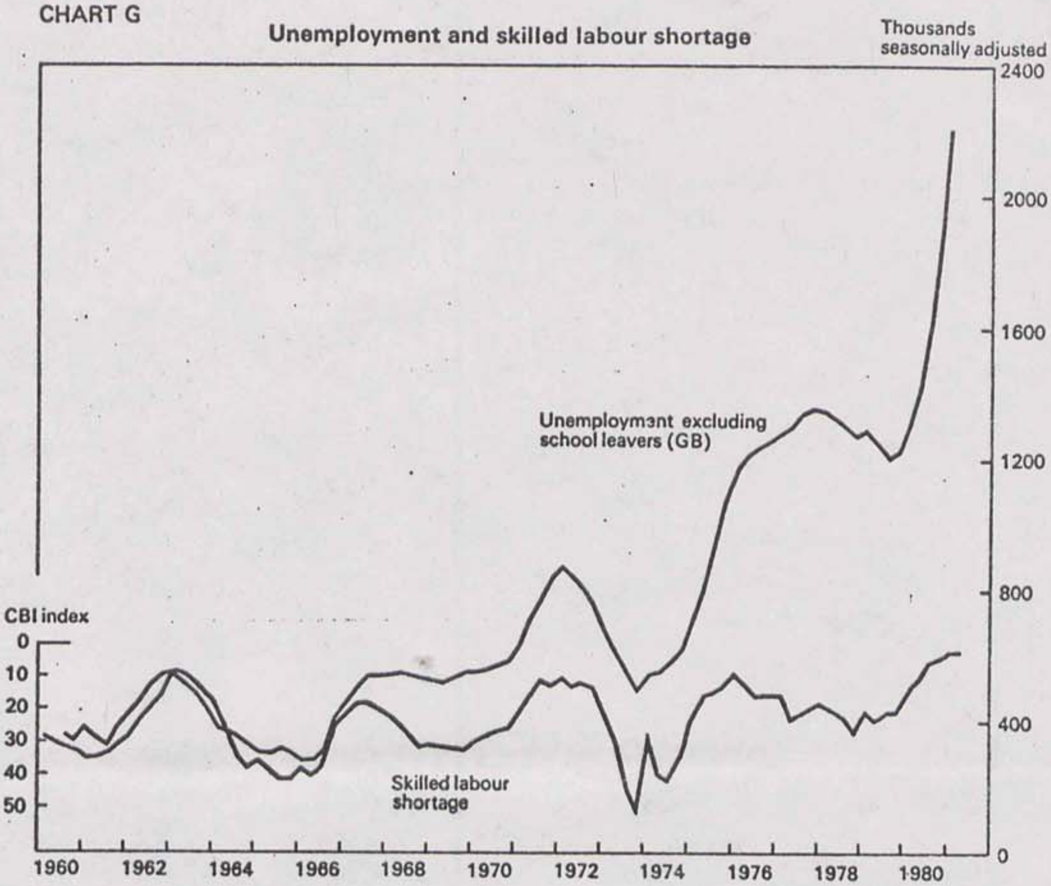


CHART H

Public expenditure and non-North Sea taxes as a proportion of national income

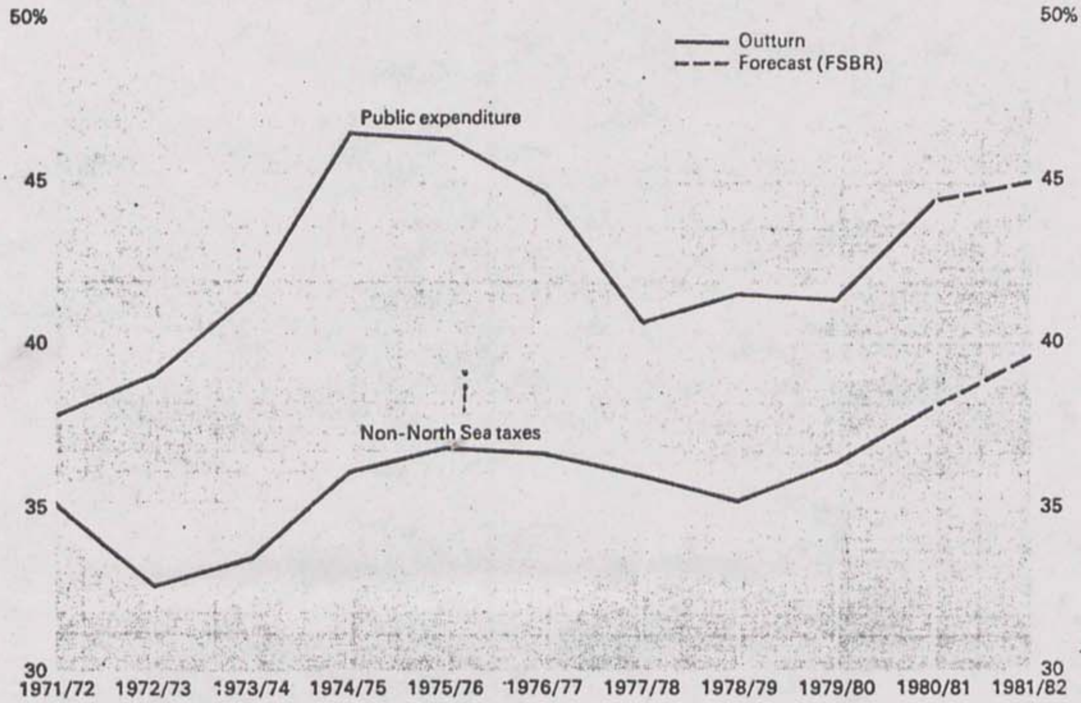
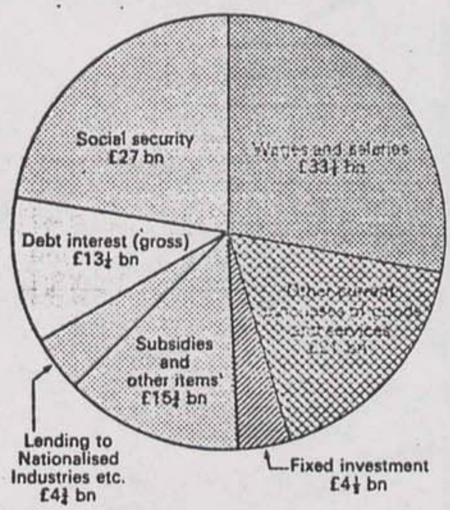


CHART I

Central and Local Government expenditure, 1981/82

Total cash expenditure : £120 billion

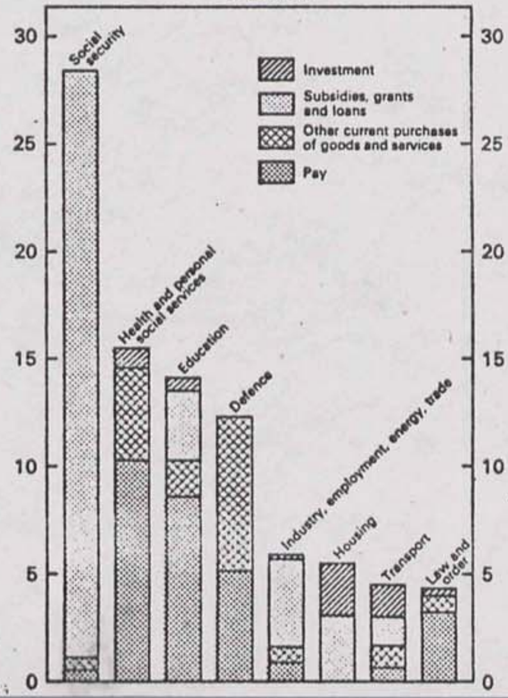


¹Other items include industrial and regional assistance, current grants abroad, student awards, grants to universities and lending for house purchase.

CHART J

Main public expenditure programmes, 1981/82

£ billion



ANNEX A

Technical note on figures and concepts used in the charts

CHART A Money Income is gross domestic product (GDP) at current market prices. Output growth is the change in GDP measured at 1975 prices.

CHART C Productivity is measured by change in output per man-hour in manufacturing. Pay is hourly earnings.

CHART E Relates to industrial and commercial companies, excluding North Sea activities. Profitability is the estimated gross trading profits plus rent less stock appreciation and capital consumption at current replacement cost expressed as a percentage of net fixed capital stock at current replacement cost plus the book value of stocks. Net Investment measures the growth of the companies' capital stock.

CHART F Real disposable income is gross income less direct taxes and contributions deflated to real terms by the GDP deflator. For companies this is equivalent to retained income plus dividend payments.

CHART G "Skilled labour shortage" in Chart G is the 'skilled labour constraint' index in the CBI business trends survey showing the percentage of respondents reporting skilled labour shortage as a factor holding back output. It is plotted in the chart with the scale inverted so that it can be more readily compared with movements in unemployment.

CHART H As paragraph 29 says the tax burden is calculated excluding the effects of the North Sea. More specifically, it embraces all taxes (including local rates) and contributions except taxes on North Sea operations, and is expressed as a percentage of GDP excluding the contribution of North Sea oil and gas. The "national income" denominator for the tax burden thus differs from that used for calculating the ratio of public expenditure to GDP. For this reason the absolute levels of the two lines in the chart are not directly comparable. The chart is designed to bring out the movements of the tax burden and public expenditure over time.

CHART I Total expenditure in this chart relates to general government (i.e. central and local government) and is divided into the main economic categories. Total expenditure on goods and services comprises the three right hand segments. "Lending to nationalised industries etc" is lending by general government only; it excludes public corporations' direct borrowing from the market and overseas.

CHART J Breaks down the main programmes into their major economic categories. Sales of council houses and land have been netted off "subsidies, grants and loans" (rather than off "fixed investment"); fees of general practitioners have been included in health pay. Programmes are on a UK basis; for example, "social security" includes the Northern Ireland expenditure (whereas "social security" in Chart I does not.

10 DOWNING STREET

Prime Minister

The Chancellor is coming to discuss this paper with you on <u>Monday</u> at <u>1530</u>. Alan Walters and Tim will be <u>looking</u> at it over the weekend.

Charlotte Stevens

Duty Clerk

5.6.87

It will need to be revised in the light of the latest events.

CONFIDENTIAL

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

6 June 1981

T P Lankester Esq.
10 Downing Street
LONDON
SW1

Dear Tim,

ECONOMIC STRATEGY

.... I attach a draft of the Chancellor's main paper for the 18 June Cabinet. Although it is still subject to further consideration by the Chancellor - particularly in relation to the concluding sections - it has been extensively worked over by Treasury Ministers. The Chancellor would be very grateful if the Prime Minister could look at the draft over the week-end, so that it can if possible be finalised at their meeting at 3.30 p.m. on Monday 8 June. The Chancellor is anxious that the physical presentation of this difficult material to his colleagues should be as attractive as possible*; to meet the printing timetable required if the paper is to be circulated before next week-end, we need to settle the text in the very early part of next week.

Also relevant to the Cabinet discussion will be

(i) the Chancellor's MISC 56 paper circulated today about the economic impact of North Sea oil and gas revenues;

(ii) a paper the Chancellor will be putting to E Committee next week about the prospects for the pay over the coming year;

(iii) a paper about public sector current and capital expenditure, which he has it in mind to circulate to the Cabinet as background material when the main strategy paper goes out to his colleagues.

* For instance, the charts will be in colour.

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The other two papers might be circulated to the full Cabinet a day or two before the 18 June meeting.

The Chancellor is conscious of the need to prepare rather carefully for the discussion in Cabinet. He therefore has it in mind to talk towards the end of next week to a small number of colleagues, and perhaps to do some preliminary scene-setting at next Thursday's Cabinet. As to the actual meeting, he suggests that it might be useful if he were to be accompanied by Mr Burns; and he is considering what further material could be made available at the meeting - e.g. some indication of the improvement in the economic prospect which might be secured through better control of unit labour costs and a better performance by UK firms competing in international markets, and some paragraphs setting out more fully the objections to some of the more seductive-looking "blind alleys".

He will be away.

yours

John

A.J. WIGGINS
Private Secretary

W.W.
CH
L.B.
J.N.
J.B.
KS.

T.B.
A.W.

ECONOMIC STRATEGY

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2. Our objectives are clear

- We aim to break out of the circle of high inflation, low productivity, poor market disciplines and responses, poor management and progressive devaluation. These are all closely linked.
- Success in this is essential for a sustainable growth of output, employment and living standards.

  This means ....
- we must substantially improve the efficiency and above all the competitiveness of the economy. And ...
- we must bring inflation down and keep it down.

3. As we made clear in our Manifesto, bringing about the necessary fundamental changes - not least changes in attitude on the part of management and labour towards the disciplines of competition and honest money - is not easy. This is especially so given the years of neglect, the tougher world setting and the competition we face from economies overseas which are much fitter than our own. We have made significant progress already. We have to consider the next stage.

I Setting the scene

4. Throughout the industrial world inflation accelerated and growth slowed down during the 1970s. Almost everywhere this was accompanied by sluggish productivity and rising unemployment.

5. The second oil price shock (oil price $17 a barrel on polling day and $35 a barrel at the end of May) has seriously worsened the prospects for the world economy over the next few years. Growth prospects for the 1980s have been scaled down markedly. Earlier hopes that, once the first oil price shock had been absorbed, the world economy would regain the growth rates enjoyed in the 1960s have long since been abandoned. In most industrial countries there are doubts whether growth in the 1980s will reach even the level recorded in the 1970s. In short, the world setting is much harsher than expected when we came into office.

6. These trends have been especially bad in Britain. Chart A shows how, through two decades, money incomes grew increasingly fast - much faster in fact, than in other industrial countries - while growth of output slowed down. Between 1970 and 1980 real output grew only 16 per cent. But money incomes increased by 335 per cent. In other industrial countries the increase in earnings over the period of the second oil shock was much more moderate than in the UK.

7. We are thus badly handicapped by a serious decline in our ability to compete. As Chart B shows, this is because our wage costs have risen much more steeply than those of our competitors and, to a much lesser extent, because North Sea oil has prevented them from being accommodated to the same extent as in former years by a lower exchange rate. Chart C compares our performance on pay and productivity in manufacturing with that of other countries. If our productivity was up to French or German standards, we could have getting on for twice the output from our existing labour force.

8. As the decline in our ability to compete has gone on for a number of years, its causes are plainly deep-seated. We cannot therefore expect a speedy recovery from our industrial problems.

9. Britain, like other countries, has reacted to rising inflation by taking measures to limit the growth of total money expenditure; and to reduce inflationary expectations by persuading people to accept and adapt to the lower

growth of money, especially in wage demands. This has included setting targets for the growth of the money supply. The effect is similar to establishing a cash limit for the whole economy, within which cash limits for the public sector are a natural consequence. The object must be to reduce from year to year the rate at which these cash limits grow. Within that framework the total increases will be divided into the part taken by inflation and the part that represents real growth of output. Our task must, of course, be to reduce the former and increase the latter.

CHART A

United Kingdom average annual growth rates

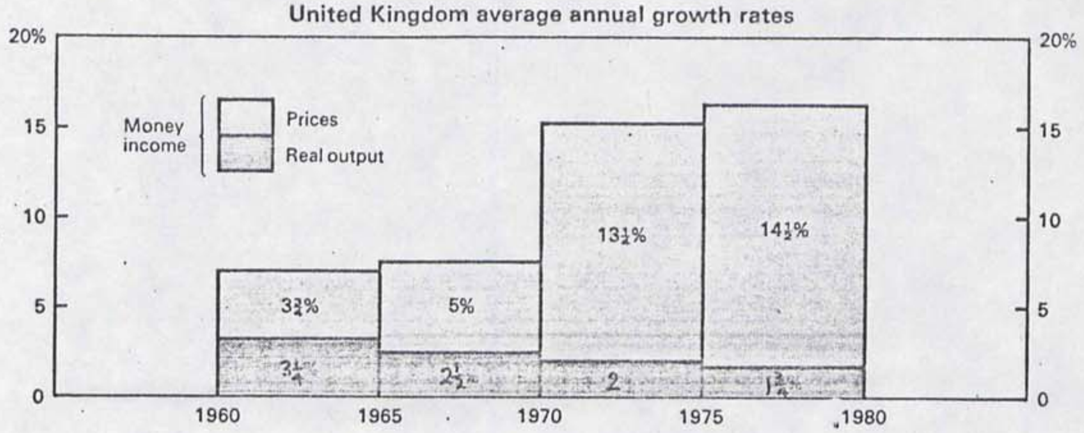


CHART B

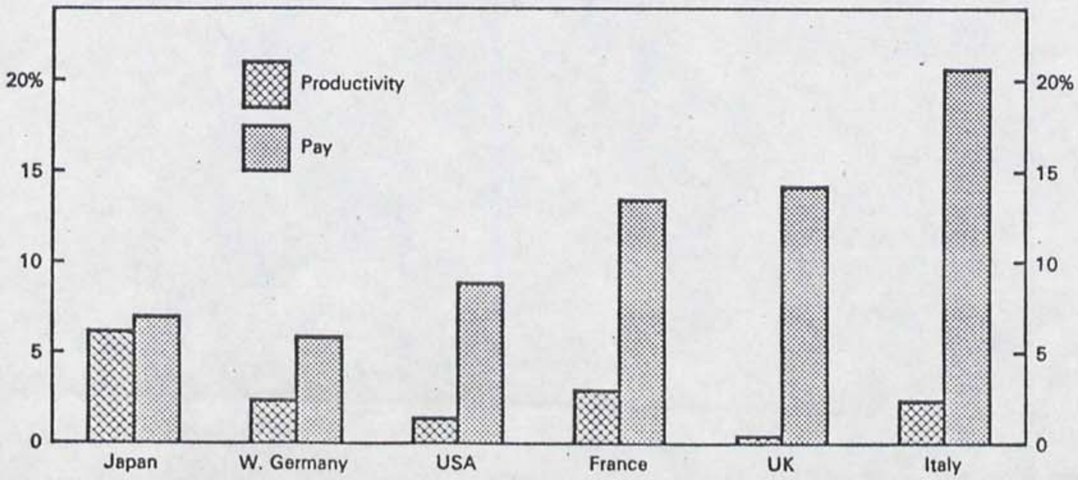
Exchange rate, wage costs and competitiveness

1975 = 100

CHART C

Pay and productivity in manufacturing

Average annual rates of growth 1976 QIV — 1980 QIV



II Inflation

10. Control of inflation, which was the first task in our Manifesto, must then remain first:-

- Because, if not controlled, inflation tends to accelerate and lead to an economic "stop".
- Because the attitudes which go with high inflation also produce poor productivity, poor management and loss of competitiveness, so reducing growth and employment.
- Because inflation is unjust and unpopular.
- Because our success or failure in reducing it is one of the main things by which we shall be judged.

11. Inflation was accelerating when we came in. We have reversed that trend. Inflation is now about 12 per cent, compared with about 22 per cent a year ago, and still headed downward.

12. As Chart D shows, in the past year inflation has fallen much more quickly in Britain than in the rest of the OECD, and we have probably achieved an improvement in productivity. But

- It is still above the OECD average and far too high.
- We must bring down our costs substantially, to help reverse our loss of competitiveness.
- The progress so far made will be hard to maintain.

13. This last point is important. Although most projections show inflation continuing to fall, there is a real risk of some reversal in 1982, even if, by firm control of the money supply, we prevent any reversal from going too far. This could come about because of such factors as:-

- A faster rise in some world prices, as activity recovers.
- Pressures when our economy picks up, as profit margins recover and employers bid for skilled labour.
- A possible further fall in the exchange rate.

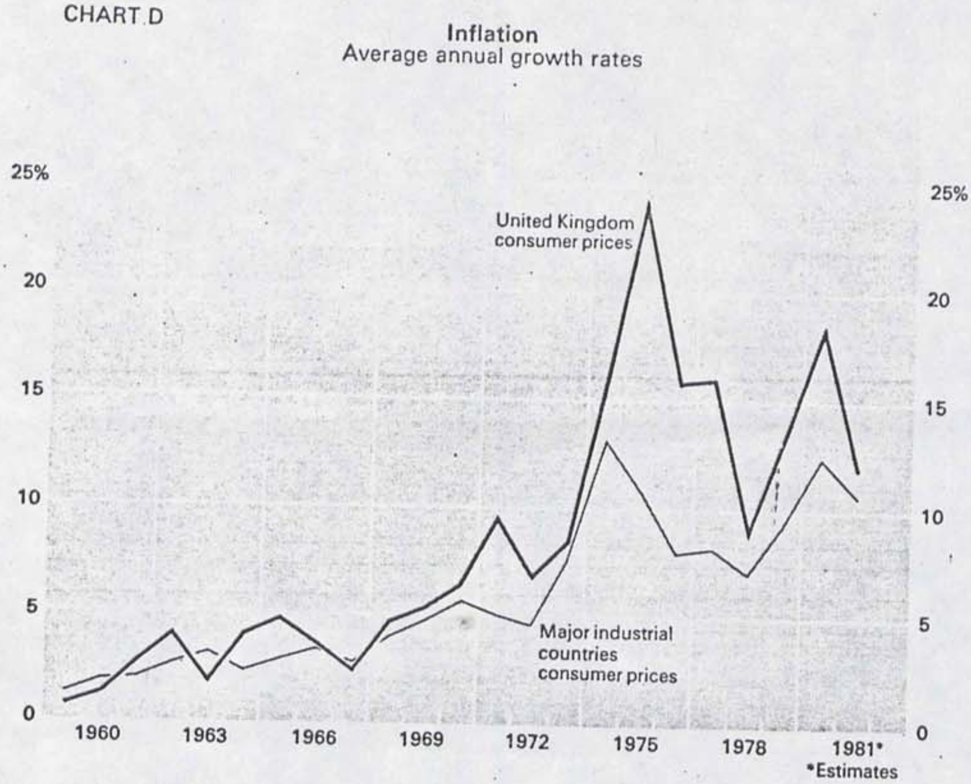
14. Some of these factors are inevitably beyond our control. So it is all the more important not to ease up on what we can do. We must take the expenditure and

tax decisions that are necessary if we are to achieve our monetary targets and be in a position to help industry, for example on interest rates. We need also to lighten the burden of rates and taxes and to improve incentives.

15. In addition we must:-

- take all possible steps to secure a reduction in unit labour costs and in the cost of the public sector;
- maintain and strengthen expectations that inflation will continue to fall.

CHART D


Inflation
Average annual growth rates
25%
20
15
10
5
0
United Kingdom
consumer prices
Major industrial
countries
consumer prices
1960
1963
1966
1969
1972
1975
1978
1981*
*Estimates

III Output

16. To repeat, over the past 10 years prices have risen by 275 per cent and money incomes by 335 per cent, but real output by only 16 per cent. Since the peak of the last cycle in the spring of 1979 output has actually fallen by over 7 per cent.

17. In part this recent fall in output reflects world-wide developments, as most major economies experienced recession following the oil price rises. Output in all the major countries of the European Community, for example, has fallen during the past year and is expected to remain roughly flat for the rest of the year.

18. But the recession has been deeper in Britain, reflecting:-

- The underlying weakness of our economy, much of it over-manned and uncompetitive.
- Excessive pay increases over many years.
- An uncomfortable side-effect of North Sea oil, through the impact of the high exchange rate on some manufacturing industry.
- The need to bring down inflation by more than other countries have had to do.

19. Chart E shows that real industrial profitability has fallen from about 14 per cent to virtually nil in the past 20 years. The rate of new investment (after allowing for the replacement of old plant) has also fallen. Chart F shows the contrast in recent years between falling company incomes - down by 25 per cent - and rising personal incomes - up by 18 per cent.

20. There are signs that, with the rundown in stocks coming to an end, and retail sales high so far this year, we are nearing the end of the recession. A number of recent indicators suggest that the fall in output is levelling off and that in some industries activity is increasing. There are encouraging reports of improved productivity. Recent CBI and other reports offer evidence of some improvement in business confidence.

21. But as with our success on inflation the improvement here is fragile. If we are to have the basis for sustainable growth we must resist any temptation to relax. The world economic setting is unfriendly and intensely competitve.

In Germany the average figure for pay settlements if 5 per cent. We need to match that kind of performance.

22. In this difficult setting, any upturn in the economic cycle will take us only a small part of the way. Essentially it will be up to business and industry to create or win new markets and to increase market share, at home as well as abroad. Government must help and not hinder this process. We still need much wider understanding, above all in the public sector where several effective labour monopolies exist, of the importance of combined effort in pursuit of better productivity. There are still too many obstacles to economic change and flexibility, probably above all in the labour market. But not only there.

CHART E

Profitability
~~Probability~~ and Investment

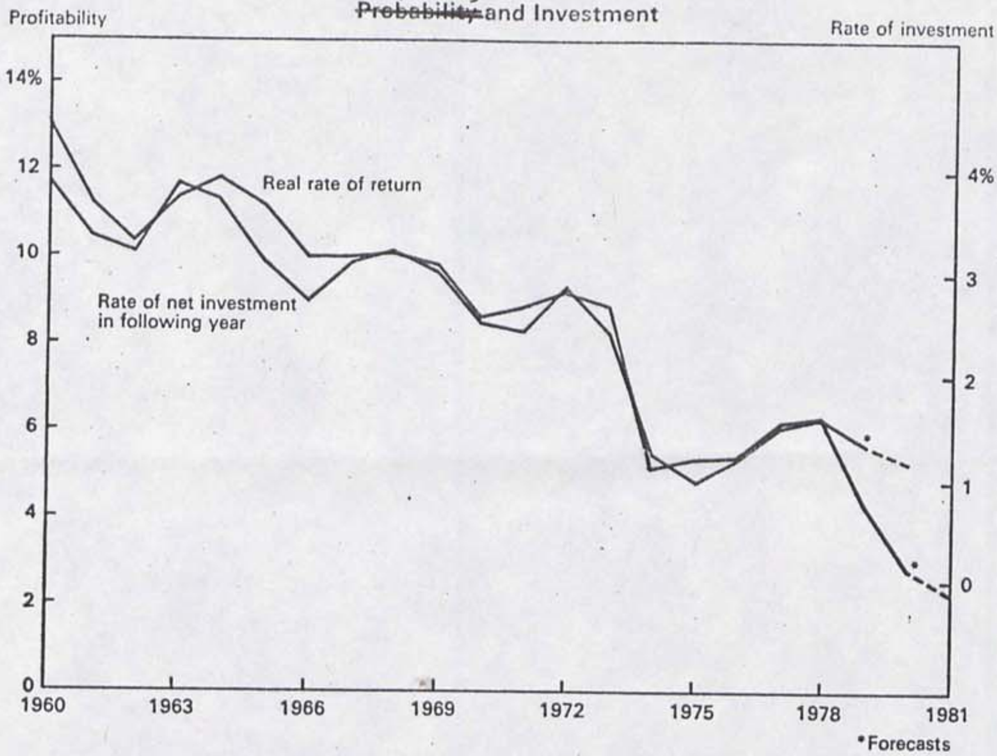
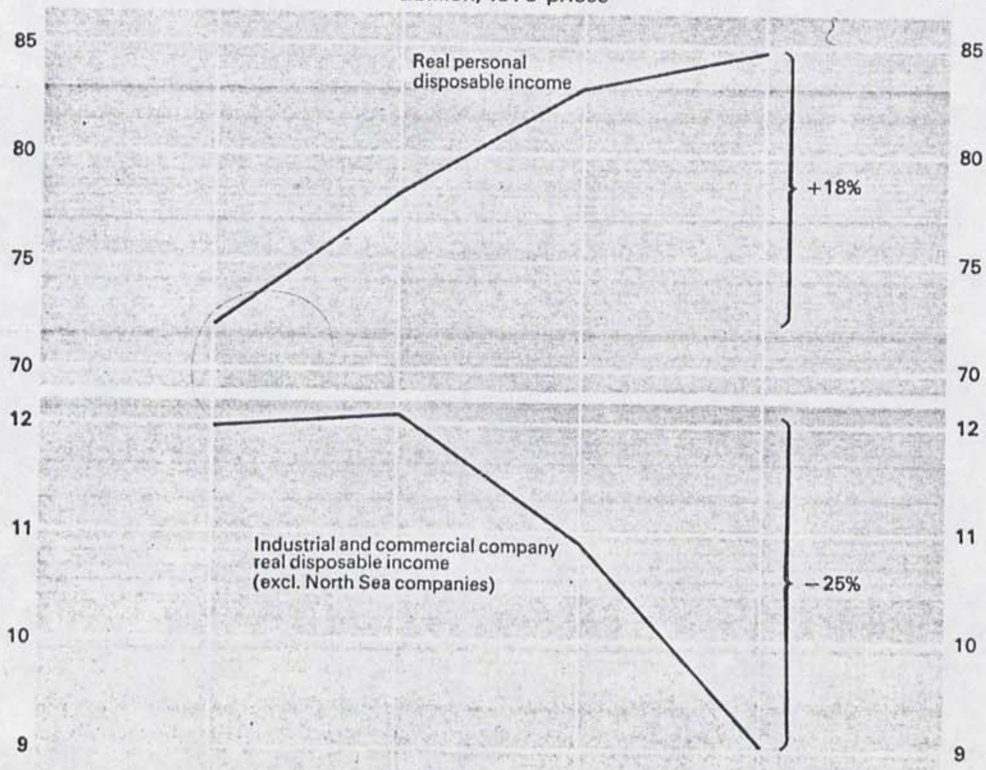


CHART F

Personal and company disposable income
£billion, 1975 prices



IV Employment

23. Chart G shows the recent very sharp rise in unemployment, following a long upward trend.

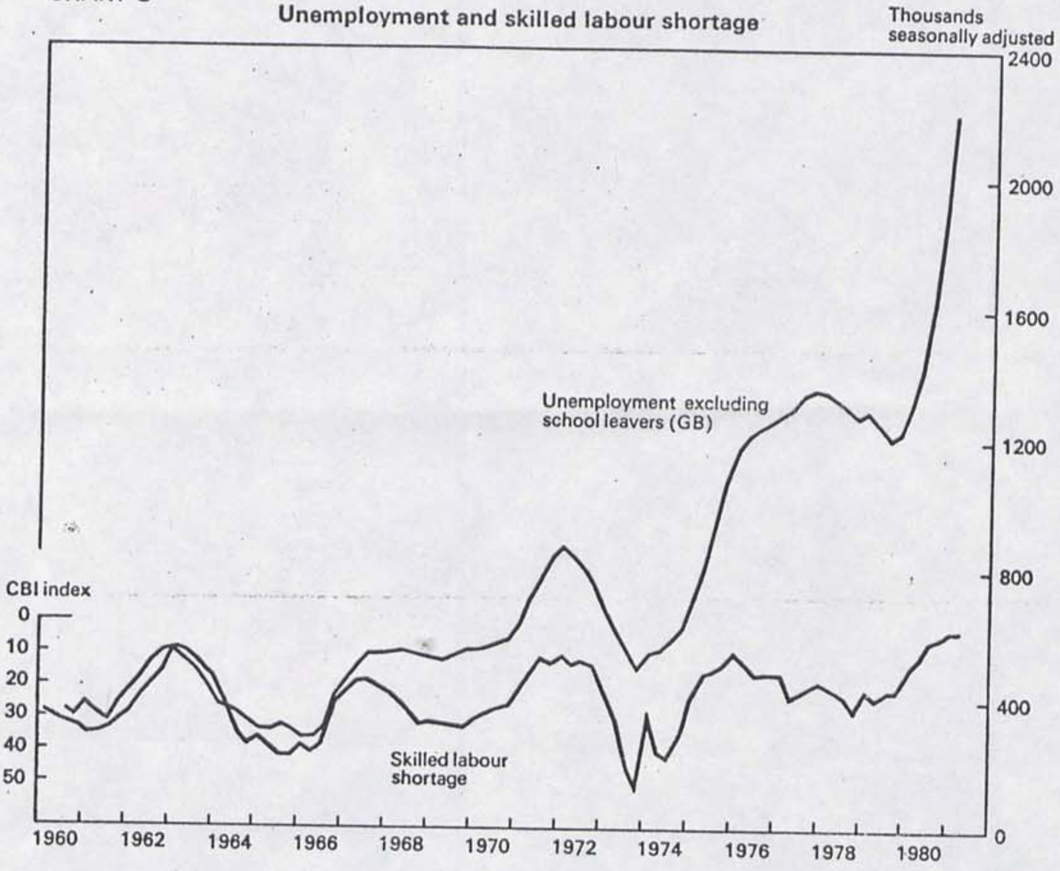
24. Most of the actions required to improve productivity and competitiveness - cost cutting, removal of restrictive practices, increasing efficiency - necessarily increase unemployment at first. We face the consequences of years of over-manning. In the longer run improving productivity and so competitiveness leads to faster growth and more jobs. That is the clear lesson of, for example, the Japanese experience. It is in fact confirmed by the record of some successful parts of the British economy. The need is to bring our average performance nearer to what our most successful firms and industries have shown to be possible and at the same time to promote the expansion of real and sustainable new employment opportunities. Within the limits of the very tight fiscal situation we have been facing, we have made strenuous efforts to make the tax system better adapted to encouraging growth and enterprise: thus we have dramatically reduced the confiscatory top rates of income tax, and we have introduced an array of new incentives to promote the establishment and growth of small businesses.

25. Nevertheless, we must recognise that, because of the big improvements needed in our competitiveness and of a growing labour force, unemployment is likely to continue to rise for some time yet, although at a slower pace. It will take a long time for business and industry to develop and exploit new markets on a sufficient scale.

26. There is another point. As Chart G shows, recorded unemployment has for some years been increasing out of line with other indicators of the pressure of demand for labour. Chart G also shows how over time each cyclical peak of unemployment is higher than the last. This implies that even when the economy recovers and the demand for labour improves, unemployment is quite likely to stabilize at a higher level than in earlier decades. We need to do all we can, without provoking renewed inflation, to speed the sustainable expansion of productive activity and real output. But we must also seek ways of containing unemployment meanwhile.

27. We need to consider the needs of particular groups, such as the young. But any such action cannot be allowed to jeopardise the need to control total public expenditure. Once again we see the need for more flexibility within the labour market. The higher the cost and the greater the difficulty of taking on new labour, the smaller will be the number of new jobs.

CHART G


Unemployment and skilled labour shortage
Thousands
seasonally adjusted
2400
2000
1600
1200
800
400
0
CBI index
0
10
20
30
40
50
Unemployment excluding
school leavers (GB)
Skilled labour
shortage
1960
1962
1964
1966
1968
1970
1972
1974
1976
1978
1980

V Tax and public expenditure

28. So far in our period of office the tax and public expenditure burdens have both risen, as Chart H shows. We have reduced the PSBR - but only by covering higher public expenditure by even higher taxes.

29. Notwithstanding what we have done to improve incentives, the tax burden has sharply increased since 1978-79:-

- Although some switch has been made from taxes on personal income to taxes on expenditure, both direct and indirect taxes are heavier than when we came to power. Excluding the effects of the North Sea, this year taxes (including National Insurance and rates) will take 39½ per cent of the nation's income compared with 35 per cent in Labour's last year.
- A married man on average earnings now pays 48½ per cent of his income in direct and indirect taxes and contributions compared with 45½ per cent when we came to office.
- We have made only moderate progress in easing capital taxes and in lightening company taxation.

Moreover, on the projections published at Budget time (based on our plans for declining public expenditure, as set out in the White Paper) the tax burden in 1983-84 would still be 38 per cent of GDP - 3 points above the level we inherited.

30. This falls well short of what is expected of us by our supporters and indeed by the country as a whole. For economic as well as political reasons we have to do better.

31. On public expenditure we set out to reduce the total substantially as a proportion of GDP. Business and industry still rightly regard this as an essential objective. We held the ratio steady for our first year in office. But:-

- In 1980-81 it shot up - both because GDP fell and because expenditure was higher than we intended (less than half of this excess can be explained by the fact that the recession was worse than expected).
- This year the ratio could approach the peak reached in the early years of the last Labour Government. In cash terms expenditure by central and local government in 1981-82 is estimated to be about £6 billion higher than forecast a year ago.
- This represents an increase of more than 60 per cent in those years, compared with an increase in retail prices of 49 per cent.

Even then, our record on public expenditure is far from entirely negative. Expenditure during the current year will be £5 billion less than our predecessors were planning, despite the additional costs of unemployment benefit and employment support due to the recession, for which their plans included no provision. Next year, expenditure will be [£8 - 9] billion less than they were planning. In achieving these reductions from previously planned levels, we have not shrunk from some very difficult decisions - for example, abolition of the earnings related supplements to unemployment and sickness benefit.

32. Public expenditure must be paid for by the private sector, either through taxes or through the high interest rates that accompany higher borrowing. To improve the outlook for the private sector we have to reverse the growth of the public sector. Charts I and J show the present breakdown of spending. They demonstrate the programmes we shall have to look to for this. And because we want to do this without adding to inflation, the apparently easy option of further increasing public sector, particularly nationalised industry, prices beyond the levels currently envisaged is not open to us.

33. As well as reducing the size of the public sector we must make every effort to contain costs. This year pay in the public services - but not in the nationalised industries - is in general rising less rapidly than pay in the private sector. We need to do better still - especially in the nationalised industries - and at least to ensure that we hold the improvements so far made.

34. Within the totals of public expenditure we should consider whether it would be possible to improve the relative prospects for private sector output and employment by changing the composition of our spending programmes. It is worth noting that within the total increase of 60 per cent in public expenditure between 1979-80 and 1981-82, fixed investment was static in cash terms. Thus we might seek to spend more on capital and less on current; and we should certainly do all we can to ensure that the public investments we undertake are those which will contribute most to making the economy more productive and competitive. But if cuts in current spending are used to finance more public sector investment, then we must face the harsh fact that we have to forego the chances of lower taxes or lower interest rates, which those cuts would otherwise have offered. The best way to finance profitable public investment is to cut out unprofitable public investment.

35. To repeat, on present spending plans, even on optimistic assumptions about the growth of the economy, we shall enter the election with an overall tax burden much heavier than the one we inherited. Not only politically, but also economically, that is not tolerable.

36. We have already recognised, and said publicly in the last public expenditure White Paper, that the present expenditure programmes are higher than we wish in relation to financial and economic objectives. Nothing has happened to invalidate that judgement. The need is clear to <u>reduce</u> the public expenditure totals for the years ahead below the equivalent of those in the last White Paper. Yet the pressures are for increases in certain programmes, notably for nationalised industries, for industry generally, and for unemployment related programmes. There are already signs of a repetition of last year, with difficult reductions required simply to hold the total against these increases, let alone reduce it.

CHART H

Public expenditure and non-North Sea taxes as a proportion of national income

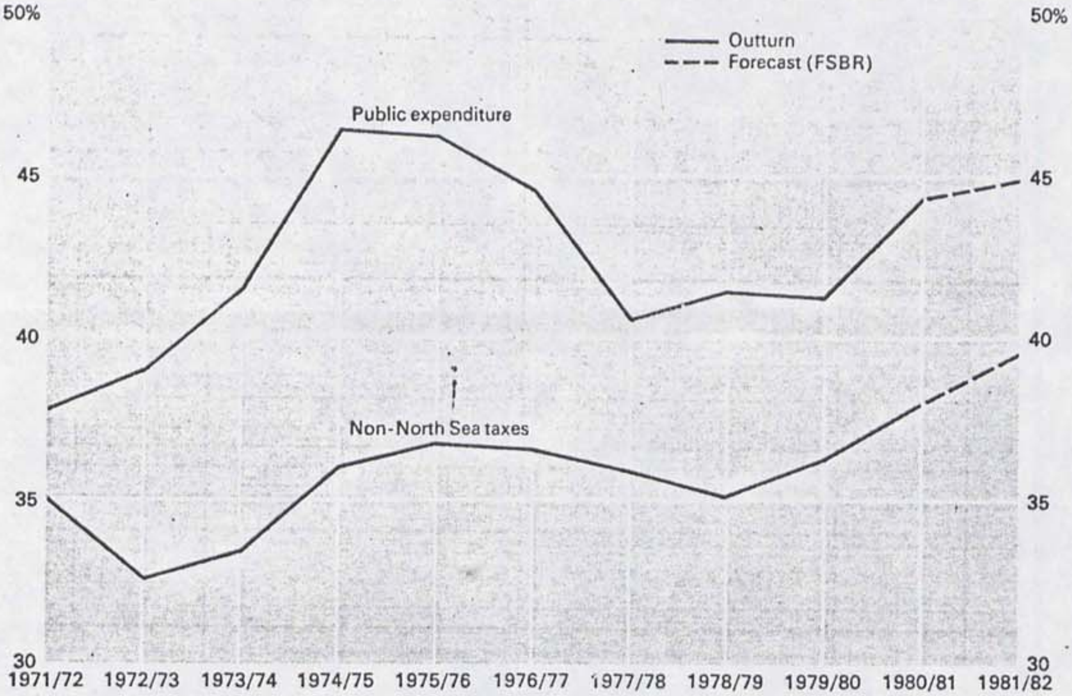
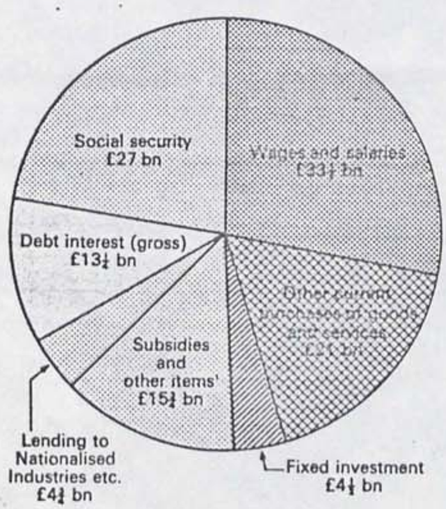


CHART I

Central and Local Government expenditure, 1981/82

Total cash expenditure : £120 billion

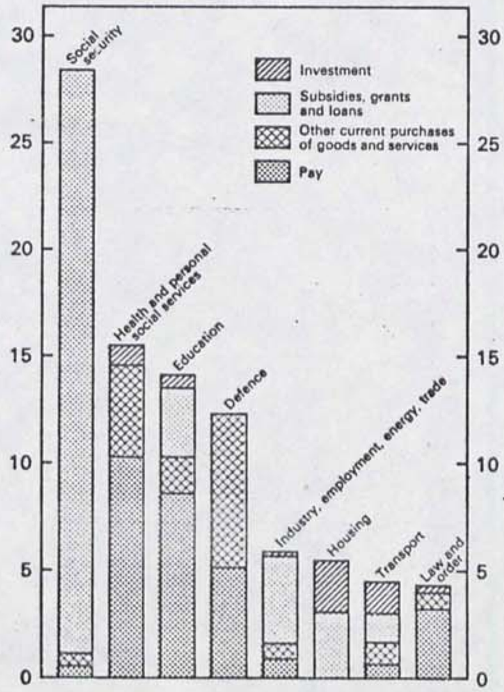


'Other items include industrial and regional assistance, current grants abroad, student awards, grants to universities and lending for house purchase.

CHART J

Main public expenditure programmes, 1981/82

£ billion



VI The way ahead

37. Recovery is bound to be slow, unemployment will go on rising for some time yet - although more slowly - and the fight against inflation will grow harder. A sustained expansion of output and jobs will only be possible if we maintain progress against the deep-seated weaknesses of the economy - poor productivity and competitiveness, resistance to difficult changes, a large public sector and, perhaps above all, monopolistic and selfishly used power in pay bargaining.

38. What the Government can do directly is limited. It is a job for everyone, Government, management, unions and individuals. But we must go further towards creating the right climate for bringing about the needed changes. The need for perseverance over a relatively protracted period poses a formidable political problem.

39. What should we be doing? There are plenty of blind alleys. Thus:-

- Relax our money stance? This would lead to even more inflation, and any effects on unemployment would be small and short-lived. And it would worsen the long-term problem of securing a proper balance between output and inflation.
- Formal incomes policy? We certainly need to ensure that the rate of growth of money incomes continues to fall. But experience shows that any success achieved by formal control is always short-lived and counter-productive when its distorting effects unwind.
- Import controls? For a major trading nation like ourselves, retaliation would be inevitable, and any short-run benefits to output and employment would be purchased at the expense of consumers and of higher inflation in due course.
- Bring down the exchange rate? It has recently moved sharply down against the dollar, but remains much higher against the D-mark than when we came into office. Although it will help sales of UK exports in the US, the recent movement is bound to cause some anxiety about the effect of higher import prices on inflation.
- Putting North Sea revenues to "better" use? A North Sea Oil Fund perhaps? But North Sea revenues, which only amount to about 5 per cent of total tax revenues (about half of annual defence spending and less than we are already spending on investment by publicly owned industries) are already helping to keep down the PSBR, and so interest rates. Any new accounting device would at best be cosmetic.

- A straight increase in public expenditure? In order to prevent this leading to higher inflation, it would entail higher taxes or higher interest rates, neither of which would help the recovery of the private sector. This would be so even if the extra public spending took the form of capital investment. The effect would be to curtail private spending, although in the long run this would almost certainly be more efficient and create more wealth than the extra public spending.

40. Clearly we must avoid the mistakes of the past and be willing to sustain the right policies for long enough to secure a lasting improvement in underlying performance. This certainly means maintaining firm control on the amount of money available in the economy, the national cash limit. By making clear our determination to stick to this discipline we can sustain the change in expectations and attitudes within industry. There are encouraging signs. But we need to build on them and not risk dissipating them.

41. To repeat, the vital need, in economic terms, is to go on reducing the share of the rising national cash limit that is absorbed by inflation and to increase the share that represents real growth of output. This can only be done if we can develop more effective answers to some hitherto intractable questions. I set out below some of the areas where we need to concentrate our thinking.

(i) Changing the patterns of economic behaviour

(a) How can we secure much wider understanding of the scale of our problems and of their real causes?

(b) What more can we do to convince people of the need - and of determination - to maintain the fight against inflation, if unemployment is to begin to yield? And to secure a sustained change in the attitudes of pay bargainers, in public and private sectors alike?

(c) In particular what more can we do to create the climate for a moderate rate of pay increases, well down in single figures, in the pay round which begins this autumn?

(ii) Improving the supply side of the economy

(a) How should we continue increasing and improving opportunties for the private sector and, most of all, for new and expanding businesses?

(b) What more should be do to remove obstacles to mobility and efficiency, for example in the housing market and in the labour market?

(c) How do we handle the prospect of a continued growth in unemployment, particularly amongst the young?

(d) Should we be doing more to tackle monopolies and restrictive practices, whether in private or state industry or in the labour market? In particular, what more could we contemplate doing to tackle the problems of union power and union behaviour?

(iii) The balance of fiscal policy

(a) How do we make faster progress in reducing the size - and cost - of the public sector and so ensuring further progress towards lower interest rates?

(b) How much importance do we attach to securing significant cuts in the present tax burden? And how important are other commitments if we are to make room for tax cuts?

42. These are difficult questions for difficult times. Popular expectations remain high and people are (understandably) impatient for success. Yet we can restore the economy to health only if we are determined, for some time to come, to sustain the policies needed to achieve a fundamental change in attitudes and institutions.

VII CONCLUSIONS

43. I invite my colleagues to:-

(i) note the need to maintain the Government's present general approach to the economy;

(ii) offer their views on how best to promote the changes in patterns of economic behaviour and in the working of markets essential if we are to improve the performance of the economy; and how best to adapt our fiscal and other policies to contribute to these objectives.

ANNEX

Technical note on figures and concepts used in the charts

CHART A Money Income is gross domestic product (GDP) at current market prices. Output growth is the change in GDP measured at 1975 prices.

CHART C Productivity is measured by change in output per man-hour in manufacturing. Pay is hourly earnings.

CHART E Relates to industrial and commercial companies, excluding North Sea activities. Profitability is the estimated gross trading profits plus rent less stock appreciation and capital consumption at current replacement cost expressed as a percentage of net fixed capital stock at current replacement cost plus the book value of stocks. Net Investment measures the growth of the companies' capital stock.

CHART F Real disposable income is gross income less direct taxes and contributions deflated to real terms by the GDP deflator. For companies this is equivalent to retained income plus dividend payments.

CHART G "Skilled labour shortage" in Chart G in the 'skilled labour contraint' index in the CBI business trends survey showing the percentage of respondents reporting skilled labour shortage as a factor holding back output. It is plotted in the chart with the scale inverted so that it can be more readily compared with movements in unemployment.

CHART H As paragraph 29 says the tax burden is calculated excluding the effects of the North Sea. More specifically, it embraces all taxes (including local rates) and contributions except taxes on North Sea operations, and is expressed as a percentage of GDP excluding the contribution of North Sea oil and gas. The "national income" denominator for the tax burden thus differs from that used for calculating the ratio of public expenditure to GDP. For this reason the absolute levels of the two lines in the chart are not directly comparable. The chart is designed to bring out the movements of the tax burden and public expenditure over time.

CHART I Total expenditure in this chart relates to general government (ie central and local government) and is divided into the main economic categories. Total expenditure on goods and services comprises the three right hand segments. "Lending to nationalised industries etc" is lending by general government only; it excludes public corporations' direct borrowing from the market and overseas.

CHART J Breaks down the main programmes into their major economic categories. Sales of council houses and land have been netted off "subsidies, grants and loans" (rather than off "fixed investment"); fees of general practitioners have been included in health pay.

PRIME MINISTER

Prime Minister gave top copy of this to the Chancellor.
TL
8/6

Cabinet Macro-Economic Discussion

The present draft of the Treasury paper is a good one. The purpose of the meeting is not simply to give colleagues a chance to criticise the economic strategy. Instead it is an opportunity to teach them the hard realities of the economic choices. The paper is particularly useful in examining the various blind alleys which have been suggested so often. It should provide a valuable agenda for exposing and nailing the fallacious arguments that lurk behind many of the alternative policies.

The paper does also provide a basis for re-establishing a fresh start and a joint commitment by colleagues. The main objective must be to change the attitudes from scepticism to confident commitment.

I suspect that the main attack will be on the counter-proposition that increased public spending would largely expand employment and output, and would have minor effects on inflation. It will be argued that, contrary to the last point in paragraph 39, there is no need to contract private output; we shall simply employ idle resources. This is another way of saying that "demand is inadequate". Our counter argument is that money demand has been expanding at over 10% a year - so where is the "inadequacy"?

I do not think there is any substantial error in the paper. And I think it performs its main purpose well. But I would suggest the following minor amendments.

(a) paragraph 7: The second sentence should not refer to the North Sea oil propping up our exchange rate. As you know, I think the North Sea oil was a minor cause of sterling over-valuation; it was mainly a monetary phenomenon. Now sterling has since fallen dramatically - and the oil is still there. I suggest we delete "and, to a much larger extent ... to end of sentence".

/ (b)

(b) paragraph 18: I suggest we also delete "An uncomfortable side effect of North Sea oil through,"

(c) paragraph 37: last line delete "and selfishly used".

ALAN WALTERS

6 June 1981

cc: Mr. Gow
Mr. Wolfson
Mr. Walters
Mr. Lankester

MR. HOSKYNS

Mr. Teddy Taylor has the following question down to the Prime Minister for 9 June:

"To ask the Prime Minister, what is the Government's principle priority for action over the next three years."

This will not be reached orally. But the Prime Minister would like to give a substantive written response, and not rest on some short reply such as "economic recovery".

I should be grateful for your suggestions for a reply. It would be helpful if I could have them in the course of Friday.

M. A. PATTISON

3 June 1981

CONFIDENTIAL

1. Mrs Stephens: I warned you of this yesterday. Can you now make the change in the diary. done cl. 3/6.

2. Mr Lankester To see.

Ecom Pol

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

3 June 1981

C. Whitmore, Esq.,
10, Downing Street
S.W.1.

Dear Clive,

TIMETABLE AND KEY DECISIONS TO CHRISTMAS 1981

As I explained to you yesterday, we have discovered a difficulty in going for 19 October rather than 12 October for the Cabinet's October macro-economic discussion: 19 October is the date of the regular monthly meeting of European Community Finance Ministers, where the Chancellor has to take the chair during the UK Presidency.

Thus we face the choice of moving ECOFIN or finding another date for the Cabinet. I have looked into the former possibility: the prospects of success are doubtful, a tiresome administrative procedure is involved, and the Presidency would be setting a bad example. You suggested, however, that it should be possible to move the Cabinet to the morning of 20 October, prior to the Prime Minister's departure to Mexico in the afternoon, and Robert Armstrong's office have indicated that they see no difficulty about this. I should be grateful, therefore, if we could agree firmly on this minor adjustment to the timetable.

I am copying this letter to Robert Armstrong.

Yours ever

John Wiggins

A.J. WIGGINS

CONFIDENTIAL

1

2 June 1981

Policy Unit

Econ Pol

CF

PA

BF for Cabinet back-up on June 17

12

PRIME MINISTER

CABINET DISCUSSION OF ECONOMIC STRATEGY

I would very much like to attend this Cabinet Meeting if you are agreeable. I have been involved, with Alan, in discussions with Geoffrey and his people on the purpose of the discussion and the Treasury paper which will be circulated for it. I assume that Alan also should be attending.

Are you happy about this?

JH

I think both can sit with you there from our office by the bookcases.

MT.

JOHN HOSKYNS

CONFIDENTIAL

Ew Cl

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

1 June 1981

1. Tx R
to see

2. Fri.

[illegible]
1v.

C Whitmore Esq
Private Secretary
Prime Minister's Office
No.10 Downing Street
LONDON SW1

Dear Clive,

TIMETABLE AND KEY DECISIONS TO CHRISTMAS 1981

The Chancellor has seen your letter to me of 26 May.

The Chancellor is content with this way of proceeding, and in particular that the aim should be for the October macro-economic discussion and specific proposals on public expenditure to be taken in Cabinet on 19th rather than 12 October. This may give some difficulty in preparing the ground properly for the detailed public expenditure discussions to start on 29 October, but the Chancellor thinks that this should be just manageable.

I am sending a copy of this letter to Robert Armstrong.

Yours ever

John Wiggins

A J WIGGINS
Principal Private Secretary

10 DOWNING STREET

Tim.

To see.

Thm.

29/v.

~~BF 27/5~~

10 DOWNING STREET

R

Clive -

to see. I have asked for RTA's comments.

Mr Whitmore R

Caroline: all suggestions noted & David W and I will discuss this week.
CL 20/5

Can you pl run an eye over these dates from the Prime Minister's point of view.

Thanks

IW

CONFIDENTIAL

cc C-O.

file AH

10 DOWNING STREET

From the Principal Private Secretary

26 May 1981

Dear John,

TIMETABLE AND KEY DECISIONS TO CHRISTMAS 1981

The Prime Minister has seen the Chancellor of the Exchequer's minute of 19 May 1981 about the key decisions on public expenditure that have to be taken between now and the end of the year.

She is content that Cabinet should consider on 23 July the Chancellor's preliminary proposals for public expenditure and what preliminary guidance, if any, might be given before the recess to local authorities for 1982-83. The Prime Minister and the Chancellor of the Exchequer will of course have returned from the Economic Summit in Ottawa only the day before this Cabinet meeting, and to ensure that the Prime Minister has had time to prepare herself for the discussion, the papers will have to be circulated in advance of her departure for Ottawa.

As regards meetings in September, the Prime Minister already has appointments for 16 September and she would therefore prefer the meeting of Cabinet to discuss the cash inflation factors and, if possible, the totals for the various local authority services to be on 15 September. If further discussion is needed on 24 September, when the Chancellor will be in New Zealand for the Commonwealth Finance Ministers' meeting, she is content for the Chief Secretary to take the lead for the Treasury.

The Prime Minister agrees that Cabinet should have a further meeting in mid-October both to have another macro-economic discussion and to give consideration to detailed proposals on public expenditure but she sees considerable difficulty in having this discussion on 12 October. She will be away for the Commonwealth Heads of Government meeting from 30 September to 7 October, with the date of her return still uncertain, and the Party Conference starts in the week beginning 12 October. If the Chancellor's papers were to be discussed at a meeting of Cabinet on 12 October, they ought to be circulated no later than the evening of Wednesday 7 October. But this would mean that the Chancellor would have no opportunity to discuss them beforehand with the Prime Minister (and it would not even be possible for him to discuss them provisionally with her before she leaves for Australia, since he is himself in New Zealand and Washington from 21 September to 2 October). Moreover, there

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could be disadvantage in a discussion of economic strategy immediately prior to the Party Conference if it became known that the Cabinet had had such a discussion and leaks and rumours suggested that there was a division of opinion. A Cabinet meeting on 19 October would avoid that problem and give the Prime Minister time to discuss the options with the Chancellor. For those reasons she prefers to go for 19 October rather than 12 October.

The Prime Minister is content that the final round of detailed discussions in Cabinet should start on 29 October and continue thereafter until decisions are reached.

To summarise, the Prime Minister thinks that we should earmark Thursday 23 July, Tuesday 15 September, Monday 19 October and Thursday 29 October plus such dates in November as are necessary for Cabinet meetings on public expenditure.

I am sending a copy of this letter to Robert Armstrong.

Yours ever,

Clive Whitmore

John Wiggins Esq.,
H M Treasury.

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PRIME MINISTER

PAY BRIEF

I attach my Department's pay brief for May. I am sending copies to members of E, E(PSP), and E(EA) Committees, and to Sir Robert Armstrong.

J P

21 May 1981

PAY BRIEF - POSITION IN MID-MAY

MS

SETTLEMENTS

1 Since the April pay brief 100 settlements covering 1,216,000 employees have been reported. For the private sector the weighted average level of settlements over the last month was 9½%. The average in the public sector (10 settlements covering 681,000 employees) was 9%.

2 The cumulative average level of settlements for the whole economy this round is 9%, the same as last month, and appears to be stabilising at about this level.

3 In the private sector the cumulative average is just over 9% (569 settlements covering 3,257,000 employees). In manufacturing, the average level is just over 9%. The average in non-manufacturing is 9%. There is a wide range of settlements (see Appendix 4). About ½ of the settlements are in the 6% to 10% band, with recent settlements tending to be at the upper end of this range.

4 According to the CBI Data Bank survey there has been little change in the general pattern of manufacturing settlements since last October with pay settlements in that sector continuing to average between 8% and 9%.

5 In the public sector the cumulative average is about 9% (51 settlements covering 3,494,000 employees). The average for the trading sector (31 settlements covering 808,000 employees) is 9½% and for the services sector (20 settlements covering 2,686,000 employees) is just over 8½%.

NEGOTIATIONS

6. In the PUBLIC SECTOR, Civil Service non-industrials (1 April - 562,000) have refused a 7% offer and are threatening to escalate industrial action. The possibility of a 5.25% offer either from 1 April, to last for 12 months, or from 1 July for 9 months for Industrial Civil Servants (1 July - 165,800) is being considered. Negotiations continue on behalf of National Health Service nurses and midwives (1 April - 492,000) where an offer of 6% has not been accepted as providing a basis for negotiation. NHS ambulancemen (1 January - 17,000) have been offered 7.75% on rates for 15 months plus an extra day's holiday for some staff - within the 6% pay factor. Next meeting arranged for 2 June.

For NHS electricians and plumbers (1 January - 6,500) the EETPU are recommending acceptance of an offer of 6% which includes partial consolidation of bonus earnings. Talks have begun on a claim by Local Authority non-manuals (1 July - 595,000) for £7 plus 7% (costed by the unions at 13.1%), and a reduction in hours from 37 to 35. Gas Supply staff (1 June - 58,500) have been made an offer of between 7.5% and 9.25%. The claim is for increases in line with inflation (estimated by the unions at 14.8%), extra holidays, shorter hours and other improvements. Unions representing British Rail clerical and conciliation grades (20 April - 150,000) have rejected an offer of 7% and referred their claim for a substantial pay increase to the Railway Staff National Tribunal. The hearing will take place on 8 June. London Transport rail supervisory and conciliation grades (20 April - 15,550) have rejected an offer of 7% - 8% in response to their claim for 12.5%. At British Steel (1 January - 125,000) the proposal to defer a settlement for 6 months with a 7% increase from 1 July has been accepted by the craft and general unions but rejected by ISTC. The issue has been referred to the ISTC conference which starts on 16 June. The national executives of the PO Engineering Union and the Society of PO Executives have agreed to recommend to their annual conferences a settlement with British Telecoms (1 July - 146,000) adding about 9% to the pay bill.

7 In the PRIVATE SECTOR, Trustee Savings Bank staff (21 February - 11,000) have submitted a claim for a 23.5% increase. Building and Civil Engineering employees (28 June - 450,000) have rejected an offer worth about 5%. The employers propose to make an improved 'final' offer at a meeting on 21 May. The claim is for increases over 20%. Unions in the Building and Allied Trades JIC (25 June - 250,000) have been made a 'final' offer of 7.5%. An offer of 10% to Newspaper Publishers Association production workers (1 January - 33,000) is being put to a ballot of members. Union negotiators for Cement Manufacture workers (1 May - 10,800) are recommending a 8.5% offer to their delegate conferences. Textiles - Spinning and Weaving workers (5 May - 40,000) have been offered a 5% increase. The claim is for 15% plus other improvements. Unions on behalf of Chemical Industries Association process workers (1 May - 50,000) are recommending rejection of a 7.3% offer in reply to their claim for about 21% on rates. An offer of 9.6% to Milk Industry workers (3 April - 94,000) is being put to a ballot without a recommendation.

PRICES AND EARNINGS INDICES

PRICES

8 In March the year on year increase in retail prices was 12.6% compared with 12.5% in February.

EARNINGS

9 For March the year on year increase in average earnings for the whole economy was 14.4% compared with 16.5% in February. Excluding temporary factors the March figure was about 15%. For the fifth successive month the underlying monthly average rate of change has been about ¾%.

REAL DISPOSABLE INCOME

10 The real disposable income of a typical family (described in the mid-September pay brief) rose by about 3% in the year to February. The figures for January, delayed by industrial action by DE computer staff, showed a rise of 3¾% due mainly to the drop in the retail prices index.

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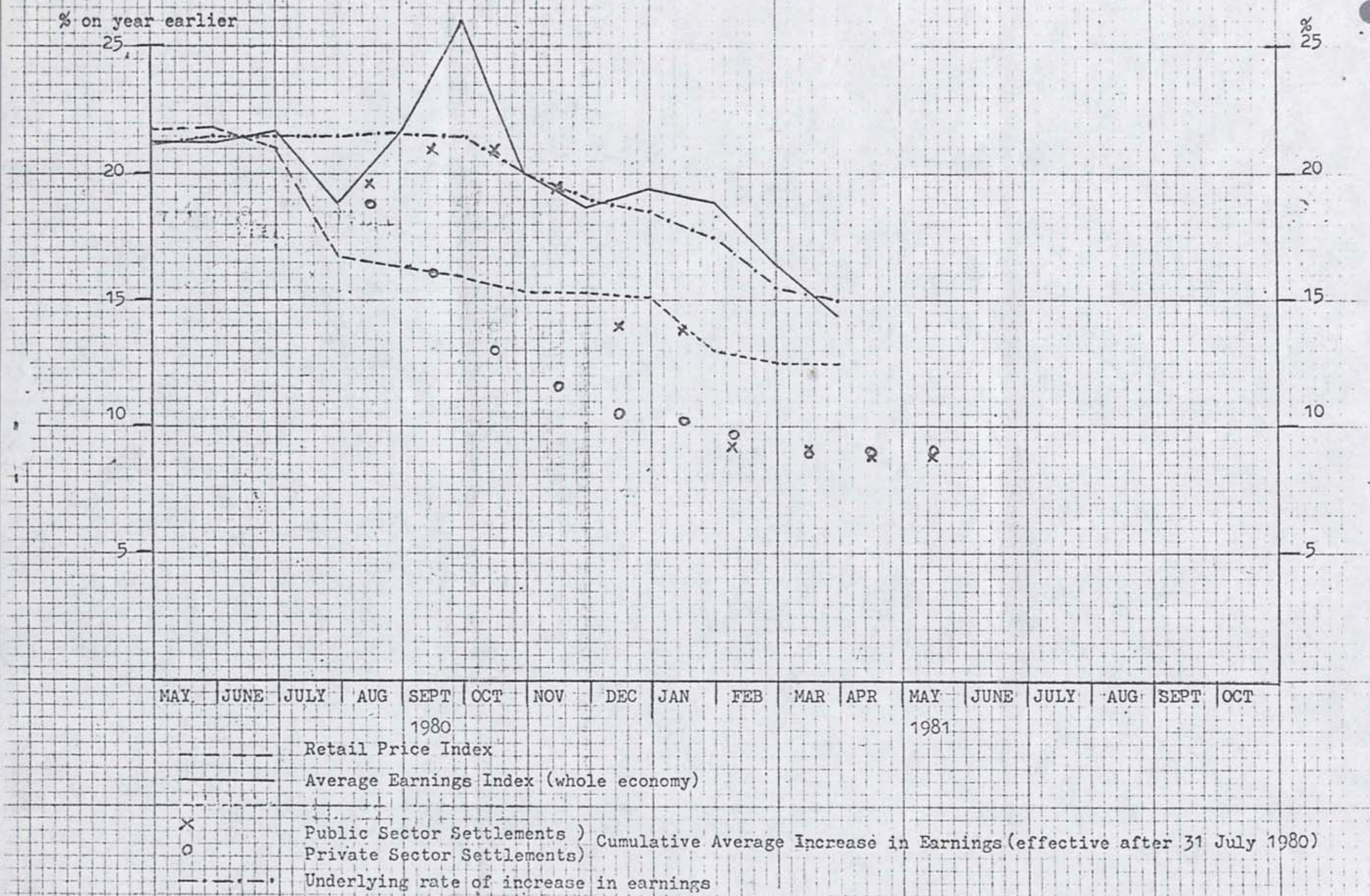
APPENDIX 1

TRENDS IN EARNINGS AND PRICES



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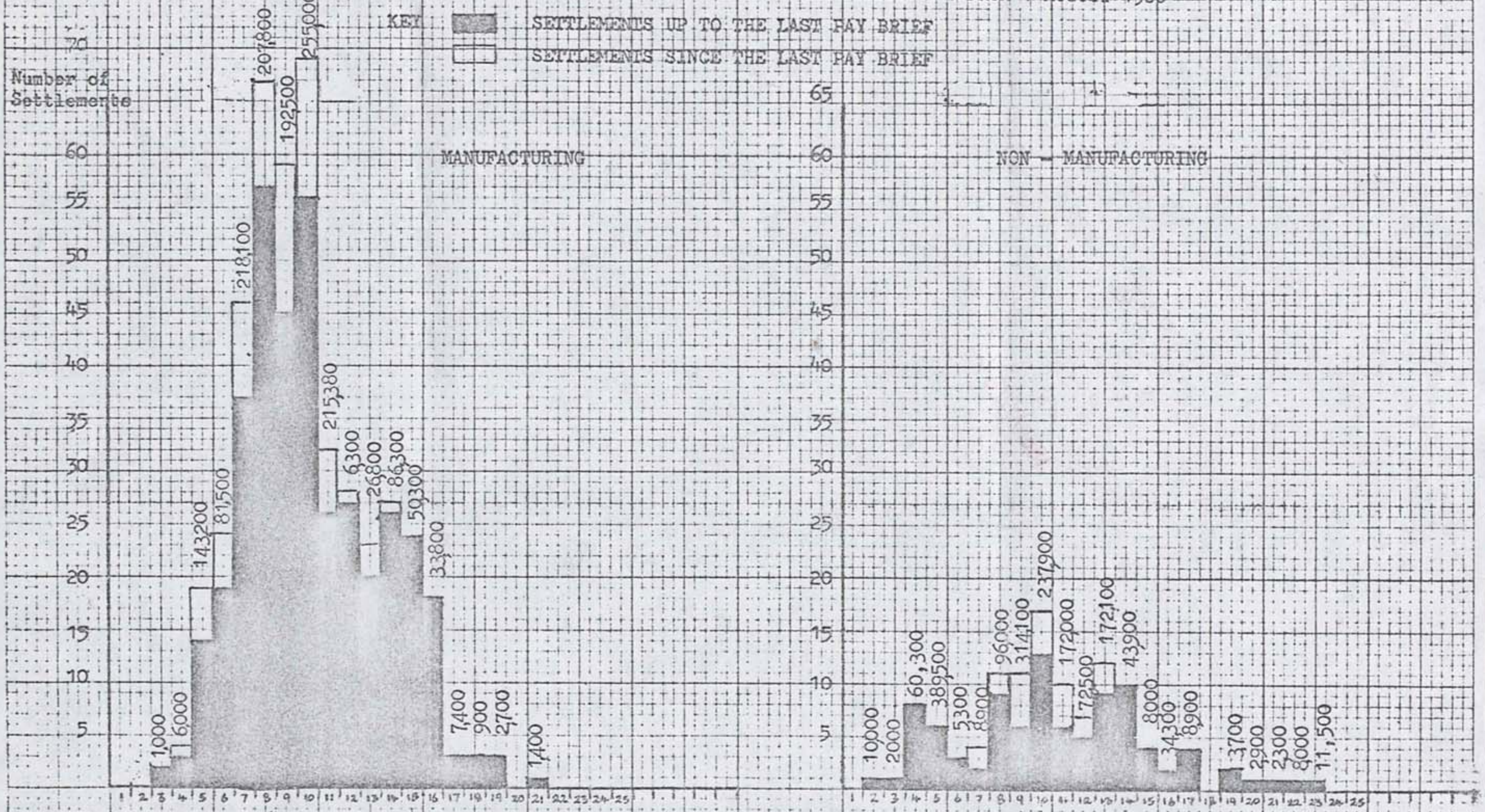
APPENDIX 2

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1980



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

NOTE - THE NUMBERS OF WORKERS (ROUNDED TO THE NEAREST NUMBER) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

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1.

Prime Minister.

Agree provisionally to Cabinet meetings on:-

✓ Thursday 23 July

✓ Tuesday 15 September

✓ Monday 19 October

to discuss public expenditure? The later dates (29 October et seq) follow naturally.

Yes mt

[initials] 22.v.81

Ref: A04959

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MR. WHITMORE

Public Expenditure Timetable to Christmas 1981

The Chancellor of the Exchequer has set out, in his minute of 19th May to the Prime Minister, his proposals for the timetable of the Cabinet's discussions between now and the end of the year of macro-economic policy and of public expenditure. I agree with the Chancellor that it is sensible to establish a provisional timetable now; when the Prime Minister has reached decisions on it, we will make sure that Cabinet Ministers' Private Offices know the dates proposed so that Ministers can then plan their engagements accordingly.

attached.

2. Your minute of 20th May, records the Prime Minister's agreement that the discussion of macro-economic policy should be on 18th June.

3. I see no difficulty in principle in earmarking 23rd July for discussion of the Chancellor's preliminary proposals for public expenditure and the preliminary guidance, if any, which might be given before the Recess to local authorities for 1982-83. But the Prime Minister will only have returned from the Economic Summit in Ottawa on 22nd July. To ensure adequate briefing, the papers would have to circulate in advance of her departure for Ottawa.

4. The Chancellor is chairing a meeting of European Finance Ministers on Thursday, 17th September. He asks, therefore, whether Cabinet could meet on either 15th or 16th September to discuss the cash inflation factors which have been provisionally incorporated into the arithmetic and, if possible, the totals for the various local authority services. The objection to these dates is, of course, that you have already circularised Private Secretaries about the Prime Minister's wishes for Cabinets in the Recess and suggested that there might be a meeting on 17th September. The Prime Minister's programme also contains appointments for 16th September. Given the Chancellor's absence on 17th September, I should think we had better bring

 You are free, Content?

forward the date of Cabinet that week to Tuesday, 15th September. The Chancellor proposes that, if necessary, there should be further discussion on Thursday, 24th September, when he will be in New Zealand for the Commonwealth Finance Ministers' meeting but the Chief Secretary will be present.

Content?
Yes [illegible]

5. The main difficulty lies in the meeting proposed for mid-October, when the Chancellor wishes to combine a further review of economic policy with his detailed proposals for public expenditure plans. As he explains in his paragraph 6, a meeting at about this time is necessary if the Cabinet is to settle public expenditure plans by around the middle of November, as is highly desirable though not essential. The possibilities are, however, constrained by the Prime Minister's absence in Melbourne for the Commonwealth Prime Ministers' Meeting from 30th September to 7th October, with the time of her return still uncertain; the Party Conference in the week beginning 12th October; and the departure of the Prime Minister and of the Chancellor on Tuesday, 20th October for the Heads of Government's Conference in Mexico ending on 24th October.

6. The Chancellor suggests that the choice lies between a meeting on Monday, 12th October and one on 19th October. He recommends 12th October on the ground that otherwise the overall timetable will slip. The Prime Minister will wish to consider carefully whether 19th October would be better. If the papers are to be discussed on 12th October they ought to be circulated no later than the evening of Wednesday 7th October; so the Chancellor would have no opportunity to discuss them beforehand with the Prime Minister (it would not even be possible for him to discuss them provisionally before Melbourne, since he is in New Zealand and Washington from 21st September to 2nd October). Moreover, as I suggested in my minute of 10th April to Mr. Lankester, there could be disadvantage in a discussion of economic strategy immediately prior to the Conference if it became known that the Cabinet had had such a discussion and leaks and rumours suggested division of opinion. Discussion on 19th October would avoid that problem and give the

19 October seems the better date. Agree?

Prime Minister time to discuss the options with the Chancellor. The other possibility of deferring this stage of the discussions until Thursday, 29th October would carry the disadvantage of letting the timetable slip by two or three weeks.

7. I am not aware of any difficulties in the proposal that Cabinet should discuss public expenditure on 29th October and at their meetings in November until such time as decisions are reached.

RtA

Robert Armstrong

21st May 1981

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HS

SIR ROBERT ARMSTRONG

I have shown the Prime Minister your minute A04931 of 18 May 1981 about the economic discussion which Cabinet is to have in June, and she agrees with the proposals in paragraph 6.

CLIVE WHITMORE

CS

20 May 1981

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Econ Pol Strategy

TL o/R

MR ~~LANKESTER~~

Bank - my folder pls.

THE CITY UNIVERSITY

Northampton Square London EC1V 0HB
telephone: 01-253 4399 telex: 263896

Centre for Banking and International Finance
Director Professor Brian Griffiths

10.15 mtg

19 May 1981

TL

The Rt. Hon. Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

Dear Prime Minister,

It has been several months since either of us have spoken to you. We have followed the progress of your policies with great interest however, and we continue to admire your courage in maintaining a firm stand in the face of opposition from many quarters.

Some of the progress we expected is now evident to all. Inflation has fallen markedly. Interest rates have been reduced. Private sector productivity has increased substantially. Industrial production shows signs of sustained recovery. Like yourself, we believe these achievements must become permanent.

In our conversation with responsible officials in the Civil Service and the Bank of England, we sense a decline in enthusiasm for implementing the medium-term strategy. The hard choices are not being made in budget policy, monetary policy or regulatory policies affecting productivity. We do not believe that your medium-term strategy will succeed unless there are some new major initiatives affecting the conduct of monetary and budget policies and also the 'supply' side of the economy. At this stage, we believe the problems are primarily political and not economic.

We see no evidence that senior officials of the Bank of England are firmly committed to the support of your policies. They remain hesitant and seem reluctant to introduce those procedural changes which, in our judgement, are necessary to prevent a resurgence of inflation.

We are convinced by experience here and abroad that resolution of these problems cannot be achieved until the management of the Bank of England includes persons committed to implementing your policies. To us, this means more than acceptance of your goals. It means a willingness to take those measures that are required to achieve the goals. We are particularly sceptical that periodic pressure from the Treasury, or from your own close advisers, will be sufficient to avoid a new surge of inflation.

The risks are particularly high now that a recovery is underway. Traditional Bank of England policies cause money growth to rise much too fast during periods of recovery. There is, at present, a very high probability that these traditional mistakes will be repeated. If so, fears of inflation will rise leading to high interest rates, a weak pound and more inflation in 1983-84.

We applaud the present initiative to cut public spending in 1982-83 by 5-7% as an indication of the importance you place on controlling the size of the public sector. We believe that controlling the size of the public sector is far more important for economic growth and the revitalization of the economy than temporary changes in the size of the PSBR or tax reduction without reduction in expenditure. Tax cuts without expenditure cuts have little lasting value.

If the proposed expenditure cuts are made, they will provide room for a further major reduction in personal income taxes and corporation taxes before 1983-84. Tax and spending reduction are the principal means by which your government can encourage the increased saving and investment essential to your medium-term strategy.

Here too, the main problems are political. The more discussion of expenditure cuts can be conducted outside the committees organized by senior Civil Servants, the greater is the chance of success.

We share your goals, are delighted at the progress that has been made and wish you every success for the future. We fear, however, that commitment to your programme has waned, and we wanted to share our concern with you.

Yours sincerely

Allan Meltzer

Brian Griffiths

Professor Allan Meltzer
John M. Olin Professor of
Economics and Public Policy
Carnegie-Mellon University
Pittsburgh
USA

Professor Brian Griffiths
Director of the Centre for Banking
and International Finance
The City University
London

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

PRIME MINISTER

TIMETABLE AND KEY DECISIONS TO CHRISTMAS 1981

I have been giving thought as to how best we might secure the necessary decisons that have to be taken this autumn in the public expenditure context, having regard to the various constraints such as our absences abroad. This minute sets out my proposals for your consideration.

2. The run-up prior to the holidays is comparatively simple. We have arranged for a macroeconomic discussion, probably on 18 June, which will be very important but at which no substantive decisions will be sought. More specifically on public expenditure, I suggest that on 23 July we consider my preliminary proposals as to what we might aim for in the Public Expenditure Survey, and what preliminary guidance, if any, might then be given to local authorities for 1982-83.

3. From September onwards the timetable gets more difficult. I proposed that on September 15 or 16 we discuss the cash inflation factors - that is, review our decision as to the 7 per cent, 6 per cent and 5 per cent which we took last week. I shall be chairing a European Finance Ministers meeting on 17 September, and I shall then be away from 21 September to 2 October at the Commonwealth Finance Ministers meeting in New Zealand and the IMF in Washington. But we need to settle this aspect of expenditure early, so we can start the expenditure discussions on a firm basis.

4. Last week Cabinet decided that decisions on local authority expenditure for 1982-83 should be taken in good time for the Rate Support Grant (RSG) settlement to be announced in November. This means that decisions on local authority expenditure for 1982-83, in terms of the totals to be spent on various services, must be taken in September. The need for some bilateral discussions with Spending Ministers after they return from leave, as the basis for final proposals to Cabinet, rules out Cabinet discussions before 15 or 16 September, although even this date will not be easy. Nevertheless I suggest we aim for it, recognising that we may end up with the 24 September. I shall be away on that date, as I say, but the Chief Secretary will be present.

5. We cannot manage in September in addition to start on the main round of public expenditure discussions which will deal with all expenditure programmes (including local authority programmes for the years after 1982-83). You and I will both be away on 1 October. I suggest therefore that Cabinet should in early/middle October have another macroeconomic discussion and give consideration to detailed proposals on public expenditure which the Chief Secretary and I will circulate. The ideal date for this would be 8 October, but you may not be back from Melbourne by then. Having regard to the Party Conference starting the following week and our departure for Mexico on 21 October, this means having this discussion on either Monday 12 October or Monday 19 October.

6. Of these two I would prefer the 12 October. The reason for this lies in the need to settle public expenditure plans by around the middle of November. This is not an absolute (eg statutory) deadline, but a variety of factors combine to make it very important - the need to have nationalised industries EFLs published in mid-November, the need (if we are to have a better chance of making reductions stick) to give programme managers as early a warning as possible of

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changes from the Cmnd 8175 figures, and the desirability that any immediate public expenditure announcements which may be thought necessary should be compatible with and reflect the Industry Act forecast we shall be publishing. Given the scale of reductions we may be seeking, and the novelty of the cash planning basis, we can expect discussions to be even more difficult than previously. Working backwards from mid-November, we cannot risk the final round of detailed discussions in Cabinet starting later than 29 October. And allowing for the bilateral discussions that must take place between Treasury Ministers and spending Ministers before that, we have to go for 12 October for a first look at our detailed proposals. I recognise that having regard to our absences abroad the 19th would be more convenient eg from the point of view of considering our proposals before they are generally circulated to colleagues. But I think that this date would put the already very tight timetable at serious risk.

..... 7. The attached sheet sets out my proposals in summary form. I hope you are able to agree to it.

8. I am copying this to Sir Robert Armstrong.

(G.H.)
19 May 1981

PUBLIC EXPENDITURE DECISIONS JUNE/NOVEMBER 1981

Timetable of Cabinet discussions

Cabinet on	To discuss	Remarks
June 18 (probably) (Thursday)	Macroeconomic Review	
July 23 (Thursday)	Direction and broad scale of action on public expenditure for 1982-83 onwards. Preliminary guidance to local authorities for 1982-83, if any.	
September 15 or 16 (Tuesday and Wednesday)	Review of inflation allowances. If possible final decisions on local authority expenditure for 1982-83 by totals for services.	Ch/Ex chairs ECOFIN on September 17. Preliminary bilaterals need to be complete. Problem of Ministers availability in early September.
September 24 (if necessary) (Thursday)	If not on September 15/16, final decisions on local authority expenditure for 1982-83.	Ch/Ex not available, CST to lead for Treasury. Latest date if RSG to be announced in November.
October 12 (Monday)	Macroeconomic Review. Specific public expenditure proposals by Treasury Ministers.	Party Conference starts at Blackpool on Tuesday. Latest date if plans to be discussed on October 29.
October 29 (Thursday)	Settle public expenditure plans in detail for 1982-83 and onwards in light of bilaterals following October 12 meeting.	Latest date if final decisions to be taken by November 12.
November 5 and/or November 12 (Thursdays)	Continuation of October 29 as necessary.	Final decisions needed by November 12 to permit publication by mid or late November on nationalised industry EFL's and other programme changes as necessary, so that these do not appear after the Industry Act forecast and report of the Government Actuary.
November 12 or 19 (Thursdays)	Final decision on RSG	

Note. If the discussions suggested above for October 12 move to October 19, later dates (except RSG decisions) are likely all to move by one week.

2

Prime Minister.

Agree the proposals in paragraph 6 below?

Yes

Ref. A04931

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MR WHITMORE

The Prime Minister told her Cabinet colleagues last month that she was proposing to arrange an economic discussion, in the context of this year's public expenditure survey, in the first half of June.

2. I have been considering when this could best be arranged. When we spoke about the matter, the Prime Minister agreed that we should not have a special meeting of the Cabinet for this purpose, but that it should be arranged in the course of one of the regular Thursday meetings. On the first Thursday in June, 4 June, the Secretary of State for Industry will be away, on a visit to the United States. The Prime Minister made it clear that she did not want to have the discussion at a time when he had to be absent. On Thursday, 11 June, the Secretary of State for Trade will be in Sweden and the Foreign and Commonwealth Secretary will be in Cambridge receiving an honorary degree. Preliminary soundings which we have taken make it clear that the Foreign and Commonwealth Secretary could not without considerable embarrassment cancel his visit to Cambridge to receive an honorary degree, and also that he attaches great importance to being present when the Cabinet has this economic discussion. On 18 June there is a meeting of Council of Ministers (Transport) of the European Community to which Mr Fowler should be going: he can, however, arrange to be represented at that meeting. There is what is described as a faint possibility that the Lord Chancellor will have an overseas engagement; it is thought, however, that if he knew well in advance he could arrange to be present for the Cabinet. The Lord Privy Seal will be on a visit to the United States.

3. All things considered it seems to me that the right course is to have the economic discussion on Thursday, 18 June. I have discussed this with Sir Douglas Wass; he would welcome (for Treasury reasons) deferment until that date, though he would not want the discussion postponed beyond then.

4. I understand that the Chancellor of the Exchequer will circulate a paper (or papers) for the meeting; one of these papers will be a discussion on recent economic developments with some indication of the forecasts for the future.

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5. It will be for question whether there should be any officials in attendance for this discussion. As you know, the normal rule is that officials are not invited to attend the meetings of the Cabinet; and I would not regard the attendance of Mr Burns and Mr Ibbs at the special meeting at Chequers last year as a precedent when we are talking about an ordinary meeting of the Cabinet. Nevertheless, I should be inclined to say that, if the Chancellor of the Exchequer wishes to be supported by Mr Burns, for this item only, the Prime Minister might agree to that. I should be inclined to suggest that we should not invite either Sir Douglas Wass or Mr Ibbs to attend in addition to Mr Burns.

6. I should be glad to know whether the Prime Minister agrees:

(i) that the economic discussion should be included on the Cabinet agenda for 18 June;

(ii) that the Chancellor of the Exchequer should be told that, if he would like to be accompanied by Mr Burns, that will be in order, but it is not proposed to invite other officials (Sir Douglas Wass or Mr Ibbs) to attend.

RtA

ROBERT ARMSTRONG

18 May 1981

CF. white

10 DOWNING STREET

PRIME MINISTER

Peter Tapsell writes about priorities in economic policy for the remainder of this Parliament. He seeks no acknowledgement, but I am asking Alan Walters to suggest a short response for you to send.

MAP

15 May 1981

From: Peter Tapsell, MP.

cc: 1. Gow ✓ 15/5

Confidential

HOUSE OF COMMONS
LONDON SW1A OAA

The Rt. Hon. Margaret Thatcher, MP,
10, Downing Street,
London, S.W.1.

13th May, 1981

Dear Prime Minister,

I had breakfast yesterday with Dr. Arthur Burns. Whenever I have an interesting conversation about economics, I Minute it to my senior business partners and I thought you might be interested to see a copy of the Minute I sent them on Dr. Burns' answers to my questions. Although his next engagement was with the Chancellor, I imagine that his natural courtesy and the, no doubt, different slant to their conversation would have emphasised different aspects of Dr. Burns' thinking.

It would appear that Reaganite policies are very similar to those which I have urged in my speeches when in Opposition and for the past two years (other than their reliance on excessively high interest rates which, if continued for any length of time, will wreck their programme also). I suspect that the Reaganite "sequence" was what you really had in mind but that it was thrown out of gear by the 1979 Budget and the failure of your Cabinet to achieve real cuts in current public expenditure during the early months of your Administration.

Like Mark Twain, I would not choose to start here - and we would not be "here" if any attention had been paid to my advice. If, however, this Parliament is not to be remembered simply as the hand-maiden to a neo-Marxist society, the most tremendous effort has got to be made now to get things into better shape and to reverse the rising trend of unemployment by mid-1982. That is why I have been making speeches about the economic situation with an increasing sense of urgency.

I have never suggested "printing money" as a solution to our problems (and was, in January 1973, along only with John Biffen and Jock Bruce-Gardyne, among the first Tory M.P's to draw public attention to this danger).

However, I am convinced that Dr. Burns' description of the Reaganite policy, of giving top priority to encouraging real investment by business and industry through a dramatic reduction in their tax burdens, is the right approach. We have increased their tax burdens, particularly when one takes Rates and National Insurance into account.

As I repeatedly said in my speeches when we were in Opposition, an expansion of business profits must be the first objective. These have been tremendously squeezed by our policies so far. The likely increase in profits from exceptionally low levels towards the end of this year (first publicly predicted, incidentally, by my commercial firm) will be transient, due to special factors, and not of a kind or on a scale calculated to stimulate real investment in the economic climate that will then prevail.

In this context, the special levy on bank profits is profoundly unwise, both economically and psychologically.

I enclose a copy of a Lecture I gave last February in which I expand on some of these thoughts.

I am sorry to burden you with this, but there really is not much point in being in public life if one does not try to make a contribution to the main issue of the day.

Please do not trouble to acknowledge this.

Yours Sincerely,

Peter Tapsell

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A.B. to P.T: 12th May, 1981

(1) Tension between Central Banks and Governments tends to be endemic in any advanced economy, but the present degree of tension between the U.S.Federal Reserve Board and the Reagan Administration is exceptional in degree and intensity both personally and theologically.

(2) For the first time in its history, the Fed is under attack from "the Right" and not from "the Left".

(3) This is due to a fundamental difference of view between monetarists (everywhere) and Central Bankers (everywhere) about (a) the duties of a Central Bank and (b) the practicality of controlling the monetary aggregates.

(4) Monetarists (necessarily) believe that the sole function of a Central Bank is to control the money supply. Other matters (e.g. interest rates, exchange rates, etc) should be wholly left to Governments or to "the market." Central Bankers (including the Fed) reject this view as simplistic, impractical, and unhistoric. They take the view that there is a complex inter-relation of factors (including the money supply), which influence each other, all of which must necessarily and properly be of concern to a Central Bank.

(5) Most (although not all) of the monetarists in the Reagan Administration are angry that U.S.interest rates have risen to such high levels. They blame this on the Fed's failure to control MIB in recent weeks.

(6) Every experienced Central Banker in the world will tell you that it is impossible to control the monetary aggregates "short-term" (i.e. under a six-month period). It is difficult even to measure them. Over a period of more than six months a Central Bank would hope to be able to influence the rate of growth of the money supply very considerably. Monetarists (e.g. the Reagan Administration), who call for precise short-term control of the money supply (as evidenced by the monthly indices) are asking for the impossible. Political policies based on such short-term expectations will only succeed by chance. Hence the great volatility of U.S. interest rates, largely caused by past monetarist "brain-washing" of the markets about the significance of the short-term indices.

(7) "Monetarism"might very well have worked in the 1960's, when the modern theories associated with that school of thought were evolved, but,because most monetarists are academics, they do not appreciate the technological revolution which has occurred in money markets in the past ten years. New "forms" of "money" are being created almost weekly (Central Bankers spend much time discussing whether a particular new instrument should be classified as "money" or not). Hence the repeated failures of the indices (MIB in U.S; Sterling M3 in U.K, etc), to measure changes in the money supply over the short-term with any degree of accuracy,and of the Central Banks to control them. In this sense, "monetarism" is a conservative, static and increasingly impractical theory about a dynamic,expansionist and increasingly innovative technology.

(8) Almost all the"experts" in U.S., whatever their economic standpoint, view the monetarist experiment in the U.K. as having been a failure so far.

(9) Nevertheless, many of them still have high hopes that they can avoid the British mistakes and that the Reaganite economic policies can be made to work. Although "the Right" in both U.S. and U.K. use the same political rhetoric about their economic policies, the Reaganites intend their policies fundamentally to differ from those of the U.K. in the following four vital respects (among others):

(10) <u>First difference</u>: Top priority will be given to reducing <u>current</u> public expenditure at once.

(11) <u>Second difference</u>: The otherwise deflationary effect of reducing current public expenditure will be off-set by real cuts in the overall burden of taxation. (From the U.S. it looks as though U.K. taxation has been restructured but not reduced).

(12) <u>Third difference</u>: The cuts in public expenditure will <u>precede</u> the cuts in taxation. The taxation reductions are aimed to be very modest in Year One but growing steadily in size in each fiscal year Two - Five.

(13) <u>Fourth difference</u>: Cuts in taxation will be concentrated on the <u>business</u> sector and not on the private individual. The over-riding aim is to increase business profits and so investment and thus

employment and demand (instead of the reverse policy sequence so often attempted in the past).

(14) It is hoped that the increase in business profits, investment and activity in U.S.A. resulting from the tax cuts will offset the loss in overall revenue to the U.S.Treasury resulting from the reductions in taxation of businesses.

(15) It is clear that these fiscal policies cannot hope to succeed (and then will be reversed by a successor Administration) unless they continue to enjoy public support.

(16) This primarily depends upon them not producing a large increase in unemployment (as the French Presidential election has demonstrated). It is hoped that the Reaganite economic programme will positively reduce unemployment levels at a fairly early stage of its implementation.

13th May, 1981. P.H.B.T.

Release Time: 13.00 hours
Tuesday, 24th February, 1981.

Mr. Peter Tapsell, Conservative M.P. for Horncastle (Lincs), lecturing to The Economists Society at The City University, Northampton Square, E.C.1. on Tuesday 24th February 1981, said:

Title of Lecture:

"British Economic Policy: what changes are needed?"

Few speech-writers have made a greater economic impact with a single sentence than Mr. Peter Jay. Ever since he inserted that phrase, in his father-in-law's speech to a Labour Party Conference, it has been the accepted wisdom, across a wide spectrum of political thought, that we cannot spend our way out of either inflation or slump. Yet even so brilliant a man as Mr. Peter Jay cannot be expected to encapsulate all economic truth in a single statement. The need to distinguish between "cost push" inflation and "demand-pull" inflation remains, as Mr. Peter Jay's own distinguished father never tires of reminding the House of Commons.

The inflation from which we have been suffering has clearly been of the "cost-push" variety, the original push coming from the rise in the international price of oil, but gathering many "fellow-pushers" along the way. It has increasingly seemed to me, however, that many of the measures, other than the vital curbing of the free-for-all wages scramble, which have been taken to combat inflation have been directed at the "demand-pull" variety. Some of these have naturally proved counter-productive.

You may not be able to spend your way out of deflation but you can only expand your way out of inflation, as the trend of the cost of living index in 1982 is likely to prove.

There are also considerable political difficulties about perpetually cutting public expenditure in a declining economy, as the most puritan members of, for example, the Lincolnshire County Council would, I think, be ready to testify.

We are far more likely to achieve a lastingly stable currency in a situation of rising productivity and falling unit-costs than in one of falling productivity and rising unit-costs. It was this latter situation which prompted the Bank of England recently to draw attention to the unprecedented decline of our competitive position in the world during 1980.

The remarkable buoyancy of our exports, the surplus on our balance of payments and the strength of our exchange rate may seem to belie that reality today, but we would be foolish to ignore the danger-signals. In economics, there seems to be a time-lag of about two years between cause and effect. Little that we do in this field now will have much effect before 1983, or even 1984. The ominous decline in our imports of raw materials, the continued fall in real investment in manufacturing, the remorseless squeeze on the profit margins of almost all businesses, great and small, both industrial and agricultural, outside the financial sector, must be arrested quickly, if our national situation in 1984 is not indeed to become Orwellian.

We can, in this small island, with our, at present, open trading system, only hope to control limited aspects of the inflationary forces at work in our economy. Of these, as I have stressed continually in speeches since 1969, the most important - and infinitely the most important - is wages. Yet it is perhaps still controversial to say, as I do, that wages are an even more important factor in inflation than public expenditure.

I very much welcome the move away from an excessive preoccupation with misleading, unreliable and largely uncontrollable money statistics, back towards a concentration on the real world of investment, profits, jobs and wages. These are what ultimately determine the level of prices. To that extent, monetarism is very definitely not enough; surely we can now all agree upon that?

I have never questioned that the money supply has an important role to play, whether it be sterling M3 recording excessive expansion, or retail M1 indicating an unduly rigorous restraint. My own guess - it cannot be more - is that M1 has been nearer to the truth and that much of the "breast-beating" in the technical financial press about the"missing of monetary targets"has been greatly over-done, providing an irritating diversion by academic theorists, in and out of Government, from the problems of the real world, now crowding in upon us.

In any case, whatever the truth about"the money supply", everyone practically engaged in industry and agriculture knows that there has, in reality, been a tightness in the conditions in which money can be borrowed. If it had been any tighter, our general national situation would today have been worse. Whether it be by luck or good judgement, it may be that monetary control has turned out about right for 1980, although too tight for the corporate sector.

Certainly, no one can fairly accuse the authorities of pursuing their policies with an excessive dogmatism. On the contrary, there has been a spirited lack of consistency to them which fully deserves the accolade "pragmatic".

Just as the money supply has an important place in the economic scheme of things, so has public expenditure. But as with the money supply, so with public expenditure you have first to define what you mean by public expenditure; secondly to differentiate between different types of public expenditure; and, thirdly, to be sure that you are able to control each type separately, if it is to be a helpful economic tool.

The first differentiation has to be between capital and current expenditure. Capital expenditure -"the seed corn"- has, as far as possible to be maintained, particularly in a slump, while current expenditure should be cut when new wealth-production is falling. So far, the approach to public expenditure has tended to be the other way round. I hope that the Budget on 10th March will start to put that right.

Secondly, we must avoid an oversimplification, in a mixed economy, of the differentiation between expenditure in the public and private sectors. Some forms of expenditure in the public sector - on defence, on telecommunications, on roads and railways, on housing for example - can be very helpful to the private sectors of industry and business. Far from "crowding out" the private sector, such expenditure - judiciously chosen - can infuse vitally needed life-blood into the private sector and into the whole free-enterprise system.

"Supply" economists should not disregard"demand". The underutilisation of our equipment and manpower surely demonstrates that there is an imbalance in the economy which needs to be remedied - an imbalance between the public and the private sectors certainly; an imbalance between the personal and the business sectors also; but, above all, an imbalance between supply and demand overall. Because of the international dimension of the inflationary problem - our domestic prices situation is far better than the misleading year-on-year statistics suggest - that imbalance can only be restored by expansion in certain sectors under our national control, top priority being given to high technology and high value-added industries, where possible.

A good deal of over-simplified nonsense is talked about the PSBR. This figure - another unreliable statistic with a recognised forecasting error of some billions of pounds either way - should not, anyhow,be discussed in isolation. It has to be put in the context of the stage of the economic cycle, the volume of personal savings, the movements of funds across the exchanges, the balance of payments and the likely trend of bank lending to the business and personal sectors of the economy. If,as now, all those tend to be counter-balancing forces, an attempt to suppress a rising PSBR during a period of deep recession can be positively undesirable. Those who clamour in a generalised way for cuts in the PSBR should give more thought to its likely practical effect on investment demand.

What is most urgently needed now is a clearly defined industrial strategy combined with lower interest rates and a lower exchange rate. Let me at once try to counter three of the parrot-cries which that statement always provokes from those who prefer to think in slogans.

First, there is the argument that we cannot "spend our way out" of the increasingly vicious downward economic spiral into which we have become trapped. This is only partially true. It is no more, and no less, true than to say that we could "under-spend our way" into a ruinous slump. There is always a balance to be struck in these matters. It is often a most difficult judgement where that balance is correctly to be found. The point of balance will constantly change as the situation develops. That is what politicians are for.

The desirability or undesirability of expenditure largely depends on the form it takes. Why should the Devil have all the best tunes? Why - deliberately to take the most extreme example of modern history - was Hitler able to expand the German economy out of a much worse economic and social background in the three years after 1933, and before he had crossed a foreign frontier, without provoking a return of ruinous inflation? Few historical analogies are ever remotely exact, but these are questions which deserve study. Are we so sure that we cannot find a decent and peace-loving method of economic expansion within our own fine national traditions - the more particularly since the threatening international situation urgently calls for a massive rearmament programme? Indeed, that is one of the points which President Reagan will be making to Mrs. Thatcher in Washington.

Secondly, it will be said that it is difficult for Governments and Civil Servants to "pick winners". I accept that. It is difficult. But surely it is preferable to have a declared industrial policy which tries to pick winners, rather than an undeclared one which, in practice, concentrates almost exclusively on backing known losers? By having no industrial policy we get the worst of both worlds. Public expenditure is not controlled but it is spent - in huge amounts - in the wrong areas. The political pressures which bring this about, in piece-meal fashion, would be easier to resist if there was a positive alternative industrial strategy, attracting as it soon would the support of the vested interests of Unions and of management and of the City.

Thirdly, it will be argued by some self-styled "monetarists" or "free-marketeers" that all this is too "interventionist" by half. I would remind them - disregarding Japan if it is argued that our traditions are so different - that the Barre Plan for France, which originally attracted them as much as the Joseph Plan for Britain once attracted the Reaganites, has always had a strongly "interventionist" side to it - and M.Barre and his closest advisers will tell you that it was the most important aspect of his Plan. Massive French Governmental support - financial, fiscal, technical, and in terms of key personnel - has been put behind carefully selected sectors of French economic activity, judged by that very entrepreneurial Government to hold the key to future French prosperity: for example, Biomass, Micro-chip, Computers, Atomic Energy and Food Production.

There will be a massive upsurge in the tax revenues from our North Sea oil between now and 1984. The big increase is still to come. It may go up from around £4 Billion this year to £15 Billion by 1984. It would be unforgivable if this extra national income were to be mainly spent on uneconomic wages in the nationalised industries, on unemployment benefit to those thrown out of work in private enterprise business and on imports of luxury foreign consumer goods,and food,which we ought to be producing here in Britain.

The oil revenues - not vast in relation to our G.D.P. but still a significant bonus - ought mainly to be spent to reduce the national debt, to lower taxation, to modernise the infrastructure of our economy, and to equip the growth industries of this country to compete internationally. Only a Government can ensure that such things happen, as the Germans, the French and the Japanese well understand. The belief that the "free market", left to itself, will achieve these ends is sheer mysticism. Nothing makes a Pension Fund manager pale so quickly as the mere mention of the words "Research and Development" - yet it is to "R and D" that the Japanese"beehive"of Government/Industry/Banks gives the highest priority.

As my last example, I will quote food production - because I represent an agricultural constituency in Parliament and because I think it generally illuminates my argument. The French Government is pouring large sums of their taxpayers money into their agriculture with the declared aim of turning France into the larder for Europe. Here, in Britain, farm incomes in the past year have fallen in real terms by 24%. Our agricultural production is declining,while its costs are rising. Investment is drying up. Hardly anyone in Lincolnshire will be buying a new farm tractor this year, or any other expensive piece of agricultural equipment,if they can avoid doing so. Yet Agriculture is Britain's largest and most efficient industry. Our land is among the best in the world. Our productivity has steadily risen over many years. Our capital investment per acre and per worker is exceptionally high. Labour relations on the farms are excellent. The tax climate is already favourable. Pension Fund managers regard this industry with a kindly eye. The food is wanted and needed. The scope for import substitution is still huge. Why then are we allowing our international competitive position in Agriculture to be weakened by the more activist support given to their farmers by the French Government, in the form of free grants and cheap credit and obstruction of imports?

Our comparative inertia in this, as in so many other spheres, is disguised under a variety of foreign-sounding pseudonyms - "Communataire", "Internationalist", "Monetarist", "Laisser Faire", and so on. Whatever guise the excuse takes, the practical result is that we fight our own national corner less fiercely and less effectively than most of our overseas rivals.

This applies right across the board. I recently asked a foreign car manufactuer how it was that his not very efficient country was so little penetrated by Japanese motorcars? "Because", he said, "we make the documentation as difficult as possible for them". Here in Britain, by contrast, we are like the woman in the hayfield who lay on her back and shouted "Rape, Rape, Rape" all summer long. The City of London, our overseas trading companies, our advertising industry, our retail network, our political philosophers, our economic pundits and public taste all encourage the maximum possible import penetration of our markets. We must be the first modern economy in the world deliberately to "export employment"to our overseas competitors, and,if we are not careful,huge amounts of our capital will soon follow it,stimulated by the prospect of a falling exchange rate and a near-Marxist Labour Government.

To avoid these and other horrors, we must have a British Industrial Strategy to which our tax policies, our fiscal policies, our energy pricing policies, our interest rate structures, our exchange rate and our "guidance" to the Banks on lending,are all subordinate and coordinated. Of course, such a Plan will not be an unqualified success. Nothing in life ever is. Yet in politics as in life, low aim not failure is the crime. Let us at least <u>aim</u> to get our Nation back to work. <u>That</u> might work too.

<u>ENDS</u>

Econ Pol
Strategy

PRIME MINISTER

Meeting with the Chancellor: 0930 on Thursday 7 May

You will wish to go over with the Chancellor the handling in Cabinet of his paper on public expenditure.

You have already agreed that colleagues should be told that there will be a macro-economic discussion on 4 June. You have still not decided, however, whether they should also be told that there will be several such discussions throughout the year. As you will recall, the Chancellor would be in favour of this; and the Policy Unit have given the idea their support (flag A). Robert Armstrong's earlier advice on all this is at flag B.

I believe the Chancellor will want to take you briefly over the banking figures which were published today - implying sterling M3 growth of about 1.8 per cent. (See Treasury note at flag C.) He has had a meeting today in the Treasury to discuss the interest rate prospects. There are some, including Terry Burns, who have argued that it would be possible to reduce MLR by a further one percentage point soon. The Chancellor is as yet undecided - though I think his gut feeling is that it would be unwise when the money supply figures are looking so high, when American interest rates are so high and when sterling has been under some downward pressure. The opposite view is that the underlying monetary figures are in reasonably good shape, and that if we look only at the crude money supply figures (ie taking into account the effects of the Civil Service dispute) it may not be possible to make any reduction for some time.

TL

6 May 1981

5 May 1981

Policy Unit

A

PRIME MINISTER

CABINET DISCUSSIONS OF MACRO-ECONOMIC POLICY

1. Geoffrey minuted you on 8 April with some thoughts about regular Cabinet discussions (he proposed three during the year) about macro-economic policy.

2. Although at first sight such discussions might look risky, because they give those in Cabinet who are unenthusiastic more chance to obstruct, we believe that, provided the discussions take place in a planned way, not as ad hoc concessions to pressure, and provided we persist with them, the advantages more than outweigh the disadvantages.

3. If you and Geoffrey have the best arguments, then debate is the only way to ensure that those arguments are really understood. Without such debate, the opponents can still obstruct (especially on public spending cuts) while supporters or intelligent potential supporters (eg Patrick Jenkin) who are capable of understanding are unable to give you effective support.

4. By contrast, with enough debate, the objectors will eventually reveal themselves (and this will vary with the different personalities involved) as economically uninformed, perhaps not particularly intelligent and, in some cases, liable to fall back on emotion and polemics when they find they are losing the argument. The damaging influence of such individuals (damaging not just in the economic sphere, but also in closely-related areas like trade union reform) could be permanently reduced provided they are given the opportunity to show themselves up in debate.

5. A further advantage is that all those who support the strategy will be far better equipped to talk publicly about it, with confidence and authority.

JOHN HOSKYNS

Covering S E C R E T

cc Mr Lyman

Prime Minister
~~Money supply~~
Banking figures
published today.

2
1

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

5 May 1981

TL
6/5

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

Dear Tim,

The provisional money supply figures for banking April will be published on Wednesday, 6 May. Though estimates have been given through PQs of the effects on the CGBR, these will be the first in which the effects of the Civil Service dispute on money are shown. You may therefore like a note setting out the background and line we propose to take in briefing. This is attached. We are also proposing to prepare an abridged version for circulation to Ministers, to enable them to field enquiries and counter allegations that the strike is doing major harm to the Government's strategy.

Yours
John

A.J. WIGGINS

MONETARY DEVELOPMENTS: APRIL

1. The provisional figures for money supply growth in banking April will be published on Wednesday, 6 May at 2.30pm. As is normal at this stage only the figure for £M3 is given, rounded to the nearest ¼ per cent. The growth of £M3 in April is estimated at 1.9 per cent - "about 2 per cent" in the Press Notice. The full money and banking figures will be published on 14 May.

Civil Service Dispute

2. Although the March figure was slightly inflated as the effect of the Civil Service dispute, this is the first month in which there has been a significant impact on the monetary figures. We estimate that about three quarters of the revenue due has been collected - rather more from Customs, rather less from Inland Revenue. In banking April this may have inflated the CGBR by £1¼ to 1½ billion. Not all of this is reflected in the money supply - for example some companies may be benefitting from a reduction in their overdrafts. After taking account of this and other offsets, we estimate that the increase in the money supply on account of the strike might be about £800-900 million, or about 1¼ per cent on £M3.

3. Although figures for the narrow aggregates will not be published on Wednesday - they will appear with the final figures on 14 May - we expect M1 to be proportionately even more heavily distorted as people find their current accounts swollen by the unpaid tax. The increase in April is expected to be around 4¾ per cent.

4. The total backlog of tax payments since the dispute started is now put at £2-2½ billion of which £¾ to £1 billion was in calendar March (and which will be carried over to the benefit of this's PSBR figure) and £1¼ to 1½ billion in calendar April. It should be borne in mind however that we have no direct way of measuring these effects and are able to estimate them only in relation to our forecasts for the CGBR. We are therefore at risk that an error in the CGBR forecast will go undetected.

Seasonal Adjustment

5. As is normal in April, the Bank will be publishing their revised seasonally adjusted figures for the past year. This is a complex process involving not just pure seasonal factors such as Christmas and holidays, but changes in the structure of tax payments such as PRT. On some occasions the result has been very embarrassing, producing an apparent deterioration in the record. This time no serious damage has been done. In fact over the target period to March 1981, the growth of £M3 has been revised down to 17.9 per cent from 19.2 per cent. It now appears that growth was faster in the first half of the year and slower after the surge in the summer. On the new figures the growth in £M3 in the six months between October and April - excluding the estimated effect of the strike - appears to be within the target range.

Other Factors

6. Study of the monetary figures is hampered by a number of other factors. First, there was some (unknown) amount of round-tripping in March which may have been unwound in April. This makes it difficult to assess the growth of bank lending. Our best estimate is that it has recovered from the very low levels of January and February but this does not necessarily indicate a surge beyond what we had been forecasting. A further factor is the recent growth of foreign currency deposits by UK residents which are outside £M3 but in M3. To some extent this may be a delayed effect of the removal of exchange control. Precisely what significance this has for domestic conditions is difficult to say but it does represent a potential worry.

Presentation

7. The monetary figures, clouded as they are by special factors and distortions, present a difficult exercise in presentation. In order to get over a favourable picture - which underlying it all seems to be there - the Treasury

will be briefing selected financial journalists. The main points we will be seeking to make are:

(i) The strike will have a dominating effect on the CGBR and monetary aggregates. We will want to give some guidance on the magnitudes - see paras 2-4 above - and to stress that, as far as we can see, the underlying position is sound.

(ii) The large increase in £M3 and the CGBR does not pose a threat to the monetary strategy as the money will eventually be recovered. Companies are not in a position to deploy the money freely in the meantime.

(iii) We will seek to counter the argument that large amounts of tax are being lost for good.

(iv) Without going into the substance of the issue, we will counter the view that the strike is putting the Government in baulk on interest rates. It will make its decisions on the best estimates of the underlying position.

(v) We will explain how the strike effects are being financed - i.e. mainly by a run down of the Bank's holdings of commercial bills. While there is an interest cost, it does not pose insuperable problems of money market management. The programme of long term debt sales is unaffected.

H M TREASURY
5 May 1981

SECRET

PROVISIONAL MONETARY AGGREGATES FOR APRIL

£ million, seasonally adjusted

As usual at this stage, all figures are subject to revision, particularly those affected by overseas holdings of gilts and others shown in brackets in the attached table. Figures incorporate the revised seasonal adjustments and there have been some further changes in these since the figures that were circulated last week.

1 Sterling M3 is provisionally estimated to have risen by 1,270 (1.9%) in banking April, in line with the first estimate based on weekly banks' figures. This figure, together with the other aggregates, is likely to have been distorted by the Civil Service strike but it is not possible to say by how much (on the basis of the forecasters' assumptions there may have been an upwards distortion of about 800 on £M3). In view of this distortion, annual rates of growth are likely to be misleading but for the record show a rate of 12.5% over the last three months and 11.2% over the last six months.

2 M1 rose by 1,420 or 4.8% with interest-bearing sight deposits accounting for 400 of the rise; NIBM1 rose by 4.0%. Strike distortions are likely to have been proportionately much greater for M1 than for the wider aggregates, making annual rates of growth even more misleading. The wide monetary base (largely notes and coin in circulation) grew by 3.8% during the month, unadjusted, or 1.1% after deducting the seasonal adjustment for notes and coin.

PSL1 grew by 2.2% in the month (the main differences between this and £M3 being a rise of 80 in public deposits which are excluded from PSL1 and increased private sector holdings of Treasury bills and LA deposits of 100 and 150 respectively). PSL2 grew by 1.7%. These aggregates have grown by 8.8% and 11.2% pa respectively over the past six months. There was a further large rise of 570 in UK residents' foreign currency deposits, of which 220 reflected transactions and 350 revaluations. M3 therefore rose by 2.4% in the month and has risen by 19.1% pa over the last six months.

3 The counterparts to the rise in sterling M3 show a very large CGBR of 1,920, about 1,250 of which is estimated to have been the effect of the strike. The difference between outturn and forecast is fully accounted for by the revision to the seasonal adjustment. Direct borrowing by the rest of the public sector other than from the non-bank private sector amounted to 80, much as expected. Net purchases of central government debt by the non-bank private sector of 1,070 included 550 of gilts and 360 of national savings.

4 Sterling lending to the private sector increased by 500. Within this, Issue Department holdings of commercial bills fell by 840 but banks and discount houses took up 640 so that with a fall of 180 in acceptances outstanding, non-bank holdings expanded only slightly, by 20. In the light of this month's figures, lending in March may have been inflated by arbitrage by somewhat less than was supposed at the time; this, together with revisions to the seasonals which altered the historical trend of lending, may account for a substantial part of the difference between the forecast and outturn in April.

5 Sterling lending to overseas rose by 310 of which 190 was market loans to unrelated banks abroad. External and foreign currency finance was heavily negative at -550 so that external factors in total were contractionary at -240. The implied balance of payments of the private sector on current and capital account appears to have been a small deficit representing a sharp reversal from the large surpluses at the beginning of the year.

6 Non-deposit liabilities fell by 60.

Financial Statistics Division
30 April 1981

DJR

D J Reid (4764) HO-4

SECRET

£ millions
seasonally adjusted

PROVISIONAL DCE, STERLING M3 ETC IN BANKING APRIL 1981

		Preliminary[ø]		Forecast*	
CGBR:	own account	+1,231		+ 775⨍	
	on-lending to LAs	+ 255		+ 240	
	on-lending to PCs	+ 437		+ 330	
			+1,923		+1,345⨍
Net purchases of CG debt by non-bank private sector: (inc. -)					
	Gilts	- 546		- 575	
	Treasury bills	- 102		-	
	National Savings	- 363		- 350	
	TSB claim on FBS	-		-	
	Certificates of tax deposit etc.	- 55		- 50	
			-1,066		- 975
Other public sector:	Local authorities	+ 1		+ 40	
	Public corporations	+ 83		+ 20	
			+ 84		+ 60
Sterling lending to the private sector:					
	Bank lending to private sector	+1,346	)		
	Issue Department commercial bills	- 841	)	+ 145	
			+ 505		+ 145
Sterling lending to the overseas sector:					
	Bank lending to overseas sector	+ 313		+ 200	
			+ 313		+ 200
External and foreign currency finance:					
	Increase in reserves (inc. +)	- 95		- 30	
	Official borrowing (inc. -)	+ 57		+ 30	
	Overseas purchases (-) of: gilts	(- 157)		)	
	treasury bills	(+ 46)		) -	
	LA debt	(+ 10)		)	
	Overseas sterling deposits (inc -)	- 88		+ 70	
	Banks' net currency deposits (inc -)	- 316		+ 52	
	Seasonal adjustment	- 3		- 102	
			- 546		+ 20
Non-deposit liabilities (inc. -)			+ 61		- 125
Sterling M3			+1,274		+ 670⨍
			+ 1.9%		+ 1.0%
DCE			+1,759		+ 775

ø Figures in brackets are more uncertain than other figures.
*As circulated in the Monetary Review of 15 April 1981.

2/3(a) B4

⨍ Since this forecast was made the seasonal adjustment on the CGBR has been revised by 580 explaining all the difference between forecast and outturn. 440 of this affected the forecast of £M3.

SECRET

Mr H. DAVIES

DRAFT BANK PRESS NOTICE

ELIGIBLE LIABILITIES AND PROVISIONAL MONEY SUPPLY: 15 APRIL 1981

During the four weeks to 15 April, eligible liabilities of banks in the UK rose by £2,084 million (3.1 per cent) to stand at £70,008 million. Reserve assets rose by £240 million to £6,807 million and the reserve ratio fell from 9.8 to 9.7 per cent.

Preliminary information suggests that sterling M3 may have grown by about 2 per cent during the month, after seasonal adjustment. This provisional figure may of course need to be revised in the light of subsequent information. The outcome for April has been substantially inflated by the effects of the Civil Service dispute. Full money and banking figures will be published on 14 May.

Seasonal adjustments

It is usual at this time of year to recalculate the seasonal adjustments to the monthly money and banking sector figures in the light of new information. This exercise has now been completed, and seasonally-adjusted figures for changes in [M1 and] sterling M3 since January 1980, on the new and old basis, are given in the attached table.

As in 1979 and 1980, certain modifications have been made to the method of calculating seasonal adjustments which was described in detail in an article in the Bank's Quarterly Bulletin in June 1978. [In particular account has now been taken of the recently observed seasonal pattern in surrenders of certificates of tax deposit by oil companies to pay Petroleum Revenue Tax.] As a result of this and other revisions, the seasonally-adjusted increase in sterling M3 in the former target period from mid-February

1980 to mid-March 1981, is now 17.9 per cent at annual rate instead of 19.2 per cent - both figures were distorted upwards by the removal of the 'corset'.

Revised figures for other aggregates, for more detailed banking figures and for earlier periods will be available when the April money and banking figures are published on 14 May.

The seasonal movements for the four weeks ended 15 April 1981 are:

£ million

Notes and coin	+310
Private sector sterling sight deposits	+100
M1	+410
Other sterling deposits (including CDs) held by UK residents	+420
Sterling M3	+830
Bank lending in sterling to the private sector	+410

The seasonally-adjusted changes are obtained by subtracting (with due regard to sign) the seasonal movement from the unadjusted change.

SECRET

MONTHLY CHANGES IN MONEY STOCK (seasonally adjusted)

	M1				Sterling M3			
	OLD SERIES		NEW SERIES*		OLD SERIES		NEW SERIES*	
Month ended	£ mns	(%)	£ mns	(%)	£ mns	(%)	£ mns	(%)
1980								
16 January	+ 49	(+0.2)	+237	(+0.9)	+ 485	(+0.9)	+1,004	(+1.8)
20 February	-411	(-1.5)	-492	(-1.8)	+ 330	(+0.6)	+ 189	(+0.3)
19 March	+304	(+1.1)	+255	(+0.9)	+ 302	(+0.5)	+ 642	(+1.1)
16 April	-105	(-0.4)	+308	(+1.1)	+ 216	(+0.4)	+ 452	(+0.8)
21 May	+115	(+0.4)	-161	(-0.6)	+1,249	(+2.2)	+1,061	(+1.9)
18 June	-297	(-1.1)	+ 9	(-)	+ 447	(+0.8)	+ 560	(+1.0)
16 July	+976	(+3.6)	+958	(+3.5)	+2,954	(+5.0)	+3,018	(+5.1)
20 August	+ 60	(+0.2)	-285	(-1.0)	+1,810	(+2.9)	+1,036	(+1.7)
17 September	+266	(+0.9)	+ 96	(+0.3)	+ 346	(+0.5)	+ 362	(+0.6)
15 October	+ 80	(+0.3)	+453	(+1.6)	+1,235	(+1.9)	+1,471	(+2.3)
19 November	+228	(+0.8)	-173	(-0.6)	+1,357	(+2.1)	+ 705	(+1.1)
10 December	+457	(+1.6)	+681	(+2.4)	+ 371	(+0.6)	+ 537	(+0.8)
1981								
21 January	+ 8	(-)	-173	(-0.6)	+ 461	(+0.7)	+ 384	(+0.6)
18 February	+271	(+0.9)	+389	(+1.3)	+ 629	(+0.9)	+ 208	(+0.3)
18 March	+281	(+1.0)	-114	(-0.4)	+ 472	(+0.7)	+ 517	(+0.8)

* The new series include some minor revisions to the unadjusted data.

FILE BK

cc: Press

10 DOWNING STREET

THE PRIME MINISTER 29 April, 1981

Dear Professor Minford,

I did mean to write to you before I left for India and the Gulf about your splendid article in The Times of 7 April in which you rebutted the 364 economists. This was a marvellous piece, and I am most grateful. Thank you too for being so robust on television. Thanks to you, Harold Rose and Ralph Harris, we won the day

Yours sincerely

Margaret Thatcher

Patrick Minford, Esq.

RH

P.a.

PRIME MINISTER

Your meeting with the Chancellor

There are two things the Chancellor may wish to discuss with you tomorrow:

(i) His proposals for three macro-economic policy discussions in Cabinet during the course of the year. (Flag A). Robert Armstrong minuted you on this before we left for India (Flag B), and you may like to go through his comments again. One particular point he made was that it might be better to have the Autumn discussion in the second half of October (i.e. after the Party Conferences rather than before them). The other point concerns the kind of discussion we should have: the Chancellor suggested an opening statement by Terry Burns; Robert believes it would be better to rely on an introduction by the Chancellor. If you agree with the points in Robert's minute, it might be better if we put them in writing to the Treasury. The Chancellor for his part, I know, thinks that we should get it established that there will be three discussions per year. The first such discussion is now set for 4 June - after the PESC guidelines discussion which is set for next week.

(ii) The coinage. You doubted the need for regional variants of the £1 coin. (Flag C).

29 April 1981

10 DOWNING STREET

PRIME MINISTER

You said you would like to write to Patrick Minford about his article in The Times (copy attached).

I attach a draft.

TIM LANKESTER

28 April 1981

Patrick Minford

A dangerous and dishonest game

Last week a group of prominent economists published an attack on the Government's strategy. In this article a leading monetarist argues that the critics are wrong

The 364 "Keynesians" who signed last week's statement attacking the government's handling of the economy have forgotten some salient facts, which would not have escaped their master. The public sector accounts in 1932, the trough of the Great Depression, appear to have been in significant financial surplus when adjusted for the economic cycle (ie, after deducting the effects of the cycle on revenue and social expenditures). The money supply had grown at less than 1 per cent a year and prices had fallen by more than 2 per cent a year over the previous five years. So Keynes could rightly observe that the actual deficit could be increased with no threat to (indeed restoration of) price stability.

Today the public sector still has a massive borrowing requirement when adjusted for the cycle—in the fiscal year 1979-80 about 5 per cent of gross domestic product and in 1980-81 about 4 per cent. This has been sustaining high inflation. But the budget for 1981-82, if plans are fully carried out, will cut this percentage to about 1 per cent of gdp and lay the basis for permanently lower inflation, even eventual price stability.

While one can write pages of algebra and estimate scores of statistical relationships, the essentials of the inflationary process are simple. It starts when a government, unwilling to cover its expenditure by overt taxation, borrows from the public.

As interest rates rise, in order to induce the public to lend, political pressures develop to hold them down. Lending to the government from the public slows down and the central bank has to lend the difference, which, of course, it does by increasing the supply of money.

During the early stages output usually rises, as extra monetary demand is met by producers whose expectations of inflation have not yet altered and who therefore think that rising prices offer them higher real returns. Expected inflation will soon increase, however, as information both about the policies and actually rising prices becomes widely known. This causes prices to rise faster and output to fall back.

At some point the increase in the rate of growth of money supply and so of monetary demand is entirely accounted for by an equal increase in inflation and output has dropped right back to where it would have been.

This description is widely accepted by serious students of macroeconomics. True, there have been—and persist—differences of view in particular about time lags and the interaction of fiscal and monetary influences. These differences ironically have been as great or even greater within the ranks of "monetarists" than between them and "Keynesians". But the economists who have developed this general line of thinking include as many Keynesians as monetarists. Indeed, the mechanism is named after a Keynesian, A. W. Phillips, who taught at the London School of Economics in the fifties.

Yet part (A) of the statement by the 364, on which the other parts are essentially based, explicitly rejects this mechanism in stating that "deflating demand" will not "bring inflation permanently under control" and thereby induce "an automatic recovery in output and employment". For, of course, that is precisely what the same mechanism asserts when the process of deficit and money creation is put into reverse, as the present Government is doing.

Charity dictates that we interpret this rejection by 364 economists as an unintentional lapse; otherwise it would make nonsense of their professional work.

To carry out this reversal of the inflationary process, to break the inflation psychology, political courage and determination of a high order are necessary because of the short-term pressures that are generated—the strong vested interests on the expenditure side, the unpopularity of higher taxes, the temporary misery of the initial recession. At a certain point in the process the siren voices murmuring easy options can become irresistible; the minds of Ministers, untrained in economics, can hardly be blamed for being easily seduced. But hard-headed professionals require our most severe censure if they back such nonsense.

One such suggestion is that instead of reducing inflation we should stabilize it as its existing level and "live with it". Yet recent studies have come up with very large costs for this option (e g, Feldstein in 1979 for the United States, G. W. Hilliard and myself in 1978 for the United Kingdom), costs which appear to be far higher than any transitional loss of output that could be involved in eliminating inflation.

The more popular easy options are reflation to increase output, with incomes policy to prevent inflation, a view usually backed by the glib assertion that the economy suffers from widespread "market failure". This is the route both of some clever general equilibrium theorists and of others who are utterly ignorant of modern macroeconomics. But a convincing theoretical account of an economy which would respond as hoped to these policies has yet to be constructed.

The evidence is brutal. Incomes policies have broken down repeatedly since 1960, leaving no trace on the inflation rate. Reflation has been followed by inflation and output has continued to rise slowly, with the massive extra demand (e g, real disposal incomes rose by more than 7 per cent per annum from 1977 to 1979) going into imports.

The effects of counter-inflationary policies have been superimposed on the adjustment to North Sea oil and a world recession of broadly the severity of 1974-75. The strains on particular companies and industries in the international sector have been intense. But there is no evidence that those with sound long-term prospects are going to the wall. Instead, we have seen rationalization, the reduction of overmanning and a sharp reduction in wage settlements. Indeed, the stock market is now increasing the capitalization of even the hardest hit sectors.

In the short run, this process worsens unemployment. But, in the long run, unemployment by general agreement can only be eliminated by this and other improvements in competitiveness. Bitter experience has confirmed what monetary theory predicts—that devaluation and incomes policies are incapable of raising competitiveness for more than a brief period. It is likely, however, that union power, high labour taxes and social security benefits and a heavily controlled housing market help to create serious unemployment and lower competitiveness.

Economic analysis can help to identify solutions. But the economist who downs tools to sign petitions for apparently political ends is playing a dangerous and dishonest game, even with 363 others.

The author is Professor of Applied Economics at the University of Liverpool.

CONFIDENTIAL

2

PRIME MINISTER

The newson pay settlements generally continues to be of single figures.

MS 24/4

PRIME MINISTER

PAY BRIEF

I attach my Department's pay brief for April. I am sending copies to members of E, E(PSP), and E(EA) Committees, and to Sir Robert Armstrong.

J P

24 April 1981

PAY BRIEF - POSITION IN MID-APRIL

SETTLEMENTS

1 Since the March pay brief 92 settlements covering 1,406,000 employees have been reported. In the private sector the weighted average level of settlements over the last month was just under 10%. The average in the public sector (9 settlements covering 929,000 employees) was just over 8%.

2 The cumulative average level of settlements for the whole economy this round is just under 9% (520 settlements covering 5,535,000 employees) compared with 9% last month.

3 In the private sector the cumulative average is 9% (479 settlements covering 2,722,000 employees). In manufacturing, the average level is just over 9%. The average in non-manufacturing is just under 9%, but the principal groups in Construction and Financial sectors have yet to settle. There is a wide range of settlements (see Appendix 4). Recent settlements have tended to concentrate in the 6% to 10% range.

4 In the public sector (41 settlements covering 2,813,000 employees) the cumulative average is just under 9%. The average for the trading sector (28 settlements covering 554,000 employees) is just under 10% and for the services sectors (13 settlements covering 2,259,000 employees) is 8½%.

NEGOTIATIONS

5 In the PUBLIC SECTOR, Civil Service non-industrials (1 April - 562,000) continue to take selective industrial action following rejection of the 7% offer. The possibility of a 5.25% offer from 1 April, to last for 12 months for Industrial Civil Servants (1 July - 165,800) is being considered. National Health Service Ambulancemen (1 January - 17,000) have been offered an option of 6% for 12 months or 7.5% for 15 months. NUPE has recommended rejection. An offer of 6% to NHS Nurses and Midwives (1 April - 492,000) in response to a claim for increases in line with inflation (15%) plus other improvements has not been accepted as providing a basis for negotiation. An offer of 6% plus consolidation of some bonus earnings into basic pay for NHS craftsmen and maintenance workers (1 January - 14,500) has been rejected after a ballot of members. NHS Admin and clerical grades (1 April - 121,000) have submitted a claim for a substantial increase, restoration of the traditional pay link with the Civil Service, improved holidays and a 35 hour week. Discussions are to begin after Easter. Local Authority non-manuals (1 July - 595,000) have presented a claim for increases of £7 plus 7% (costed by union at 13.1%) and a shorter working week. A claim has been submitted by Gas Supply staff (1 June - 58,500) for increases in line

with inflation, estimated by the unions at 16.1%, extra holidays, shorter hours and other improvements. The next meeting is on 30 April. Negotiations continue on a claim by Electricity Supply clericals (1 May - 50,000) for increases in line with inflation plus 2% to restore differentials with the manuals, shorter hours, longer holidays, an earlier settlement date and other improvements. Over half of the workforce at British Airways (1 January - 50,000) have now reached settlements based on the proposed 3 month pay freeze with an 8% increase from 1 April. Negotiations continue within separate National Sectional Panels. Unions representing British Rail clerical and conciliation grades (20 April - 150,000) are reported to have rejected a 7% offer. The claim is for a substantial pay increase. Next meeting arranged for 16 April. London Transport rail supervisory grades (20 April - 15,550) are claiming 12.5%. London Transport bus drivers and conductors (28 March - 19,800) have rejected an offer of 7.5% on rates made in response to a claim for increases in line with inflation, a reduced working week from 39 to 35 hours and 1 extra day's holiday. Negotiations resume on 22 April. An offer to Post Office UCW postal workers (1 April - 156,000) of 8% from 1 April with a further 1% from 1 October is to be put to a ballot of members. Discussions are continuing for BBC staff (1 April - 27,600) who have rejected an offer of 8.5% plus £100 (9.5% overall), 2 extra days holiday and other improvements in allowances. Unions for British Shipbuilders, staff and manuals (1 April - 70,200) are seeking endorsement of a 7.5% on basic pay (8.2% on average earnings) settlement. Result is expected soon.

6 In the PRIVATE SECTOR, selective industrial action is being taken by BIFU members of London Clearing Banks clerical staff (1 April - 146,000) over a claim for increases of up to 20%. CBU members have accepted the offer of 10%. Unions for Scottish Clearing Banks clericals (1 April - 17,125) are considering an offer of 9½% on salary plus 1½% bonus, made in response to a claim for 20% plus 2½% bonus. Trustee Savings Bank staff (21 February - 11,000) have rejected an offer of 8.75%. The claim is for 23.5%. Union negotiators for British Printing Industries Federation workers (24 April - 128,000) are recommending acceptance of up to £7.50 on rates, but a majority of unions representing Newspaper Publishers Association production workers (1 January - 33,000) have indicated that they are not willing to recommend acceptance of an 8% offer to their members. Employers in Building and Civil Engineering (23 June - 450,000) are considering an alternative offer from June within the same cost limit as the proposal put to the unions for a 4 month wage freeze with a 5.75% increase on minimum rates from November. The claim is for increases over 20%. Unions on behalf of Chemical Industries Association process workers (1 May - 50,000) are seeking confirmation from their members for the rejection of a 6.4% offer. The claim is for about 21% on rates. Union representatives for Norwich Union staff (1 April - 7,200) are recommending rejection of an 11.5% offer.

PRICES AND EARNINGS INDICES

PRICES

7 In March the year on year increase in retail prices was 12.5% the same as in February.

EARNINGS*

8 In January (latest available published figure) the year on year increase in average earnings for the whole economy was 18.8%. All available evidence points to a continuation of the much slower rate of growth of average earnings shown by the index to January.

REAL DISPOSABLE INCOME*

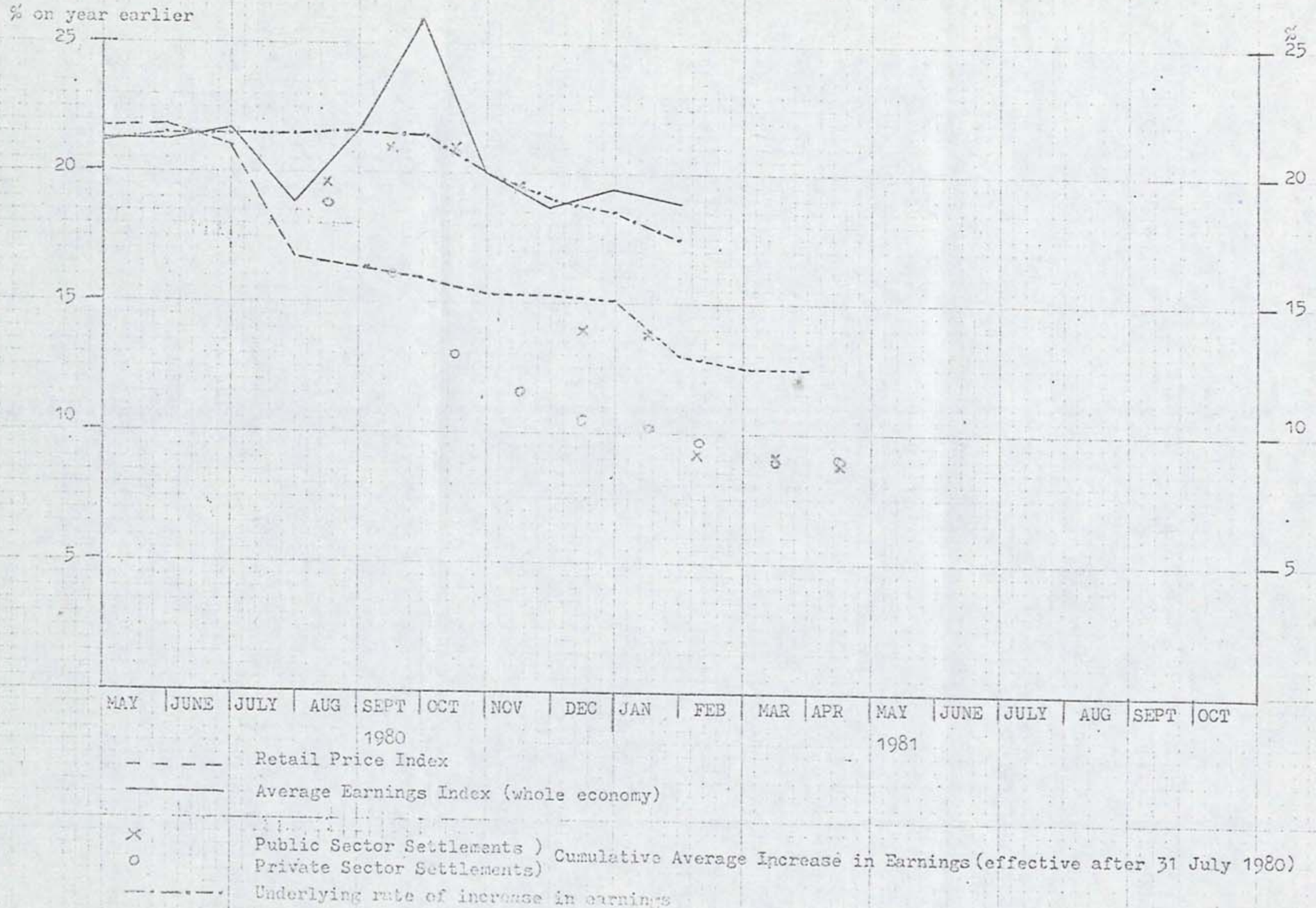
9 The real disposable income of a typical family (described in the mid-September Pay Brief) rose by about 2½% in the year to December (latest available).

* Due to industrial action by Department of Employment computer staff more recent published figures are not available.

CONFIDENTIAL

APPENDIX 1

TRENDS IN EARNINGS AND PRICES



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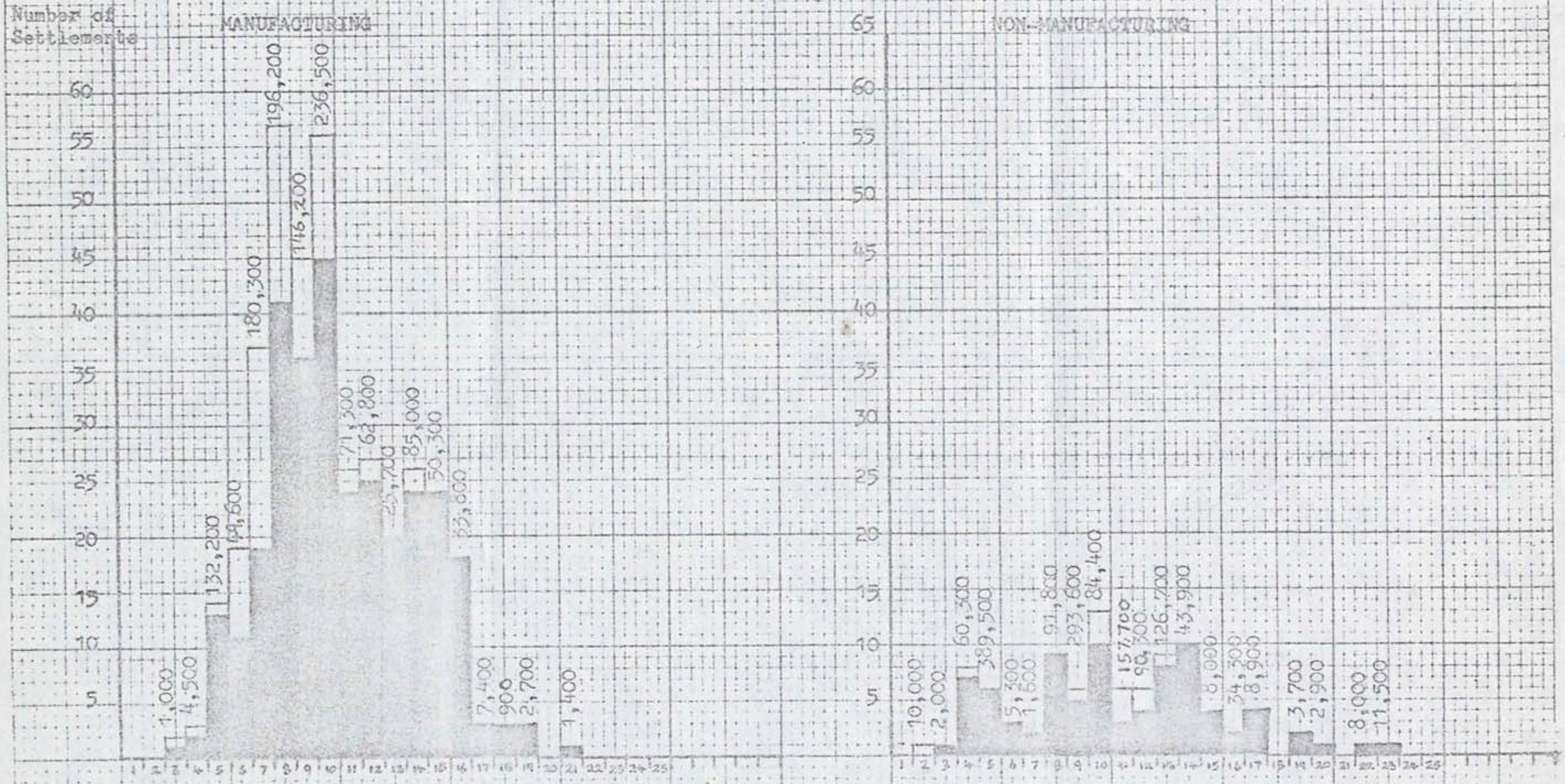
APPENDIX 2

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1980

KEY: SETTLEMENTS UP TO THE LAST PAY BRIEF
SETTLEMENTS SINCE THE LAST PAY BRIEF



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

NOTE - THE NUMBER OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENTS IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

PL(0/2) MS 14/4

Mr Gow
Mr Wolfson

Prime Minister
You should see this note by Adam Ridley on the Treasury Select Committee: it confirms, amongst other things, that the Conservative Members, with the exception of Beaumont-Dark, have not been helpful.
[illegible] 28/4

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

14 April 1981

Chief Whip
No.12 Downing Street
LONDON SW1

MS

Dear Michael

Following our discussion of the Treasury Select Committee at last Thursday's Cabinet, I thought you might be interested in the attached note by Adam Ridley, who has been keeping an eye on the Committee at my particular request. My own impressions coincide with the more fully recorded views expressed in Adam's note.

I am sending copies of this letter to the leader of the House and to No.10.

Yours ever
Geoffrey

GEOFFREY HOWE

A.28

CHANCELLOR

You asked me to pass on to you some thoughts about the Treasury Select Committee which have been causing continuing concern. As you have requested, I have maintained the closest liaison with the Committee which time, tact and considerations of Parliamentary privilege permit. I have summarised my observations briefly and baldly, but I would claim that they are well-founded and can, naturally, give a good deal of chapter and verse to support each.

(1) Attendance Membership of the TCSC is undoubtedly onerous. Some absences are inevitable - for example Jock Bruce-Gardyne on a recent trip to Mexico. But that does not make the frequent, and on occasions avoidable, absence of Conservative members any the less damaging. Richard Shepherd, in particular, has increasingly frequently failed to attend key meetings.

(2) Cohesion Our members do not appear to support one another very much, whether in the general direction of their actions or, specifically and importantly, when it comes to voting on contentious passages in draft reports. Since the Labour members vote fairly consistently "en bloc", this makes it very difficult for a Government supporter to get more than occasional short passages of a sentence or two into reports at key points.

(3) Role of Advisers The Committee's advisers have been drawn predominantly from those hostile to the Government's policies. Many of them are highly motivated politically and, being in many cases pure academics, they can spend a great deal of time on the Committee's business. That fact in itself was sufficient to drive the most important Government sympathiser amongst the advisers (Alan Budd) to resign after the preparation of the major study of

monetary policy which was published in early March. I gather that Harold Rose, too, has felt that his participation is a waste of time on the main economic studies and has only been tempted to stay on because the Committee may discuss the report of the Scott Committee, of which he, of course, was a member. The bias in the appointment of advisers continued with the new recruits appointed for the latest report on the Budget. In particular Paul Ormerod is an active Labour politician, being a member of the Ted Knight faction of Lambeth Council. All this matters greatly because the advisers very largely determine what is written and how in the reports, the subject matter being so technical. I gather that an approach has been made to two other possible advisers who are less unlikely to be unequivocally hostile to the Government. But it brought no result in time for the Budget enquiry, and it could well be that neither individual will want to waste his time on the Committee after the experience of Budd and Rose. Apart from anything else, "our" people tend to work full-time for their living!

(4) Bias As far as can be judged the Committee's output fairly consistently leans towards the most unfavourable presentation of facts and treatment of Government policy which it can manage, not only in big matters but in small. The cumulative impact of this is very considerable, not least in entrenching a wide range of myths and inaccuracies about Government policy. It would not appear that the Chairman exercises the power of his office to counteract this tendency, except occasionally in public while evidence is being given at hearings.

(5) Speed The Committee often operates at great speed, for reasons which are understandable. But this haste is not always necessary, and is unhelpful since it strengthens the hand of those who draft reports - mainly advisers and Committee staff - and weakens that of individual members still further. For example, in the case of the monetary study, the Committee's members worked for several critical weeks without a coherent draft and then, suddenly at the last minute, some 250 pages of the new report were circulated at very short notice and sent to the printers at the same

time. I gather this meant both that there was little or no time in which to scrutinise the penultimate text properly and that the scope for amendments was very small indeed.

(6) Turning to personalities, as at some stage one must, Tony Beaumont-Dark has been consistently helpful without compromising his independence, and has almost single-handedly conducted a heroic exercise in damage limitation. Without his efforts I am convinced that the nature and tone of the Committee's reports would have been totally unacceptable and provoked the gravest problems. Jock Bruce-Gardyne has helped too, latterly, though not as much as one might have hoped. The remaining three have contributed little, apart from the intermittent occasions where their own particular interests reinforce the Government's.

(7) Treasury officials, as a group, have very considerable experience of Parliamentary Committees including the present Committee's predecessors. I find that they are often struck by the unusually masochistic way in which our members conduct their business. Normally this is just a matter which they mention to me tactfully in conversation, knowing my liaison role . However recently Brian Unwin, who as Under Secretary co-ordinating our evidence sees the Committee more regularly than anyone else, was prompted to a cri de coeur of which I attach a copy. As you know, Brian is a most temperate and responsible person, so one attaches weight to what he says!

AR

ADAM RIDLEY
10 April 1981

PERSONAL

COMPOSITION OF TREASURY COMMITTEE

This is a familiar cry, but we were stuck again last night by the general unhelpfulness of the Government members of the Treasury Committee (Mr Bruce Gardyne may have behaved differently, but he did not turn up). Absent in Mexico, I think - AR

2. I would not claim that we were skilful enough to give answers that gave scope for the Government members to make frequent helpful interventions. But opportunities were there, and for the most part they chose to kick through their own goals. For example, Mr Shepherd dismissed the Budget help on energy prices; Mr Eggar had a go at the £10½ billion PSBR judgement, and followed this up with some unhelpful remarks on the radio late last night; and Mr Beaumont Dark produced an unhelpful little lecture on the problems that uncertainty about the exchange rate caused for businesses in Birmingham. Mr Higgins was also generally unhelpful but fortunately was so confused on some issues that he did not get very far. This is all strictly outside my province. Our job is to deal as best we can with whatever questions are put. But it really does not help the Government's image to have the Conservative members of this Committee (which the press, for its own reasons, has elevated to such a status) constantly appearing to share in the general hostility and criticism.

Most unhelpful

Schroders

J. Henry Schroder Wagg & Co. Limited,

Economic Perspective

Spring 1981

The UK Short Term Outlook

For the second time in less than six months, the Chancellor of the Exchequer has taken deflationary fiscal measures in an attempt to regain contact with the Medium-Term Financial Strategy.
The November measures and the recent budget should be viewed together. They are both designed to limit the expansion of the Public Sector Borrowing Requirement which is rising above target levels and is threatening to destroy the financial and inflation objectives set by the Government in the March 1980 Budget. However the balance of the measures taken is changing. There was less emphasis in the Budget on cutting public expenditure and more on raising personal sector taxation.
It is clear that the political and economic options are narrowing and becoming more clearly differentiated as a consequence of the budget. The Chancellor will need to demonstrate that his policies are yielding dividends, in the form of lower inflation and increased industrial efficiency, or else they will be reversed.
We believe that demand in the economy is stabilising and will rise, albeit slowly, and that the budget substantially reduces the risk of a significant upturn of inflation in 1982. It remains to be seen whether this will represent a sufficient improvement in the economy for the Government to be able to contain the political pressure for a change of direction.

☐ On unchanged policies the Chancellor expected that the PSBR would be £13½bn in 1981/82. By raising indirect taxes, by allowing no increase in personal income tax allowances and by certain other measures – extra taxes on banks and oil company profits and further restrictions on public expenditure – he hopes to reduce the PSBR in 1981/82 to £10½bn. This is still £3bn above that specified when the financial strategy was unveiled in March 1980 but is nevertheless a highly ambitious target.
Moreover it seems as if there will not be any serious efforts made to claw back the excess monetary growth in the 1980/81 financial year. One may therefore infer, in the philosophical context of the Medium-Term Financial Strategy, that the best that can now be expected by 1983/84 is that inflation falls into the range of high single figures.

☐ Destocking in the final quarter of 1980 totalled £945m in 1975 prices and £1.8 bn for the year as a whole. This is 1.6% of GDP and it was therefore by far the largest contributor to the provisionally estimated 2% fall of GNP in 1980. It would seem that destocking has continued into 1981, as imports and industrial production have continued to fall while retail sales have remained firm. However the rate of destocking is about to decline sharply. Retail stock levels are stabilising and wholesale and manfactured stock levels will also level out shortly.

☐ This will have a number of significant consequences. One is that the sharp decline of industrial production – it has fallen by 12% in the twelve months to January 1981 – will come to an end. Another is that the corporate sector will find that its internal cash flow improves. It will also mean that the volume of imports ceases to decline further. This will cut into the large current account surplus which is running at around £600m per month.
It is much less clear however whether there will be an appreciable expansion of demand and output during 1981. Exports and private fixed investment are likely to fall while the budget measures will reduce real disposable personal income. Nevertheless our judgement is that real demand will rise and by the end of the year be above most current expectations.
One reason for this belief is that as the year on year rate of inflation continues to fall towards single figures, it will encourage the personal sector to maintain its real level of expenditure and indeed may also encourage it to extend its borrowing which would support additional real expenditure. Another is that the corporate sector, which responded quickly and savagely to the deterioration in its prospects in the second quarter of 1980 and has as a result managed to protect its liquidity, will be in a position to spend rather more freely on investment and stocks. Nevertheless even if there is a modest expansion of demand through the year, of the order of 1-2%, unemployment is likely to rise further.

☐ A final consequence is that short term interest rates will probably fall further in the coming months, to around 10%, as monetary growth remains within the new target range, of 6-10%.

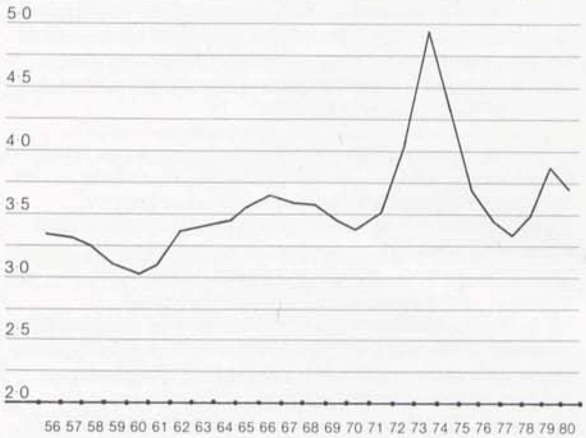
☐ It was the unexpected strength of sterling in 1980 that forced the corporate sector to destock as profitability deteriorated.
It has also been the prime contributor to the improved outlook for inflation this year and it remains of critical importance in determining the future balance between the corporate and personal sector. The budget measures should have the effect of limiting sterling's decline this year, though on balance we continue to believe that it will be lower by the year end. This is because UK interest rates are leading the decline (along with Japan) of world interest rates. Oil markets will be weak in 1981 and we expect a significant diminution of the UK's current account surplus as the year proceeds.
If the exchange rate does fall modestly then this will mean that the inflation rate is unlikely to fall much below 10% in 1981.
A further decline in sterling in 1982, which we believe is probable, would then have the effect of maintaining the inflation rate at around 10%, for much of that year also.

Gross Total return

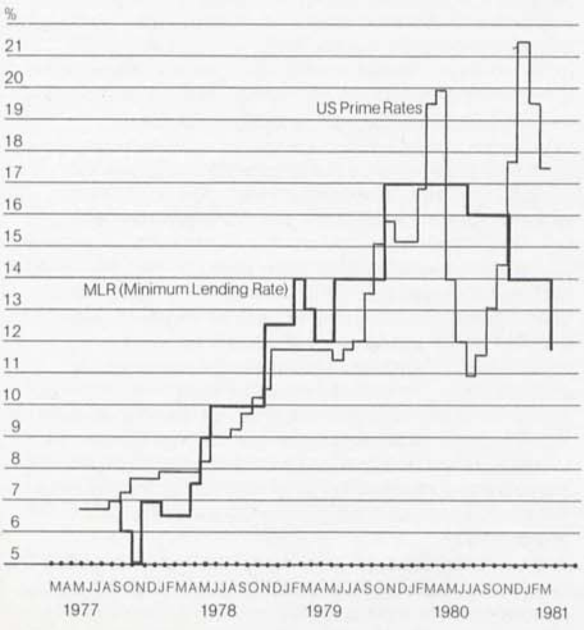
%	1977	1978	1979	1980	1981Q1
F.T. All Share Index	+48·0	+ 8·4	+10·5	+35·2	+ 7·6
F.T. Govt. Secs. over 15 years	+47·8	− 3·4	+ 4·5	+21·4	+ 5·5
Schroder Property Unit Trust	+16·4	+17·8	+25·2	+21·1	+ 3·7
S & P Composite Index*	−26·2	+ 6·6	−24·3	+23·0	+ 8·1
New Tokyo SE Index*	− 6·1	+55·9	−45·9	+18·8	+11·0

*through $ premium (discontinued on 23rd October, 1979).

The ratio of house prices to average earnings



Source: Nationwide Building Society
Earnings have now largely caught up with the rapid rise in house prices seen in 1978/1979.
The current fall in interest rates gives scope therefore for another advance in house prices, which can be expected to have a favourable impact on consumer confidence generally.



Following the sharp rise in US interest rates in the latter part of 1980, both US and UK short rates are now on a declining trend.

Recent Market Movements

The first quarter of 1981 saw a further advance in market values in most areas. UK equities had made no progress by the time of the budget on 10th March, and fell a full 2% on the following day, but this initial gloom soon disappeared and attention once again focused on the likelihood of a further fall in interest rates and a recovery, albeit very modest, in economic activity in the second half of 1981.
Long dated gilts similarly made no progress by budget day but then responded favourably; there was relief at the firmer than expected control being exercised on the PSBR, which lessened somewhat the fear of an eventual rise again in inflation; at the same time, the introduction of an indexed linked stock was seen as having a favourable impact on long interest rates.
Continued foreign buying in Japan combined with reduced domestic selling allowed the new Tokyo index to advance by 8 %, while a rather more modest advance in the US was boosted in sterling terms to 6·7 % by virtue of the continued strength of the dollar.
After a slightly easier trend in the second half of 1980, commercial property prices edged up again with prime shop yields back below 4%.

Market Outlook

The budget has been described as following a high risk policy. If it is successful – as on balance we believe it will be – then there is the prospect of a more sustained, though slower than normal, economic recovery. If it is not successful then by the end of the year the demand for some stimulus to the economy may well become irresistable. The balance of risk and reward has probably shifted therefore slightly away from long gilts in favour of real assets.
The present declining trend in short term interest rates, however, which is not limited to the UK and likely to continue for some time, should have a beneficial impact on both types of assets.
The new index linked Government stock, while having some of the characteristics of a conventional gilt, is probably best viewed as an ultra safe alternative to equities and property and one which in the long term will perform less well than either.

Overseas

Business and consumer confidence in the US has recovered very considerably under the new administration. While this confidence may prove fragile, as some of the administration's objectives appear to be hard to reconcile, the US economy could well advance in 1981 by slightly more than the major European economies. Following the outstanding performance in 1980 of US energy, defence and electronics stocks, a rather more diversified portfolio may prove advisable in 1981. In Japan another year of 4-5% economic growth is in prospect with consumer demand replacing exports as the main contributor. Continued foreign buying and reduced domestic selling of securities give the prospect of strong support for the equity market.

The Industrialising Countries of South East Asia

At a time when the world economy is dominated by dislocation in the oil markets, it is perhaps ironic that some of the countries with much the best economic performance had an almost complete absence of any domestic sources of energy: the newly-industrialising countries of South East Asia. Taking their lead from Japan, these economies have come through the 1978-80 round of oil price rises relatively unscathed. They have had few problems funding their higher current account deficits; inflation has stayed, in general, under control; and the growth in economic activity has been, by any but their own standards, impressive.

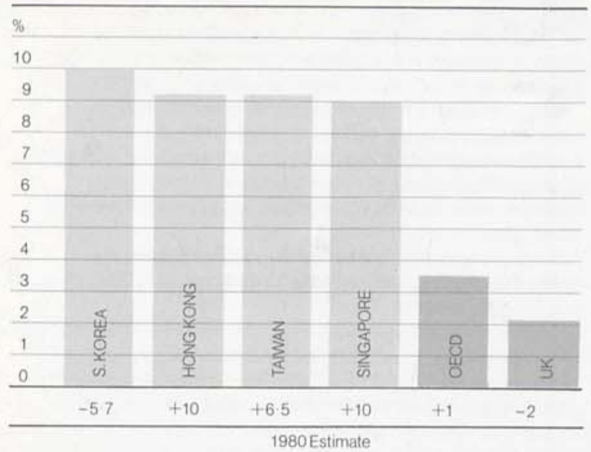
Central to their success have been high export growth and the maintenance of their investment programmes. The growth of exports has come from electronic products and electrical equipment, and, in Hong Kong's case, a huge re-export trade with China, while traditional export products (textiles, footwear, cheap plastic etc) have suffered. At the same time, domestic investment has been boosted by further inflows of foreign capital, attracted by the region's low cost and productive labour and (in all except Hong Kong) the investment incentives offered by governments.

☐ Can this success continue? The cautionary tale for all these economies is South Korea. Korea went through the first oil crisis with comparative equanimity, but came badly unstuck after 1978. The second round of oil price rises exposed major structural weaknesses – eg. huge over-investment in the heavy goods industries and high wage inflation – that led to a collapse in economic activity, a problem compounded by political upheavals. GNP fell 5.7% last year, prices rose sharply, and large over-capacity developed (the fledgling auto industry, for example, was running at only a third of its capacity by the middle of last year). The lessons for the rest of the region were clear; a break in the virtuous circle of export-led expansion can have serious destabilizing consequences. Korea faces a long and painful struggle to regain its old growth path.

The danger for these rapidly growing economies therefore lies with the threat of declining international competitiveness destroying their shift into higher-quality products. The experience of the last two years suggests that they will avoid this trap. Inflation, though not declining as quickly as hoped for in Hong Kong and Taiwan, has been broadly under control. Government policies have been tight and, in Hong Kong's case, the inflow of immigrants has kept real wages down. Productivity growth has also been maintained, although the methods have varied widely, with the strong government interventionism of Singapore and Taiwan contrasting with Hong Kong's laissez-faire.

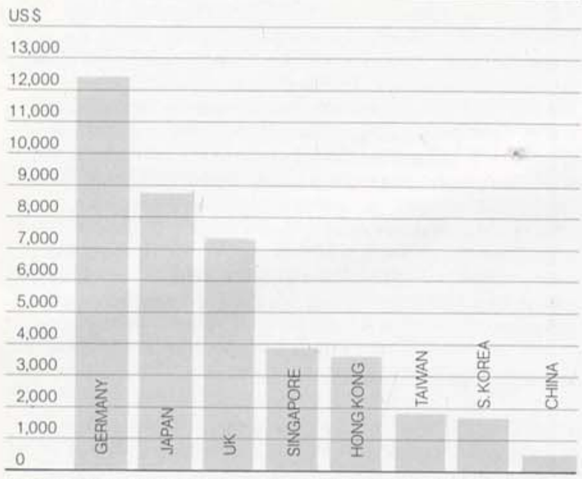
☐ In the immediate future, the outlook for these economies must be for some consolidation, as weak export demand and anti-inflationary policies limit GNP growth. However the region is well placed to take advantage of a recovery in world trade later this year. GNP growth rates will be below their historic trend but against a background of lower inflation. The appeal of the two stockmarkets in which foreigners can invest (Hong Kong and Singapore) is clouded by uncertainties over property prices and the high ratings of both markets, but their long term attraction remains. These economies have all the characteristics that put Japan in its current strong position; a well-educated and highly flexible labour force, an industrial base that is quick to respond to changing circumstances, and strongly pro-growth governments. For the investor, that allows considerable opportunities. For Western companies, it constitutes an increasingly comprehensive challenge as these new competitors move upmarket into the products and markets of the West's industries.

The growth of GNP % p.a. 1970/1979



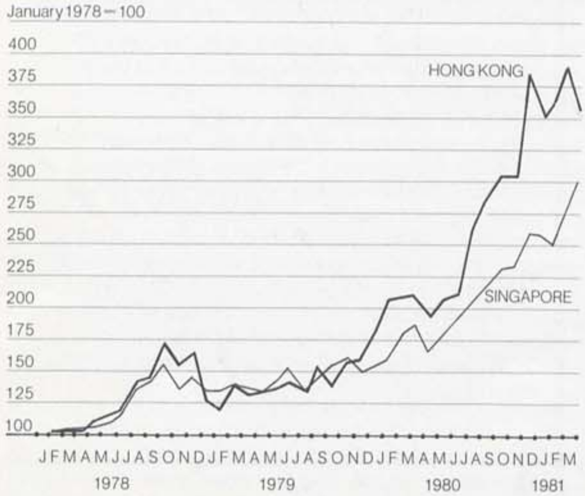
The high fliers of the 1970s continued to grow in 1980, but Korea took a tumble.

GNP per capita (1979)



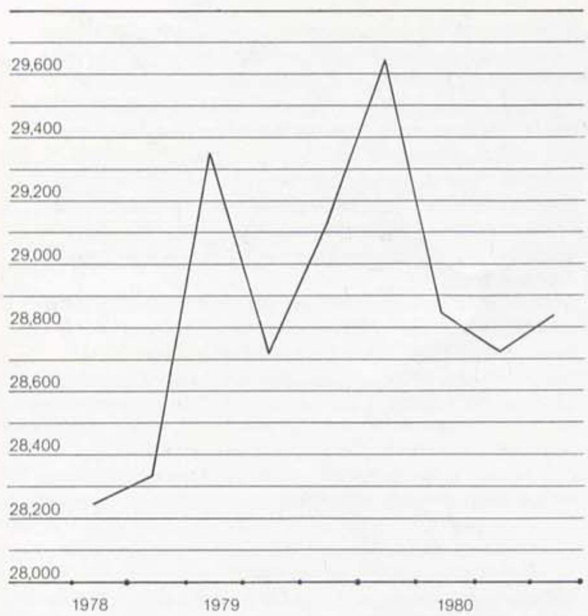
Part of the rapid growth has come from the catch up in income and technology to the levels of the West. At current growth rates, Singapore and Hong Kong will have income levels comparable to the UK's by the early 1990s.

Hong Kong and Singapore's Stockmarkets



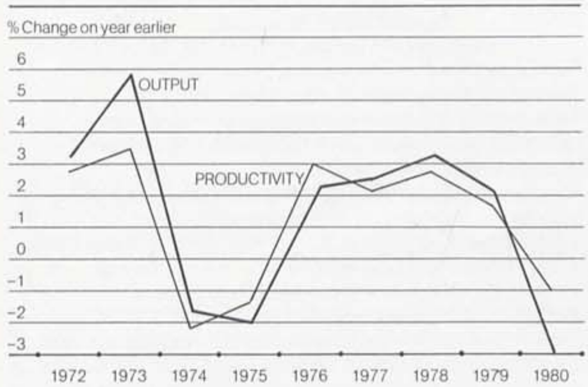
The stockmarkets, having soared on the back of strong property prices and inflows of foreign funds, are now showing signs of being overpriced in the short-term.

Domestic Demand excluding stocks (£ 1975)



Domestic demand excluding stocks has not declined since the first half of 1979.

Productivity and Output



On the basis of provisional output data, productivity fell by 1% in 1980. However it is probable that the output estimates for 1980 will be revised upwards. They have invariably been so in the past. At the end of the day therefore, it is quite possible that we will discover that productivity actually rose in 1980.

The Business Outlook after the Budget

Reactions to the budget have ranged from bemusement to outright hostility. It is easy to see why. The failure to achieve the monetary and PSBR targets has subjected the Medium-Term Financial Strategy to ridicule. At the same time unemployment has become a much more potent concern compared to inflation. However it is also clear that the government had little choice but to introduce the kind of budget that it did.

A reflationary budget would have undermined sterling and quickly reversed the downward momentum of inflation. It would moreover have done little to improve long term employment prospects.

Nevertheless the response to the budget has been out of proportion to its prospective impact on the economy. This is for two principal reasons.

The first is that the recession is no ordinary recession. It has been much more than a destocking in response to a typical or normal deterioration in aggregate demand. To a considerable extent the destocking and collapse of production reflects the perception by many companies – prompted by the rise of sterling – that there is no prospective profit to be earned on many of their activities.

In a real sense therefore the recession reflected a lack of supply rather than a deficiency of demand. Indeed final demand, excluding stockbuilding, hardly declined at all in 1980. The increase in taxation can easily be borne by the personal sector as real incomes have continued to rise, while the liquidity of the corporate sector, which has not deteriorated as it did in 1975, will be eased by the decline of interest rates.

The second is that the productivity performance of the economy in 1980 has been exceptional, as indicated in the chart opposite. When final output data for 1980 is available and estimated at 1980 prices, we will probably find that productivity actually rose.

There has therefore been an enormous shake out of labour which reflects primarily a highly concentrated, though admittedly incompetently handled, adjustment of the real economy to the existence of North Sea oil. This should now provide a reasonably solid basis for a recovery of output and demand over the next few years.

Rebalancing the Economy

If current policies are maintained the likelihood is that the initial expansion in the economy will be modest. However of much more importance to businesses is that the expansion will go hand in hand with a recovery of profits and a reorientation of activities towards those that are much more suited to the realities of an oil rich industrial economy.

The recovery of profits will be partly cyclical in nature, though it is also likely to reflect the improved productivity base of the economy.

The orientation of activities will be towards services, distribution and construction. Part of this expansion is also likely to be towards services that are now (and could well remain) the preserve of the public sector, such as health care and education.

Moreover, the budget may be of rather more help in this reorientation than is now realised. Thus the introduction of an indexed linked stock for institutions, further efforts by the authorities to tap personal sector savings directly and the probable introduction of a wider range of short term debt instruments will strengthen the capacity of capital markets to finance expansion by the corporate sector. Also fiscal and monetary policies are still quite consistent with a decline in the real exchange rate over the next one to two years. This will improve profit margins and encourage companies to invest in higher technology and value added products.

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5th April 1981

Econ Pol Strategy

cc Mr Lankester

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PA (cf file)
NJS 7/5

MR CASSELL

cc Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Anthony Rawlinson
Mr Ryrie
Mr Middleton
Mr Battishill
Mr Bridgeman
Miss Brown
Mr Evans
Mr Monck
Mr Allen
Mrs Case
Mrs Gilmore
Miss Peirson
Mr Turnbull
Mr Bush
Mr Willetts

Mr Ridley
Mr Cropper
Mr Cardona

Mr Lankester No 10

Prime Minister

This report is being published today (Wednesday). As we have come to expect from the Committee, it is pretty unsympathetic. I have side-lined some of the more important comments: we will get some more briefing tomorrow.

TL

SELECT COMMITTEE: BUDGET REPORT

I attach the CFR of the Budget Report. It is significantly less helpful than the earlier version circulated on 2 April.

2. Last night CU ran quickly through the briefing prepared yesterday, to try to update it in the light of the CFR. The revised briefing is being submitted separately this morning. Could you and copy recipients please look out for the fresh points raised by the Committee and let Mrs Gilmore and Mr Folger have as soon as possible any further amendments to the briefing that you consider necessary.

Harry Bush

H J BUSH
8 April 1981

The Treasury and Civil Service Committee have agreed to the following report:

The 1981 Budget and the Government's Expenditure Plans 1981-82 to 1983-84

I Introduction

1. This report is the third in a series of short reviews of the Government's economic policy, the first of which was prepared after last year's Budget and Public Expenditure White Paper and the second last Autumn after the Chancellor of the Exchequer's statement of 24th November. Once again our report has had to be written quickly so that it could be published in time for the debate on this year's Public Expenditure White Paper (Cmnd 8175) on 9th April 1981 and the Second Reading of the Finance Bill.

2. We took oral evidence from Treasury officials on 18th March, from the Chancellor on 25th March and from the Governor of the Bank of England on 30th March. We should like to thank our advisers, Mr Brian Henry, Dr Paul Neild, Mr Paul Ormerod and Mr Terry Ward for their assistance in the preparation of this report.

3. As before we have considered it our duty to question some of the assumptions on which the Government is basing its policies and of the main thrust of the Budget and the Medium-Term Financial Strategy (MTFS). We therefore set out our views in the following paragraphs on the impact of the Budget, on the realism of the White Paper and in particular the balance between capital and current expenditure. We also draw on the analysis set out in our recent report on Monetary Policy[1] to consider how the MTFS has been modified by theGovernment in the light of experience.

II The Budget Measures

4. Our 1980 Autumn Review[1a] commented on the Treasury's November economic forecast but left detailed consideration of the fiscal measures announced at that time to be undertaken in the wider context of the tax and spending changes announced in the Budget. In examining the effect of these proposals on the Government's fiscal stance for the financial year 1981-82 we must, therefore, take into account the effects of the November 1980 measures, the changes in spending announced in the White Paper and the changes in taxation announced in the March 1981 Budget.

5. The major effects of those measures for government expenditure and revenue in 1981/82 at out-turn prices compared to "unchanged policies" are:

November 1980 Measures £bn	Effect on PSBR of Revenue Measures	Effect on PSBR of Expenditure Measures
Increase in National Insurance Contributions	-1.0	
Oil taxation measures	-1.0	
Higher EFLs, industry and employment support, other additional expenditure		+1.5
Expenditure savings		-1.4
March 1981 Measures		
Non indexation of tax allowances	-1.9[2]	
Increase in excise duties "over and above revalorisation"[3]	-1.2	
Special tax on banking deposits	-0.4	
Other revenue measures	+0.2	
Other expenditure measures		+0.3
TOTALS	-5.3	+0.4

Note: There are inevitably difficulties of definition in constructing a table such as the above. For example, some of its components are within Government's discretion; others are not. The table is designed to show in simple form what changes Government has made over the period. The table is on an "indexed" basis.

These measures can therefore be seen as a tightening of the fiscal stance in 1981/82 compared with an unchanged policy position. This tightening comes at a time when the economy is already in deep recession.

6. An alternative way of looking at the measures for 1981/82 would be to compare the change between 1980/81 and 1981/82 in the size of the PSBR measured as a % of GDP. Table 8 of the MTFS shows a reduction from 6% in 1980/81 to 4 1/4% in 1981/82.

7. In his Budget Statement the Chancellor announced a cut of 2% in MLR following the 2% cut made in November. When asked to quantify the effect of falling interest rates on industry he referred to the CBI estimate that each one point reduction in the interest rate is worth about £350 million a year.[4] However this represents only the direct benefit. As we discussed in our report on Monetary Policy,[5] in a regime of fixed money supply targets, lower interest rates may lead to a lower real exchange rate which will bring further benefit to many industries. On the other hand, if the Budget were to lead to a reduction in output, the balance of payments might improve and could put upward pressure on the real exchange rate. The balance of these effects would have to be substantially favourable to offset the direct effect on domestic sales and orders resulting from the overall tightening of the fiscal stance.

8. The Budget measures flow from the Chancellor's judgment that the objective for 1981-82 should be a PSBR of £10.5 billion. The original illustrative path for the PSBR in the 1980-81 FSBR would have given a figure of £7.5 billion, but this was judged "unduly restrictive".[7] The Financial Secretary has suggested[8] that the £3 billion increase is "a result of the recession being greater than we then expected". An additional reason is perhaps the difference in the pattern of the recession, with the burden falling on manufacturing industry in particular and the faster rise in unemployment that this may have caused.

9. The major reason advanced by the Chancellor for the choice of £10½ billion was that it would be "consistent with this announced monetary target rate for 1981/82, a sum that could be financed without putting undue strain on the capital market".[10] As we argued in our report on Monetary Policy,[11] the relationship between the PSBR, money supply and interest rates is a complex one. The Governor agreed that one cannot quantify the exact relationship.[12] Much depends on a judgment of how easily the PSBR can be financed; we were told that there were a number of things which actually improve the prospects for meeting a target in the forthcoming period.[13] It is possible that a higher forecast PSBR could be financed in such a way as to be consistent with falling interest rates without violating the £M3 guidelines. The London Business School suggests that a PSBR of £12½ billion could be consistent with monetary growth of about 8% in 1981-82, and indeed expects that this will be the actual outcome under current policies because it does not accept the official forecast for public sector costs.[14]

III Public Expenditure White Paper

10.

Total Public Expenditure, Percentage change over previous year

		1979/80	80/81	81/82	82/83	83/84
Planning Total:	Volume	-0.2	+1.9	-	-1.7	-2.4
	Cost*	+0.3	+3.7	-1.0	-1.7	-3.1
Total (incl. debt interest):	Volume	+1.0	+2.4	+0.3	-1.6	-2.3
	Cost*	+1.5	+4.1	-0.6	-1.6	-3.0

* Volume adjusted for relative price effect

[Source: Cmnd 8175, Tables 1.1, 4.12.
Relative Price Effect for 1982/83 and 1983/84 from 1981/82 MTFS.]

The planning total for public expenditure is now estimated to have increased in 1980/81 by 1.9% in volume terms, and by over 3.7% in cost terms, which is more meaningful so far as government borrowing is concerned. If debt interest is included total spending rose by 2.4% in volume terms and 4.1% in cost terms. These increases are substantially greater than forecast in last year's White Paper as noted below. Expenditure is projected to show little change in 1981/82 on either measure and is forecast to fall quite significantly in both 1982/83 and 1983/84.

1980-81 Outturn

11. The Treasury sent us a note comparing the expected outturn for 1980-81 with the figures published at the time of the 1980 Budget.[15] Their paper - which did not examine the overrun in debt interest - outlined the following additions to particular public expenditure programmes in cash terms, of which about a third was financed from the Contingency Reserve:

	£ millions
Increases in:	
Total Local Authority expenditure	800
Lending to Nationalised Industries	770
Social Security payments (of which about half related to unemployment)	700
Defence Expenditure	470
Special Employment measures	380
Payments from redundancy fund	250
Agricultural support	150
	3520

12. From this should be deducted £1.1 billion, half of which resulted from the EEC Budget refund negotiated in May 1980 and the other half from various EEC transactions. Of the £800 million local authority overrun, current expenditure on goods and services accounted for £500 million, subsidies (mainly the effect of higher interest rates on housing subsidies) for £200 million, and higher lending (probably associated with council house sales) £80 million.[16]

13. The recession is said to have been behind much of the excess spending by the Ministry of Defence as contractors have, in the face of the tight financial conditions facing them, carried out work faster and also billed earlier for their work. We assume that the defence cash limits have been lowered for future years to reflect this. We are asking the Treasury to confirm this.

14. It is difficult to say how much of the total over-spend is the result of the volume of public expenditure being higher than forecast last year and how much is the result of a higher than expected increase in the average price of spending. The Public Expenditure White Paper contained estimates of the revision to volume figures since the last White Paper, as well as estimates of the revision to the relative cost of expenditure. It appears from the Treasury evidence, however, that the figures in both last year's and this year's White Paper are not the same as those included in the Financial Statement and Budget Report, because they were prepared some months before the Budget. This seems to us to be a serious defect of the present procedure. While we welcomed last year the simultaneous publication of public expenditure plans and the forecasts of tax revenue at Budget time, we are concerned that these should be on a consistent basis so that sensible comparisons can be made.

15. So far as a comparison between this year's White Paper and last year's is concerned, there has been an upward revision to the volume of total expenditure in 1980-81 of £2.2 billion at 1980 survey prices.[17] However, because the relative price of public spending was much higher than assumed (as a result of high pay settlements), the upward revision to the cost of total expenditure was £4 billion at 1980 survey prices including the RPE.[18] The Treasury stated in a note to us that much of this cost overrun was incorporated in the forecasts of cash outlays made at the time of the March 1980 Budget, but that there had been some rise in the relative price of public expenditure because the general rate of inflation in the economy as a whole had turned out to be lower than assumed.[19] To the extent that this was the case, cash limits allowed public expenditure to rise more, relative to actual inflation and therefore in relation to tax revenue, than was intended when the limits were fixed.

Information in the White Paper

16. In our Report on the 1980 Budget and Public Expenditure White Paper we noted that the White Paper did not contain the breakdown of expenditure plans by economic category after 1980-81.[20] We were told then that no such table had been prepared.[21] This year's White Paper does however contain a table[22] which shows for 1981-82 the difference in spending plans by economic category from last year's White Paper. Precisely how this was calculated is not explained. A breakdown for years after 1981-82 is still not provided. It is still not possible to tell how much the Government intend to spend on, for example, capital projects as opposed to say subsidies or lending, and it is not possible to assess satisfactorily the full implications of the expenditure plans. We do however welcome such further information as has been made available, for instance the details of past and forecast relative price effects for different components of public expenditure.[23]

Projected Plans

17. Wages and salaries account for just over 30% of total public expenditure. Public service pay is therefore a major determinant of public expenditure. There is provision in the White Paper for an increase in earnings of 6% in annual settlements[24]. Table 4.13 shows that this assumption entails a fall of 2½% in public pay relative to overall prices. Many public service employees have already settled for pay increases in excess of 6%. It follows that there will have to be reductions in manpower, over and above those already planned, if cash limits are to be adhered to. Each overall percentage point over 6% adds some £300m to public spending at current prices or requires a reduction in the number of employees in the public services of about 50,000.

18. In our report on the Budget last year we queried the likelihood of the assumed turn round in the financial position of the nationalised industries between 1979/80 and 1980/81. Government lending to nationalised industries has in fact turned out to be over £1 bn higher (at 1980 Survey Prices) in 1980/81 than was originally planned. The current White Paper maintains the expectation of a massive improvement in the finances of the nationalised industries:-

£m at 1980 Survey Prices

	1980/81	1981/82	1982/83	1983/84
Total Capital Requirement	4750	5400	5500	5500
of which:				
financed internally	2250	3650	4750	5450
financed externally	2500	1750	750	50
Government Lending to Nationalised Industries	2050	1400	350	-150

(Source: Cmnd 8175, Tables 1.7 and 3.1)

This improvement, based on estimates about the middle of last year, 'assumes continued application of policies of economic pricing and success in reducing current losses' and is 'subject to general trading conditions'.[25] In evidence to us the Chancellor said that this year's estimates "are not subject to the same uncertainty as last year", although he felt that they were not "un-ambitious".[26] Any failure of the economy to attain a sustained recovery this year and over the medium term must make these figures appear optimistic. We remain sceptical about whether they will be achieved.

19. The requirement for the nationalised industries to achieve "economic pricing policies" generally entails either improvements in relative efficiency or rises in prices above the general rate of inflation. As the Chancellor told us, real gas prices would rise by 10% per annum and real electricity prices by 5% per annum. There may indeed be sound grounds from the point of view of energy pricing policy for such significant real increases. The question remains, though, whether it is economically prudent to use the monopoly powers of these nationalised industries as a means of reducing the PSBR through what is in effect additional taxation.

20. A large part of the fall in public expenditure from 1981/82 to 1983/84 arises from reductions in expenditure on the industry and employment programmes:-

	£m at 1980 Survey Prices				
	1979/80	80/81	81/82	82/83	83/84
Support for Aerospace, Shipbuilding, Steel and vehicle manufacture	377	523	820	390	30
Department of Employment expenditure	1243	1750	1797	1390	1290

(Source: Cmnd 8175, Table 2.4)

The White Paper has apparently included only spending that has already been approved and the envisaged falls suggest the phasing out of the substantial assistance such as that to British Leyland and British Steel which has been such a feature of Government policies in recent years and the running down of the special employment programmes - this despite the White Paper's projected rise in unemployment. In our view it is probable that further expenditure will be approved which cannot be wholly accommodated from the contingency reserve.

Balance between Current and Capital Expenditure

21. An outstanding feature in recent years has been the decline in public sector capital expenditure both absolutely in volume terms and as a share of total public expenditure, a decline that is forecast to continue, albeit on a very modest scale, into 1981/82:-

9

	1975/76	76/7	77/8	78/9	79/80	80/81 (estimate)	81/82 (planned)
Fixed Capital Expenditure at 1980 Survey Prices £m (including nationalised industries)	15,809	14,759	12,470	11,628	11,140	9,930	9,837
as % of total public expenditure	19.4	18.6	16.8	14.9	14.3	12.5	12.4

(Source: Cmnd 8175, Table 1.8 and 3.2)

One cause of the past decline has been the relative ease with which, when spending cuts are required, capital spending can be reduced. Irrespective of what political view is taken about overall public spending as a proportion of GDP, the Committee believe that the decline in capital spending relative to current expenditure should be halted and reversed. Provided that the programmes are properly appraised and efficiently implemented, public sector investment can be as desirable as private sector investment. Major improvements of the infrastructure are necessary for the maximum effectiveness of the economy. We note that nationalised industry investment is planned to rise by 14% over the next year. Nevertheless such investment in 1981/82 will still be 4% below that recorded in 1975/76. Public authorities capital expenditure on construction falls 6% in 1981/82 compared with 1980/81 and the fall since 1975/76 is 35%.[26a] We urge the Government to raise significantly the proportion of public investment within the total of public expenditure from its present low level.

22. There is good reason to believe that nationalised industry investment is being constrained by the present financing arrangements which require that all borrowing should count against the PSBR, irrespective of the circumstances of each industry. A number of solutions have been suggested, but each has its own difficulties and at the moment no solution is in sight. We were, however, encouraged by the Governor telling us that a good deal of hard thought was being given to this problem in the appropriate places and by the Chancellor indicating that he had an open mind about possible solutions.[27] The Committee hopes to enquire more deeply into these issues in the future.

23. In his Budget statement the Chancellor announced changes in the system of public expenditure planning. Future public expenditure surveys will be conducted in current prices for at least the first year of the survey. This marks a major change in the way public expenditure is planned. The present procedure of expressing expenditure at constant survey prices certainly has important defects. In particular, it does not allow for changes in the relative cost of public sector purchases and payments, which have financing implications in the same way as volume changes. But planning in cash terms involves equally important problems. It makes it difficult to know what level of service a given cash allocation will actually finance. The Committee will be considering these matters further.

IV Medium-Term Financial Strategy (MTFS)

24. The MTFS as stated in the Chancellor's Budget speech and in the Financial Statement and Budget Report (FSBR) has departed significantly from the form in which it was first put forward last year. We first discuss here the various changes that have occurred.

Modifications in the MTFS

25. i) Monetary targets are more tentatively stated. In 1980 the FSBR said "there would be no question of departing from the money supply policy, which is essential to the success of any anti-inflationary policy."[31]

26. The 1981 FSBR says that:

> "... the intention would be to hold firmly to the main thrust of the financial strategy - which is to bring about a progressive reduction in the growth of money supply and inflation over the medium term."[32]

27. ii) The pursuit of the £M3 target is not exclusive as the MTFS now takes account of other indicators, including the exchange rate. In the past there has been doubt as to what role indicators other than £M3 play in monetary policy. For example the Green Paper on Monetary Control (Cmnd 7858) said, on the one hand, that "As no one aggregate is by itself a sufficient measure of monetary control it could be argued that there should be targets for several or all" and, on the other, "The Government therefore believes that targets are best set in terms of a single aggregate"[34]. It is now somewhat clearer that indicators other than £M3 play a role in the Government's monetary policy. The 1981 FSBR stated:

> "£M3 is accordingly being retained as the main target variable in the medium-term financial strategy, though as in the past year the significance of short-run movements for interest rate policy will be interpreted in the light of other financial developments as well."[35]

28. The weights that are to be attached to the various indicators such as the exchange rate, inflation, and monetary indicators other than £M3 are unclear. Perhaps this is inevitable in the present circumstances. What is clear is that, without more information on the relative importance assigned by the Government to the various indicators, any supposed impact on expectations about inflation must be markedly reduced.

29. iii) The expected rate of inflation is now within the target range for the money supply. The 1980 FSBR forecast a 16½ per cent increase in the retail price index from the fourth quarter 1979 to the fourth quarter 1980. The target range set for £M3 from February 1980 was 7 to 11%. The Committee in its report on Monetary Policy, said that:

> "... as a matter of practical judgement we believe it is unwise to base economic policy in the United Kingdom on the assumption or hopes of general short term wage flexibility ... Such assumptions seem to us unrealistic, with the consequences that policies based on them are likely to have heavy costs in lost output and unemployment."[37]

The 1981 FSBR forecast a 10% retail price increase from the fourth quarter 1980, and set a target range for £M3 of 6 to 10%.

30. iv) The time horizon of firm targets has been reduced. The 1980 FSBR set targets for £M3 growth for four years. The Committee's report said the MTFS "was overambitious ... in setting specific targets for a four year period."[38] The 1981 FSBR does not roll on the tentative targets into 1985.

31. v) A large increase in the money supply is being accommodated. The 1980 FSBR said:

> "After 1980-81, for which a target range of 7-11 per cent has been announced for £M3, the Government intend to set a target range consistent with the annual growth of money supply being reduced to about 6% in 1983-84. The Government intend that there should be a progressive deceleration over the period."[39]

The Committee in its monetary report said, "In any future financial and economic strategy it would be wise to allow for modification of the tactics in the light of developments."[40] After allowing for the corset, the growth of £M3 exceeded the target range for 1980-81 by about 6%. Although the 1981 FSBR retained the same ranges for growth of £M3 in 1982-83 and 1983-84, they were rebased from higher actual levels than had been intended and they contained no allowance for clawing back this extra growth of £M3.[41] Even if the Government were to claw back some of the past year's rapid growth of £M3 there would still have been a large temporary increase in £M3.

32. Thus in its tentativeness, time horizon, setting of targets relative to expected inflation, conditionality, and accommodation of temporary increases, the MTFS has been substantially modified. In a number of important respects the greater flexibility in the MTFS is consistent with the recommendations in our report on Monetary Policy.

Monetary base control

33. Uncertainty about present monetary developments is increased by the various moves that are being made by the Bank in a manner that is said to be consistent with a later move to monetary base control. No firm proposals or timetable for proposals have been made. The Governor of the Bank of England told us that:

> "I do not myself see an early move to monetary base control. What I do see is the continuing of the discussions which I mentioned and of the operations which I have spoken of, all of which are consistent with it but do not themselves represent the decision to go to it."[42]

Until more precise proposals are made it is impossible to form a final view about how effectively they will work. However, for the reasons we outlined in our monetary report, we remain sceptical of the value of monetary base control.

The MTFS in 1981-82

34. It has been argued that there has been a tendency to enhance the status of the PSBR in the MTFS at the expense of the monetary indicators. Both Treasury officials and the Chancellor vigorously denied this.[43] While the PSBR is not regarded by the Chancellor as a target, fiscal measures taken in the Budget were chiefly determined by the need to provide for a PSBR consistent with the monetary target.

35. The PSBR is the difference between two large numbers, public spending and public revenue, and it is most unlikely that any particular figure will be exactly achieved (the average annual Treasury error since 1973 in forecasting the PSBR has been equivalent at today's prices to £4½b.[44]) It follows that it would be unwise to emphasise the importance of its precise achievement.

36. In the MTFS, the 'fiscal adjustment' represents the margin between the PSBR considered compatible with monetary targets and that implied by current expenditure plans and tax rates. In last year's MTFS, fiscal adjustments of £2½bn and £3½bn (at 78/79 prices) were possible in 1982/83 and 1983/84 respectively. Since then a substantial negative fiscal adjustment has been made and tax rates are now at a higher level than last year. Nevertheless, the scope for positive fiscal adjustment in 1982/83 and 1983/84 is now only £1bn and £2bn respectively, less than it was last year. As the 1981/82 MTFS states, these sums represent no more than would be required to offset the rise in the personal tax burden expected this year and adds that this is "clearly unsatisfactory in the context of the Government's wider economic objectives."

37. The MTFS now assumes a reduced rate of medium term growth in GDP, ½% a year for the period 1980-83 as opposed to last year's assumption of 1% per annum. The implication of this is that unemployment by the end of the MTFS period is now expected to be higher than was previously thought. If output does not in fact grow at a higher rate than this, there seems little chance before 1984, given the forecast increase in the population of working age over the next few years, of unemployment falling significantly from its current high level.

38. Achieving the target rate for £M3 of 6-10% should, we believe, be easier this year. The Governor detailed a number of current developments which improved the prospects for meeting the target.[45] Moreover, two special factors which the Treasury and Bank say operated last year to push up £M3 growth (the ending of the corset and the accumulation of liquid resources, which in part reflected a desire to rebuild savings balances eroded by inflation) should now be removed; whilst the monetary growth desired by the Authorities is no longer as optimistic in relation to the expected rate of inflation as it was last year.

V Prospects for Recovery

39. The Treasury's forecast in the FSBR, "Economic Prospects to mid-1982", suggests that the fall in GDP will end during the year and indeed start to move up.[51] We first examine the differences between the Treasury's forecast and those of other economic forecasters and then look at the different components of this recovery in turn.

Comparison between Treasury and other forecasts

40. Table 1 compares the post-Budget forecasts of the Treasury[52], the London Business School[53], the National Institute [54], Phillips and Drew[55] and the Economist Intelligence Unit, which uses the Treasury model[56]. The main features are summarised below.

The Year 1981

41. The Treasury forecast for overall activity in 1981 as measured by GDP is in the middle of the other forecasts (the average forecast decline is just over 2%). This conceals somewhat differing views on the components of output. For 1981 the Treasury is the least pessimistic forecaster for gross fixed investment, projecting a decline of 4½% which compares with the 9.1% decline estimated by the National Institute. Views on consumption this year fall within a narrow band. On exports the Treasury expects the largest decline of 5.5%. On imports the Treasury forecast a fall of 2½%, much in line with the NIESR. On stockbuilding, the Treasury is forecasting a continuing large decline as are the National Institute and the EIU. The LBS alone forecasts no decline in stockbuilding over the year. All forecasters project a significant current account surplus for 1981. Inflation expectations are much in line with one another as are unemployment forecasts.

The Year 1982

42. Treasury forecasts unfortunately extend only to the first half of 1982 which makes comparison virtually impossible. It would be helpful if the Treasury published their forecasts looking two years rather than 18 months ahead. Of the other forecasters the LBS emerges as the most optimistic about output growth. It and the EIU, project, however, a higher rate of inflation by the 2nd quarter of 1982 than do the Treasury. Views of the likely current account position in 1982 range from a surplus of £3.8 billion foreseen by the NIESR to a deficit of £1 billion given by Phillips and Drew. The National Institute and Phillips and Drew differ widely in the likely outcome for investment in 1982, the Institute being markedly more pessimistic. The National Institute is markedly more pessimistic than the Treasury on stockbuilding, the Institute envisaging a further decline in stocks, the Treasury a rise.

The Components of recovery

43. Stockbuilding. Treasury officials said that much of the fall in GDP during 1980 was a result of destocking, particularly in manufacturing industry.[57] Although £1.7 billion (at 1975 prices) of further destocking is forecast for the first half of 1981 the rate of fall drops to £400 million by the second half and restocking starts in the first half of 1982. This leads, the Treasury suggests[58], to a manufacturing stock-output ratio in mid-1982 which is close to the average for

Liverpool

7

Table 1

COMPARISON OF FORECASTS

Percentage change year-on-year in constant 1975 prices unless stated otherwise		Treasury[1]	London Business School	NIESR	Phillips & Drew	EIU
Gross Domestic Product	1981	-2	-1.5	-1.5	-3.1	-3.0
	1982	1	2	-0.1	1.5	-0.5
Consumers' Expenditure	1981	-1	0.5	0.5	-0.6	-1.3
	1982	1	na	1.1	0.4	-0.5
Gross Fixed Investment	1981	-4.5		-9.1	-7.6	-6.4
	1982	-0.5		-4.1	1.6	-0.5
General Government Current Expenditure			1981 -1.5			
	1981	1		-1.0[13]	1.6	-0.5
	1982	-1		-1.8[13]	0.3	-1.0
Exports of Goods and Services	1981	-5.5	-4.5	-1.7	-3.4	-5.0
	1982	-1.5	na	2.4	3.6	-1.0
Imports of Goods and Services	1981	-2.5	-4	-2.6	-0.8	-5.0
	1982	8	na	5.2	8.7	6.0
Stockbuilding (£M)	1981	-2,100	0[4]	-2,040	-1,843	-2,150
	1982	150	na	-700	833	0
Balance of Payments on current account (£b current price)	1981	3	2	5.3	3.4	4.3
	1982	0	0[1]	3.8	-1.0	0.5
Public Sector Borrowing Requirement (£b current prices)	1981/82	10.5	12.5	9.2	11.0	11.5
Retail Price Index (12 month rate of increase)	1981	10[2]	9.5[2,6]	11[6]	10.5[2]	11.5[2]
	1982	8[3]	9.5[3,7]	9.5[6]	8.5[3]	10.7[3]
Unemployment (GB adults, millions)	1981	2.5[10]	2.7[5]	2.68[8]	3.00+[9]	2.65
	1982	2.7[11]	2.4[12]	3.10[8]	3.30[9]	3.00

1. Figures for 1982 refer to first half only.
2. Fourth quarter 1980 to fourth quarter 1981.
3. Second quarter 1981 to second quarter 1982.
4. Change in stockbuilding as % of GDP.
5. By end of 1981-82.
6. Change in consumer price index fourth quarter on fourth quarter.
7. Change in consumer price index.
8. Fourth quarter.
9. End of year, wider definition of unemployment.
10. Average 1981/82 - White Paper assumption.
11. Average 1982/83 - White Paper assumption.
12. By end 1982-83.
13. Public Authorities Current Expenditure.

na: not available

Note: Owing to differences in starting assumptions used in the various forecasts, strict comparison between them is not possible.

1975-79 and so "it would make sense to think in terms of a levelling out of stocks and hence this kind of path of totalstock-building and of output".[59] However, given the current financial situation of many industrial companies and given the continuing large excess of nominal interest rates over the increase in the price of stocks[60], it might be that companies would prefer lower stock-output levels than those which were usual in the past.

44. With an average error of £750 million[63] (in 1975 prices) in previous forecasts of the annual rate of stockbuilding, it is clearly difficult to be precise about what may happen. Whether a turn round in stockbuilding would open the way for sustained growth after 1981 depends in particular on whether there is a marked recovery in exports and investment.

45. Consumers' Expenditure The Treasury forecasts a strong recovery in real consumers' expenditure by the first half of 1982 following a substantial fall in the second half of 1981,[64] partly as a result of a falling savings ratio[65] which in turn is partly, but not mainly, a result of falling inflation.[66] Treasury officials gave an estimate that, with fixed real incomes, a one per cent fall in inflation increases consumers' expenditure in the short run by about 0.2 per cent.[67] This would appear to be a relatively small effect.

46. Fixed Investment The Treasury forecasts a slight rise in fixed investment (other than general government investment) in the second half of 1981 but that this will be reversed by the first half of 1982.[68] Given the level of most companies' existing spare capacity, for private investment in plant and machinery to pick up a substantial increase in sales and profitability would appear to be needed. This is particularly true of manufacturing industry. However the Chancellor did suggest that the number of private housebuilding starts may be recovering from its very low level of 1980.[69]

47. Overseas Trade The Chancellor pointed to recovery in world trade as a possible source of UK recovery.[70] However, it would appear that much of the effect of recent lost competitiveness of UK industry has yet to come through. The FSBR suggests that the UK's share of the volume of world trade in manufactures is "significantly affected by changes in competitiveness with a lag which extends over several years"[71] and forecasts a fall of 5½% in total exports (in 1975 prices) in 1981 over 1980, with the fall continuing into the first half of 1982.[72] Meanwhile, imports are forecast to rise by 8%, comparing the first half of 1982 with a year earlier[73]; as destocking ends import volume will presumably rise.

48. The North Sea The Government has provided considerably more detailed information about future oil and gas revenues this year than was made available last year; we welcome this development. We note that in the event the 1980 Budget forecasts of revenue and production were not, for 1980-81 at least, unduly underestimated as we had suggested in our Report of a year ago[74]. For the future, the Government forecasts that the direct contribution of North Sea oil and gas production to GNP will grow by £1.1 billion at 1979-80 prices between 1980 and 1981 and £0.6 billion between 1981 and 1982.[75] This is an increase equivalent to about 0.25% of GNP per half year. Comparison with the Treasury's forecast for total GDP[76] is made difficult by the considerable differences between the changes in oil prices and prices for other components of GDP between 1975 (used as the price base for the GDP forecast) and 1979/80. However, it would seem that something like a third[77] of the 1% growth in GDP forecast between the first halves of 1981 and 1982 is due to growth in the contribution from the North Sea.

The medium term

49. As the Chancellor suggests [78], it is perhaps too easy to be sceptical about each of the components of the forecast recovery in turn. We agree that there are some indications that the very rapid fall in GDP experienced last year has slowed down[79] but also agree with the Governor that turning points in the economy are difficult to predict.[80] Nevertheless, even if, as we would hope, the factors identified by the Treasury do promote some recovery in the components of GDP in the short term, it is noticeable that none of them individually seems to be a reason to expect significant sustained growth in the medium-term; even when taken together, they do not lead to an view of the future that there will be a stong upturn. As the Governor said, "I think it is generally felt that when the upturn comes ... It is not likely to come with a rush and be fairly strong."[81]

50. The Financial Secretary has given the view that:

> "It is the Government's contention that it is essentially the growth of the money supply in relation to inflation that will be the prime determinant of the overall level of domestic demand and hence output in the economy, and not the fiscal stance."[82]

With inflation forecast to fall within the target range for growth in the money supply and given a trend increase in the velocity of circulation, the Financial Secretary goes on to suggest that, in these terms, the MTFS is not contractionary and that "the reduction in the PSBR brought about by the Budget is unlikely to make much overall difference to the total level of demand".[83]

51. It is unclear precisely what the Financial Secretary has in mind. Relating his statement to the coming financial year it could be argued that, following the monetary squeeze in 1980/81, the rate of inflation has fallen so rapidly that it will undershoot the rate of growth of the money supply in 1981/82. This would be associated with a recovery in real output if it is believed that the initial monetary squeeze only has an effect on real output in the short run, leaving it to resume its steady rate of growth in the long term. As a general proposition relating to the longer term, the argument would appear to suggest that the future rate of inflation is taken as given, so that the MTFS determines the rate of growth of the real money supply and of output. This would be hard to reconcile with the Treasury's view that the rate of growth of the nominal money supply determines the rate of inflation in the medium term.[84] The rate of growth of the money supply surely cannot be used in advance as an instrument to control both independent objectives of the rate of inflation and the real level of output? It is unclear why, in the Financial Secretary's view, money supply growth above the rate of inflation should end up increasing output rather than prices. The Government should take the opportunity offered by the debates on the Public Expenditure White Paper and the Second Reading of the Finance Bill to spell out its position more clearly.

52. The Financial Secretary suggests that the "whole purpose" of the Government's economic strategy is that future behaviour will not be like that of the past.[85] But any influence of money supply targets on behaviour must be substantially diluted by the recent history of £M3 and by the Government's present acceptance of the £M3 overshoot as the base for this year's £M3 target. One of the factors intended to help in changing behaviour was the incentive effect of reduced taxation. However, the overall level of taxation on individuals has risen since 1979, particularly as a result of the present Budget.[86] As we have seen above, the scope for "fiscal adjustment" within the MTFS is only enough to offset the rise in the personal tax burden expected this year. We note that, had income tax thresholds been raised in line with statutory indexation provisions, there would have been some 700,000 fewer taxpayers in 1981-82 than in 1980-81[87]; as it is, there are expected to be 500,000 more.[88] Such changes have implications for other aspects of policy: if people are concerned about their real post-tax wages there may be adverse effects on the climate of wage bargaining.

53. As we have discussed above the fiscal impact of the Budget and November measures was to take some £5 billion out of the economy. The argument that this will not be contractionary because there will be an expansion in the real money supply seems to us to be unconvincing. The private sector components of GDP may show some recovery in the short term but it is hard to discern any engine of sustained recovery. The Treasury's revision of their original "deliberately cautious" assumption of an average GDP growth rate of 1% per year after 1980[89] to one of ½% per year[90] may therefore be justified. With such a low level of growth, much of which is accounted for by North Sea oil and gas, and the implications this has for the other sectors of the economy, the medium term prospects for unemployment in particular are bound to give concern.

Will discuss with Chancellor, MT

Prime Minister

I think you ought to have a word with the Chancellor about this before you leave. We will try to fit him in on Monday.

Ref. A04697

MR. LANKESTER

Flag A — You asked for my advice on the Chancellor of the Exchequer's minute of 8th April to the Prime Minister about economic policy discussions in Cabinet.

2. I think that it is a good idea to have three macro-economic discussions during the year. I agree that mid-January and mid-May are the right times for the first two. I think that mid-September is probably the best time for the third, because it is probably the last convenient moment before the Party Conference. But it does not fit so well with the cycle of economic forecasts, and from that point of view a better time would be in the second half of October, before the new Session of Parliament and The Queen's Speech.

3. How important is it to have such a discussion in Cabinet before the Party Conference? I can see the value of establishing a Cabinet consensus on economic strategy before the Prime Minister and the Chancellor of the Exchequer prepare their Conference speeches. The possible disadvantage is that, if (as we must assume) it becomes known that the Cabinet has had such a discussion and the leaks and rumours suggest division in the Cabinet, that may not be the best prelude to the Party Conference.

4. So I think that there is quite a good case for thinking that the second half of October would be the best time for the third economic discussion.

5. As to the form of the discussion, I agree with the Chancellor that it would be important to avoid putting into commission particular economic and financial decisions. The object of the occasions would be to discuss and to re-establish reassurance and consensus on the strategy and the broad stance of policy.

6. For these purposes I doubt whether the best course is to have an opening statement by Terry Burns. It should be a discussion, not a seminar; and I believe that colleagues were left with some feeling of discontent after last year's seminar at Chequers, because they felt that they had not really had a chance of discussion. I think that the normal pattern should be for the Chancellor to introduce the discussion with an opening statement, based on the

current economic forecast and describing the outlook for the period ahead. If that called for general changes in the direction of policy, he would no doubt say so, without particularising how he proposed to go about it. I would expect that he would want to make his statement orally rather than in writing, and I think that colleagues would be content with that; but I also believe that it would be useful if there were some supporting material in visual form: perhaps outline figures from the forecast, perhaps some charts, perhaps even some brief prose on the outlook. Without such supporting material it can be very difficult for colleagues to digest a complicated oral statement on economic matters.

7. I think that the suggestion in paragraph 10 of the Chancellor's minute is a useful one.

8. I expect that the Prime Minister will want to discuss these matters with the Chancellor of the Exchequer; but, if there is not time before she goes to Saudi Arabia, and she agrees in general with this minute, I should be very happy to incorporate it into a draft minute for you or her to send to the Treasury.

RtA

ROBERT ARMSTRONG

10th April, 1981

CONFIDENTIAL

HS

BF 28.4

MR. WRIGHT

I enclose a minute that the Chancellor of the Exchequer has sent to the Prime Minister about economic policy discussions in Cabinet. I am sure the Prime Minister would welcome Sir Robert's advice on it.

J. P. LANKESTER

8 April 1981

CONFIDENTIAL

cc Wolfson
Walters

CONFIDENTIAL

also copied
to Cabinet
ministers.

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

PRIME MINISTER

MACRO-ECONOMIC POLICY

I have been thinking since our talk last week about the case for giving Cabinet more regular opportunities to discuss macro-economic policy.

2. We have already agreed to have a discussion of this kind in May, ahead of our consideration of the substance of next year's PESC. As I mentioned the other day, I think that it would be a good idea for me to follow this up with the suggestion that we make such discussions a regular, but not too frequent, occurrence.

3. I should not, as you know, be suggesting simply that we bow to pressure. For I am increasingly convinced that the more we expose the whole Cabinet to economic realities and to the absence of any viable alternative to the substance of present policy, the more likely we are to secure their active support. If we cannot convince colleagues that we are right, then we shall find it difficult to convince the country. Inevitably there is a wide spread of views within Cabinet and not every colleague will ever be totally convinced. But I believe that by taking them more fully into our confidence we can secure more whole-hearted commitment to the message - and to the

/need to sell

need to sell it - to the country.

4. You will remember that all this was in our minds when we discussed the possibility of a macro-economic discussion in Cabinet, before the Budget. I was then favourably disposed to the idea, as I think you were too, and we were only put off by the unhelpful leak that occurred in The Times, which had the immediate effect of representing a Cabinet discussion as a "surrender" by both of us to outside pressure. We were also much influenced by the possibility, which that leak only made stronger, that if such a discussion were to take place and were to involve the disclosure of specific Budget measures, the whole Budget might well have leaked.

5. In suggesting a regular economic discussion, I certainly do not envisage that we should "put into commission" any particular economic decisions, such as the formulation of our monetary guidelines or (least of all) the Budget itself. Those matters must remain the responsibility of the Chancellor of the Exchequer, subject, of course, only to my clearing my proposals with you. But from all that I have heard, I do not think that more than one or two of our colleagues (if that) want to be involved in Budget-making itself, except insofar as their Departmental interests are concerned. Where they do want to be reassured on is the broad stance of policy. And I believe we can hold them to that.

6. The programme which I mentioned to you would be on something like the following lines. We would aim to have three macro-economic discussions, more or less equally spaced throughout the year. I should not necessarily put in a paper, but either I or, perhaps, Terry Burns would make an

/introductory statement

introductory statement describing how the economy had been developing in recent months, indicating whether it had been departing in any serious way from the path we had expected and describing the outlook for the period ahead. I would obviously give an indication if in my view existing policy was going awry; this would mean acknowledging the scope for some adjustments of policy.

7. It would clearly be necessary to time the first such discussion of the year well forward of the Budget so as to avoid a detailed discussion of Budget measures; and on this footing I think that the first meeting of the year ought best to take place in mid-January. By then I would have the Treasury forecast and would be able to talk in general terms about the outlook for the year ahead. But as I would not have crystallised my Budget thinking, I could refuse to be drawn into detail.

8. The next discussion would be four months later in mid-May, which would be the opportunity for a post-Budget stocktaking and for a discussion which would set the scene for the forthcoming public expenditure survey. This could be an invaluable opportunity for me to alert colleagues to what the requirements were likely to be of the survey, so that when we got down to detailed public expenditure discussions, these took place against the background of the underlying economic situation.

x June

9. Finally, the third meeting would be in mid-September, i.e. immediately after the holidays and before I got caught up with the annual meetings of the Commonwealth Finance Ministers and the IMF. This would give Cabinet a good opportunity to examine how policy would be presented at the party conference.

/I would like to

CONFIDENTIAL

10. I would like to suggest one other change. This would take the form of a short report to the Cabinet once a month on economic developments. Cabinet members are already provided with a note by the CSO on the main indicators. This is valuable as far as it goes, but I suspect that colleagues find it a rather clinical document and that it does not have much impact. What I am suggesting is that I ask Terry Burns to draft a couple of pages, slightly more impressionistic but rather more readable and informative. This would get ordinary Cabinet circulation alongside the CSO note. I do not think that it need always give rise to regular discussion. There might be occasions when some of our colleagues would want to pick something up in it and have a short impromptu discussion. I would not wish to resist that. Indeed the Cabinet agenda might include a monthly reference to 'Economic Affairs' to act as a peg for such a discussion.

11. You will want to think these matters over and perhaps we could have a further word about them, particularly about the related question of timing, including the date for a resumed discussion of the change to cash budgeting. I would like to have your views before you go to Saudi Arabia, since we are in any case to have our first Cabinet discussion in May and I should like to start to prepare the ground now.

(G.H.)

8 April 1981

D/O

PRIVY COUNCIL OFFICE

WHITEHALL, LONDON SWIA 2AT

Chancellor of the Duchy of Lancaster

PRIVATE & CONFIDENTIAL   6 April 1981

Dear Bernard,

You will recall discussing this subject with the Chancellor of the Duchy a little while ago and I now attach a list of the planned composition of the Committee, together with a copy of a letter which the Chancellor has sent to those concerned. He would be most grateful if you could participate as proposed.

Yours ever,

David.

D C R HEYHOE
Private Secretary

Bernard Ingham, Esq
Press Secretary
10 Downing Street
LONDON

Enc

Copy to Mr Whitmore

CHAIRMAN:	The Rt Hon Francis Pym MC MP
	The Rt Hon George Younger MP
	The Rt Hon Leon Brittan QC MP
	Norman Tebbit MP
	John Wakeham MP
	The Rt Hon Lord Thorneycroft CH
	Alan Howarth
	Bernard Ingham
JOINT SECS:	Conservative Research Department
	Paymaster General Staff

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

PRIVATE AND CONFIDENTIAL

6th April 1981

Dear Peter,

I have been giving thought during the past few months to the arrangements needed for the effective and coordinated presentation of Government policy. It seems to me that our existing arrangements are less than satisfactory in this respect and I see an important gap to be filled here. In the past, throughout the 1950s and again in 1970-74, a Liaison Committee with members drawn from Government and the Central Office operated for this purpose. It provided a regular public relations link between Government and the Party, and I believe that there is a need for similar arrangements today.

I therefore propose, with the Prime Minister's agreement, to revive this Committee with the following terms of reference (which are very similar to the original terms of reference):

> "to give guidance to Members of Parliament and others on the interpretation of Government policy and to take such action as in their opinion is necessary to sustain public confidence in the Government".

The purpose of this letter is to ask if you would be so good as to agree to serve as a member of the Committee. I attach a note of its proposed composition. I realise the very many demands that there already are on your time, but I do hope that you will be able to accept.

I am keen for the Committee to begin its work as soon as possible and I therefore plan to hold the first meeting at 10.15 am on Wednesday, 15 April to discuss the way ahead. I hope that this will be convenient. Thereafter, I envisage that the Committee should meet weekly.

I look forward very much to hearing from you.

Yours ever
Francis

FRANCIS PYM

The Rt Hon Lord Thorneycroft, CH
Conservative Central Office
Smith Square
SW1

Enc

CABINET OFFICE

With the compliments of
Sir Robert Armstrong KCB, CVO
Secretary of the Cabinet

C. A. Whitmore, Esq

70 Whitehall, London SW1A 2AS
Telephone: 01-233 8319

CONFIDENTIAL

Copies to: ~~Mr Wolfson~~ Mr Walters. Mr Lankester.

Econ Strat 7w

CABINET OFFICE

70 Whitehall, London SW1A 2AS Telephone 01-233 8319

From the Secretary of the Cabinet: Sir Robert Armstrong KCB, CVO

Ref: A04638

6th April 1981

I didn't record this in the minutes of last Thursday's Cabinet because there was no item under which it readily fell; but I should place on record - hence this letter - that the Secretary of State for Employment suggested that time should be found for a discussion in Cabinet on economic strategy, and the Prime Minister said that there would be an opportunity for such a discussion in the context of forthcoming consideration by the Cabinet of this year's public expenditure survey, probably some time in May.

I am sending copies of this letter to Clive Whitmore and Richard Dykes.

ROBERT ARMSTRONG

A.J. Wiggins, Esq

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Note for the record

Top copy destroyed in view of CAW comments

c.c. Sir Robert Armstrong
Mr. Whitmore

At their meeting yesterday afternoon, the Prime Minister and the Chancellor discussed the question of whether, and when, Cabinet should have a discussion on economic policy. The Chancellor suggested that it would be a good idea to have, say, 4 economic policy discussions a year; when foreign affairs was on the Cabinet agenda every week, it seemed unreasonable to many colleagues that there should never - or hardly ever - be anything on economic policy. He thought a commitment of some kind to have a discussion every three months would help to mollify some of the critics within the Cabinet. He suggested that there should be a first discussion either at the meeting at which the PESC guidelines were to be discussed, or possibly at the meeting prior to that discussion. This would mean either economic policy and PESC on 30 April, or economic policy on 30 April and PESC on 7 May. He proposed to set out his proposals in a minute in the next few days.

The Prime Minister expressed some doubts about the wisdom of having a regular economic policy discussion; but she was prepared to contemplate a discussion in conjunction with the discussion of the PESC guidelines.

I. P. LANKESTER

Tim: TL.

I had a word with Robert Armstrong at Dep Secs this morning about how we set up the discussion on economic policy which Cabinet agreed this morning. I do not think, for example, that we want a repeat of the Burns presentation we had last July. Much better not to have a paper from the Chancellor which he introduces in the ordinary way. Robert & I agree that in the first instance he should have a word with Douglas Wass about this.

[illegible]
2/iv

2 April, 1981.

CONFIDENTIAL

FILE

R H

BC/ Mr Ingham

Econ Pol

10 DOWNING STREET

Principal
From the Private Secretary

1 April, 1981

Liaison Committee

The Prime Minister has seen the Chancellor of the Duchy of Lancaster's letter of 30 March to her about the revival of the Liaison Committee.

The Prime Minister is content with the draft letter attached to Mr Pym's letter, subject to one point. Since civil servants are to be included - rightly, in the Prime Minister's view - in the membership of the committee, she thinks that the terms of reference should be made slightly less party political by changing their last few words to read " ... to sustain public confidence in the Government".

With much the same thought in mind the Prime Minister has also suggested the omission of the reference to candidates. The opening words of the terms of reference would thus read "to give guidance to Members of Parliament and others ..."

If the Chancellor of the Duchy is content with these changes, a consequential amendment to the opening of paragraph 2 of the draft is needed. Perhaps something on the following lines would do "I therefore propose, with the Prime Minister's agreement to revive this committee, with the following terms of reference (which are very similar to the original terms of reference):"

W. G. A. WHITMORE

D Heyhoe, Esq
Chancellor of the Duchy of Lancaster's Office

SP

1

PRIME MINISTER

LIAISON COMMITTEE

The attached letter from the Chancellor of the Duchy of Lancaster seeks your approval for a letter re-establishing the old Liaison Committee which he would like to send to the proposed members of the Committee.

I have shown the draft letter to Bernard Ingham, and he and I have only one comment on it. The proposed terms of reference, which are the same as those for the original Committee, do carry something of a party political flavour, and Mr. Ingham feels - I think, understandably - that this might put him as a civil servant in a slightly difficult position. We could get over this minor obstacle quite simply by changing the last few words of the terms of reference to read as follows:

" . . . . to sustain public confidence in the Government".

Are you content with this small change? Yes. I think the reference to candidates would have to be deleted.

If you are, a small consequential amendment will be needed to the beginning of paragraph 2 of the draft letter. This is something I can agree with Mr. Pym. It is not necessary. MT.

MW.

31 March 1981

N.B. We shall be in difficulty (on reflection) because M.P.'s are not confined to the govt. side. MT.

PRIVY COUNCIL OFFICE
WHITEHALL. LONDON SW1A 2AT

Chancellor of the Duchy of Lancaster

30 March 1981

Dear Margaret,

LIAISON COMMITTEE

Following our recent talk about this subject, I attach the draft of a letter which I would like to send to those concerned, together with a list of the planned composition of the Committee. This does not include John Harvey, since I am not sure whether you have yet had a chance to talk to him.

Are you happy for me to proceed on the lines now proposed?

Yours ever

Francis

FRANCIS PYM

The Rt Hon Margaret Thatcher, MP
Prime Minister
10 Downing Street
LONDON

Enc

DRAFT

I have been giving thought during the past few months to the arrangements needed for the effective and coordinated presentation of Government policy. It seems to me that our existing arrangements are less than satisfactory in this respect and I see an important gap to be filled here. In the past, throughout the 1950s and again in 1970-74, a Liaison Committee with members drawn from Government and the Central Office operated for this purpose. It provided a regular public relations link between Government and the Party and I believe that there is a need for similar arrangements today.

I therefore propose, with the Prime Minister's agreement, to revive this Committee with its original Terms of Reference, which were:

> "to give guidance to Members of Parliament, candidates and others on the interpretation of Government policy and to take such action as in their opinion is necessary to sustain public confidence in the Conservative Administration."

The purpose of this letter is to ask if you would be so good as to agree to serve as a member of the Committee. I attach a note of its proposed composition. I realise the very many demands that there already are on your time, but I do hope that you will be able to accept.

I am keen for the Committee to begin its work as soon as possible and I therefore plan to hold the first meeting on [ ] to discuss the way ahead. I hope that this will be convenient. Thereafter, I envisage that the Committee should meet weekly.

I look forward very much to hearing from you.

Chairman	The Rt Hon Francis Pym MC MP
	The Rt Hon George Younger MP
	The Rt Hon Leon Brittan QC MP
	Norman Tebbitt MP
	Whip
	Lord Thorneycroft
	Alan Howarth
	Bernard Ingham
Joint Secs	Conservative Research Department
	Private Secretary PMG side

Econ

NBPM

cc Mr Vorke

SECRETARY OF STATE FOR EMPLOYMENT

PRIME MINISTER

27/3

PAY BRIEF

I attach my Department's Pay Brief for March. I am sending copies to members of E, E(PSP), and E(EA) Committees, and to Sir Robert Armstrong.

J P

24 March 1981

CONFIDENTIAL

PAY BRIEF - POSITION IN MID-MARCH

SETTLEMENTS

1 Since the February pay brief 98 settlements covering 926,000 employees have been reported. In the private sector the weighted average level of settlements over the last month was 7%, but this was heavily influenced by implementation of a 3%-6% offer for Motor Vehicle Retail and Repair (370,000). The average in the public sector (7 settlements covering 232,000 employees) was just under 8½%.

2 The cumulative average level of settlements for the whole economy this round is 9% (429 settlements covering 4,135,000 employees) compared with 9½% last month.

3 In the private sector the cumulative average is just under 9% (397 settlements covering 2,250,000 employees). About 4/5 of the settlements recorded so far have been in manufacturing, where the average level is just under 9½%. The average in non-manufacturing is just under 8½%, but the principal groups in the Construction and Financial sectors have yet to settle.

4 In the public sector (32 settlements covering 1,884,000 employees) the cumulative average is just over 9%. The average for the trading sector (24 settlements covering 416,000 employees is just under 9½% and for the services sectors (8 settlements covering 1,468,000 employees) is 9%. If the two agreements for Teachers (558,000) are ratified these will reduce the average for both the services sector and for the public sector overall to just over 8½%.

CHARACTERISTICS OF THE PAY ROUND

5 At about the half way stage in the round our information on settlements indicates that:

(1) In the public sector the average level has dropped from about 21% (Police) to about 9%. In the services sector, as was expected, apart from special cases (Police, Firemen) the settlement for LA manuals (7½%) established a going rate which will probably be followed by other major groups. A settlement for the Civil Service should set the seal on the round. No trend is as yet discernible in the trading sector where the average is dominated by the miners settlement, publicly presented at 13%. But other energy groups are pressing for similar treatment.

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(2) In the private sector there is a wide range of settlements generally (see Appendix 4). Recent settlements have tended to concentrate in the 7% to 12% range. Almost ½ of the settlements covering about ¾ of the employees are in single figures.

(3) There has been a significant decline in the level of settlements with each month's average being lower than the previous month's, but there are now signs that the level may be stabilising.

(4) Up to March manufacturing industries, being exposed to international competition and a high exchange rate, have settled on average for less than non-manufacturing. This month, however, the trend has been reversed due to the low settlement in Motor Vehicle Retail and Repair but will probably revert when groups in the financial sector settle.

(5) Sectors below the average include engineering, road haulage and clothing. Those above the average include oil and chemicals, food and drink and the financial sector.

(6) About ¼ of employees achieved longer holidays but few settlements included reductions in hours.

(7) There was a continuing erosion of the principle that settlements should last for 12 months but the majority of groups retained the traditional date.

NEGOTIATIONS

6 In the PUBLIC SECTOR, Civil Service non-industrials (1 April - 562,000) are taking selective industrial action following rejection of a 'final' offer of 7%. Negotiations are taking place for NHS craftsmen and maintenance workers (1 January - 14,500) on the basis of a 6% offer combined with partial consolidation of bonus payments. The claim is for parity on basic rates with the electrical contracting industry, estimated to be worth 21%. Offers of 6% have been rejected by NHS ancillaries (13 December - 211,000) and ambulancemen (1 January - 17,000), but the possibility of higher settlements to last for more than 12 months, to keep within the pay factor, is being considered for these two groups. A claim by NHS nurses and midwives (1 April - 492,000) for an increase in line with inflation - with a minimum of £92 per week - and a 35 hour week (from 37½) may be discussed at a meeting on 24 March. Unions

representing University manuals (1 November - 21,000) are considering a 17 month agreement giving 7.3% from 1 November 1980 and a further 2% from 1 April 1981. Teachers in Primary and Secondary Schools (E&W) (1 April - 480,000) and Further Education (E&W) (1 April - 78,000) have accepted 7½ offers, subject to ratification. Gas Supply manuals (18 January - 41,000) have rejected a staged offer worth 10% on the paybill (11.3% in a full year). Negotiations resume on 26 March. Electricity Supply manuals (20 March - 92,000) have rejected an offer worth 11½%. Negotiations continue on 2 April. In British Airways (1 January - 50,000) negotiations continue on a proposal for a 3 month pay freeze to be followed by an 8% increase from 1 April. An offer of 5.25% has been rejected by British Shipbuilding employees (1 April - 70,200) and unions representing BBC staff (1 April - 27,600) are consulting members on an offer reported as about 9½%. The claim is for an increase in line with inflation, extra holidays and a reduced working week. Post Office UCW postal workers (1 April - 156,000) have submitted a 20% claim and a claim for a significant increase for British Rail Clerical and conciliation grades (20 April - 150,000) is expected to be presented at a meeting on 19 March.

7 In the PRIVATE SECTOR, employers have agreed an interim payment of 12% to Merchant Navy seamen (2 January - 26,000) pending the outcome of arbitration. Unions on behalf of Officers (1 November - 36,000) are to put an interim offer of 12% to a ballot of members. Result is expected by 22 March. Further talks will take place when the seamen's arbitration findings are known. London Clearing Banks staff (1 April - 146,000) have rejected an improved offer of 10% in response to claims for up to 20% and Trustee Saving Bank staff (21 February - 11,000) have rejected an offer of 8¾%. Union representatives for British Printing Industries Federation workers (24 April - 128,000) are recommending acceptance of an increase of up to £7.50 (craft I) on rates. An 8% offer to Newspaper Publishers Association production workers (1 January - 33,000) appeared to have been accepted by the union negotiators but indications are that they may seek further talks. Norwich Union staff (1 April - 7,200) are considering an offer of 10.1%. Employers are expected to respond on 31 March to a claim by Chemical Industries Association process workers (1 May - 50,000) for an increase of 21% on basic rates. Building and Civil Engineering employees (28 June - 450,000) have rejected a proposal for a 4 month freeze with a 5.75% increase on the MEL from November. The claim is for increases in excess of 20%. Next meeting 9 April.

PRICES AND EARNINGS INDICES

PRICES

8 In February the year on year increase in retail prices was 12.5% compared with 13.0% in January.

EARNINGS

9 In January the year on year increase in average earnings for the whole economy was 18.8% compared with 19.5% in December. Excluding temporary factors the January figure was about 17½%.

REAL DISPOSABLE INCOME

10 The real disposable income of a typical family (described in the mid-September Pay Brief) rose by about 2½% in the year to December.

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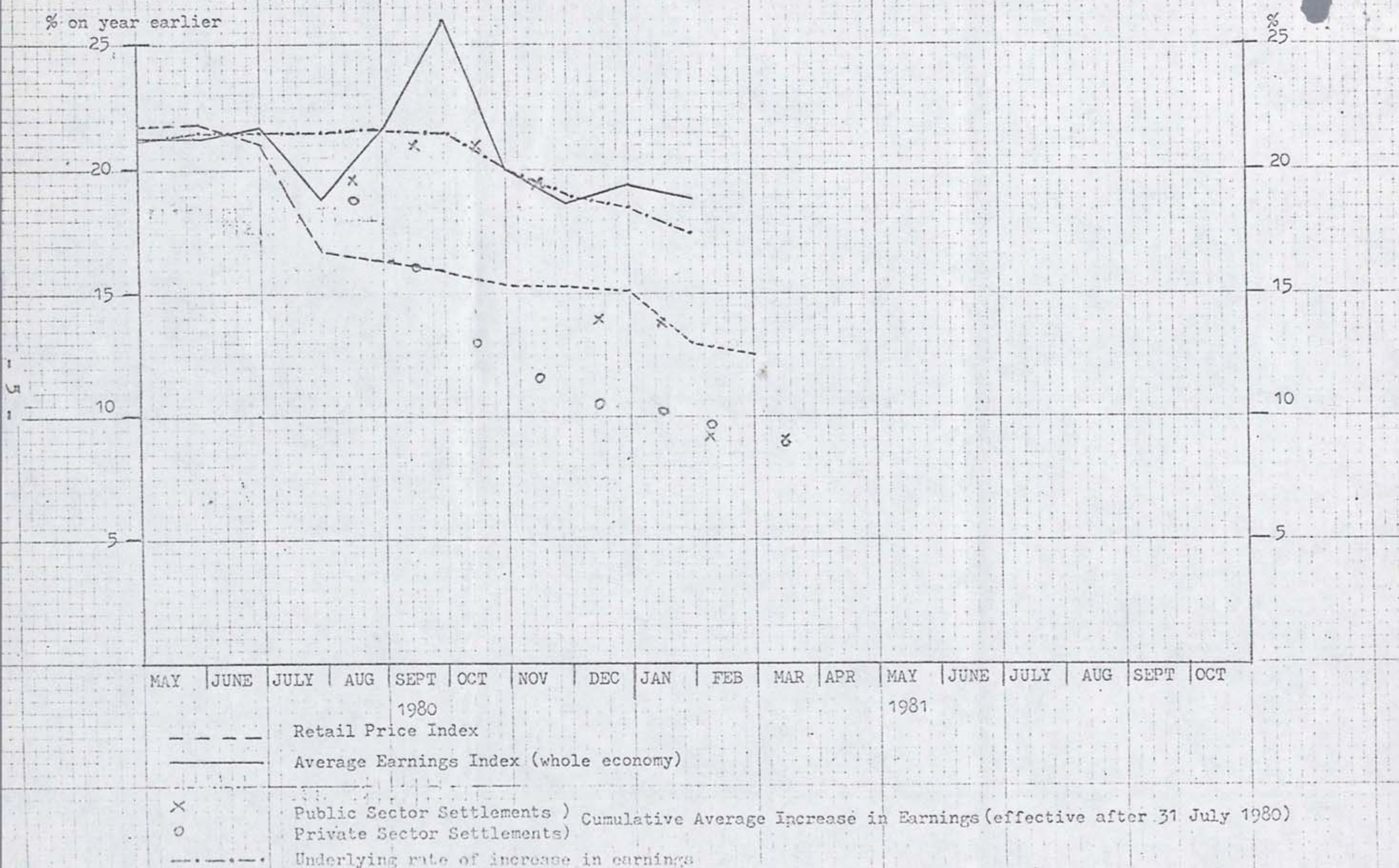
APPENDIX 1

TRENDS IN EARNINGS AND PRICES



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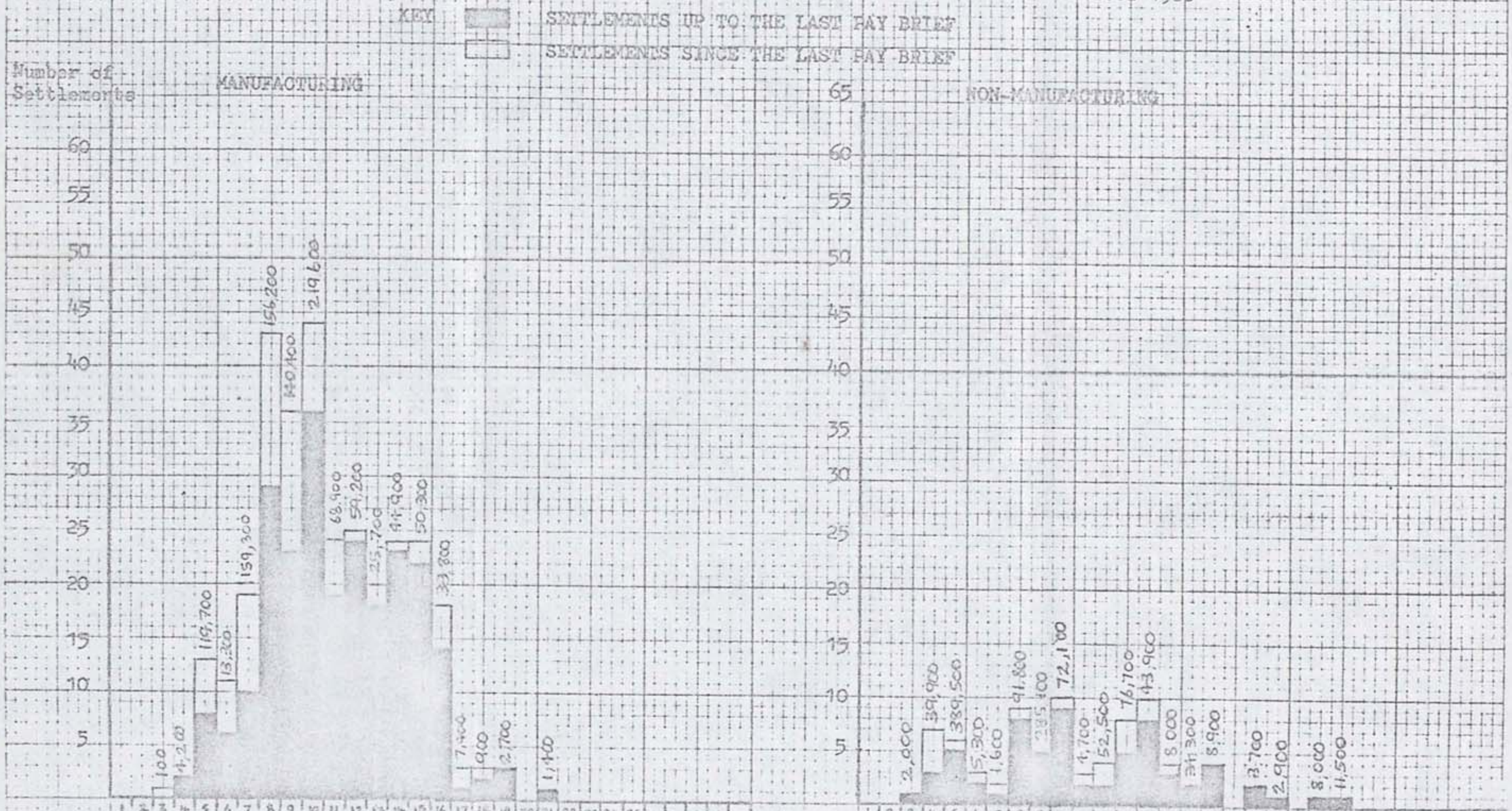
APPENDIX 2

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1980



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

NOTE - THE NUMBERS OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

CONFIDENTIAL

Mr Whitmore

Mr Whitmore

To the best of my knowledge we are awaiting a meeting between PM & Mr Pym which had to be cancelled. I think we ought to hold it soon.

Mr Ingham.

Thank you.

Where do we stand on Mr Pym's proposal to revive the Govt/Party group on policy presentation?

18.iii

10 DOWNING STREET

From the Press Secretary

CHANCELLOR OF THE DUCHY

ECONOMIC PRESENTATION

1. I have held a meeting this week with Mr. Gaffin, Mr. Vereker, Mrs. Gilmore (Treasury), Mr. Mower (Employment), Mr. Taylor (DHSS), Mr. Gillis (Energy) and Mr. Woodrow (Industry). Our objective was to review the post-Budget situation and to make recommendations for the presentational work required over the next six months, i.e. to the autumn, when the usual PESC exercise will come to Ministers.

2. Our conclusions are set out below (Paras 13 and 14).

Background

3. We examined future presentation against the background of what has so far been achieved, and not achieved; current attitudes; and the reported attitudes of some Ministers that the present strategy is on probation for no more than six months.

Political

4. Information officers are now batting a very sticky wicket. Divisions within Government and Cabinet over policy are now manifest and sharply delineated and these may intensify over the next six months. They provide no basis for credible presentation of the Government's economic policies. Public declarations by Ministers of support for the strategy and private criticism or scepticism of it are particularly damaging. Ministers therefore

/have

have a particularly key role to play over the spring and summer if economic presentation is to be improved.

5. Our assumption is that the bickering will not merely continue but conceivably intensify.

6. The CBI is now ranged against the Government, at least in the public mind. There is some evidence that it is pulling back after last week's excessive criticism of the Budget but the fact remains they are unhappy and have carelessly planted the idea that the Budget will bring more despairing bankruptcies. We shall have to take a line on their campaign for another £1 billion off public expenditure.

7. The TUC is now more deeply entrenched in its opposition to Government policies and has irresponsibly lent strength to the idea of another 5% on pay claims on account of the cost of the Budget. Trade union conferences over the spring and summer are likely to be particularly unhelpful and critical.

8. The backbench rebellion over 20p on petrol and diesel will, if carried through to the Finance Bill, compound the difficulty of rallying support for the Government's strategy.

9. The Opposition is in a mess and unable to present an alternative strategy. But the Social Democrats may sharpen the economic policy debate.

Economic

10. Inflation is nonetheless coming down - the central objective of Government policy. The fall will not be maintained over the next few months but the trend over the summer should be in the right direction. If this is so - and if money supply and borrowing are held in check - there might be a prospect of further reductions in MLR and mortgage rates. But unemployment is likely to continue going up, if more slowly, even though the recession is believed to be flattening out.

/11. The

11. The best we can probably hope for is moderating inflation and the stabilising of unemployment, with hope being engendered of an end to the recession.

Industrial

12. It is wrong to argue that the Government has done little or nothing for industry. We need to get over persistently and effectively the extent of the Government's help for private as well as public industry, and how the two interact, and how much we are doing to assist entrepreneurs and help to get small firms off the ground.

Proposals

13. On this analysis we reached the following conclusions about our presentational needs over the spring and summer, subject, of course, to review and tactical adjustments:

i. Given the extent to which the strategy will be under attack during its most severely testing period (without real alternatives being advocated), we need to re-argue the case for the existing strategy and why only this strategy can succeed;

ii. we need to bring out and exploit in a balanced way any sound evidence of the success which the existing strategy is having; and, not least important,

iii. given the possibility at least that increased bloodymindedness on the part of the trade unions will coincide with some lightening of the gloom, we need to intensify the campaign to contain wage claims and settlements in advance of the next pay round, starting in the

/autumn

autumn; to the extent that the economy is seen to be picking up, the message "Don't throw it all away" could strike a sympathetic chord in the public.

Mechanics

14. These conclusions require orchestration. The lead must be given by the Prime Minister. But we must also:

i. identify each week who should carry the message to the public in the press, radio and TV each weekend;

ii. ensure that Junior Ministers have the basic texts - speaking notes - on which to build speeches or respond to interviews; Mr. Vereker has work in hand on this; and

iii. apply pressure on Ministers and Departments to use appropriate opportunities, as identified, to get over our messages.

Action

15. I suggest you should call an early meeting of the group responsible for these conclusions to discuss them and the action required.

Bernard

B. INGHAM

19 March, 1981

JFF

PERSONAL

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

PS/ Secretary of State for Industry

12 March 1981

Clive Whitmore Esq
Private Secretary to the
Prime Minister
10 Downing Street
LONDON
SW1

Prime Minister.

You have agreed to see Sir Keith Joseph and Mr Tebbit on Monday to discuss, at their request, how representations from MPs to you about closures should best be handled.

Sir Keith has authorised his Private Secretary to send me this letter which he sees as serving as a basis for Monday's meeting. I am afraid there is much in it you will not like. [initials] 13.iii.

I will deal with this MT

Dear Clive

GOVERNMENT INTERVENTION IN FACTORY CLOSURES

1. I am writing to you privately to explain some of the thoughts which lie behind the very strong reservations held by Sir Keith and Mr Tebbit about the Prime Minister's recent actions in connection with factory closures. Sir Keith and Mr Tebbit are calling on the Prime Minister at 3 pm on Monday 16 March to discuss these issues.

2. Both Sir Keith and Mr Tebbit fully understand that the Prime Minister has given her word to see individual Members of Parliament whose constituencies are affected by major closures. They also understand the Prime Minister's wish to appear to be helpful towards those concerned.

3. They believe, however, that by seeing individual MPs the Prime Minister may be creating the impression - and may even be convincing herself - that the Government is able to alter the repercussions of agreed policy without very serious risks. Both Sir Keith and Mr Tebbit believe that the Government has no alternative but to allow closures to take place and that decisions about individual closures have to be left to the companies concerned: only those who have direct management responsibility for the plants in question can have the necessary understanding of the commercial, industrial and market considerations which determine whether or not a plant, or one plant rather than another, can continue in operation. They think that the Prime Minister's intervention in connection with the Bowater plant at Ellesmere Port, the Tate & Lyle plant in Liverpool and the BSC foundry at Distington have been seen by outsiders as evidence that the Government is second guessing the managements concerned. They are worried that this may be undermining the ability of the managements to manage and companies to reach necessary but painful decisions.

4. Moreover, the Secretary of State and Mr Tebbit believe that the great majority of trade unionists and many others are deeply ignorant of the economic facts of life and believe that the

/Government

Government can "rescue" uneconomic plants as if by magic and at no cost. Correcting this misapprehension is difficult and they think that the Prime Minister's willingness to intervene in connection with closures may be helping to prevent the wider public from gaining an understanding of the impractability of "preserving" employment articifically.

5. Sir Keith and Mr Tebbit also believe that the Prime Minister's intervention may result in the wider public perceiving her as a court of appeal to whom work forces may turn in attempts to prevent closures. They also think that because of her personal prestige, her interventions may influence firms to take completely uneconomic decisions to defer closures. If this were to happen they think it would damage the whole economy since uneconomic jobs would be artificially perserved and employment in other plants operated by the same employer would be damaged. They are also concerned about the burden on the Prime Minister's time.

6. Sir Keith and Mr Tebbit would like to suggest to the Prime Minister that when she sees Members of Parliament about closures she should draw a distinction between representations and action taken prior to a closure or redundancy and actions taken to mitigate the effects after closure. In their view no pressure should be exerted on a company to distort its commercial decision (although clearly regional aids may be available to improve the prospects of viability) and neither unions nor Opposition should be given the impression that the Government can in any way prevent closures taking place. They think that, prior to a closure, the Government can only say that the decision is for the commercial judgement of the company concerned, that no Government money will be available to prevent closure (except in special circumstances where the national interest is directly involved or through the normal structure of regional aids) and that the Government will not intervene with the company to distort commercial decisions.

7. Sir Keith and Mr Tebbit think that the Prime Minister should instead concentrate on action which can be taken to mitigate the effects of a closure after it has taken place. The Government has a battery of support measures (assisted area status, regional development grants, selective financial assistance under Sections 7 and 8 of the Industry Act and under the Science and Technology Act, assistance to clear derelict land, advance factories, infrastructure measures etc) and the Prime Minister can describe these as they apply to the particular area affected by the closure in question. By concentrating on remedial actions the Prime Minister will be able to give the MP concerned some hope for the future and can demonstrate that the Government is not indifferent

/to ...

to the human impact of closures. At the same time the necessary (but socially unfortunate) process of structural industrial adjustment can go forward without being hindered by Government intervention.

8. So far as the closure at Distington is concerned, Sir Keith and Mr Tebbit feel strongly that the Prime Minister should not seek to ask Mr MacGregor to justify his decision. They are particularly reluctant to see her acting in response to a request from Mr Dale Campbell-Savours who has been acting most unconstructively in connection with the closure proposal at Distington. The closure itself forms part of the BSC Corporate Plan and has been approved by Ministers collectively. The delay in making the closure is adding to BSC's costs and hence to BSC's call on public expenditure. The decision itself has been considered by Mr MacGregor carefully and Mr Campbell-Savours has sent the Prime Minister a document (which may or may not have been stolen) demonstrating that Mr MacGregor has considered the issues again. Sir Keith himself has mentioned Distington to Mr MacGregor who stands by his decision. The Welsh Secretary is concerned that a reprieve for the Distington foundry would lead to a comparable closure in Wales (or perhaps in Scotland, a point which has not yet occurred to political interests in Scotland). In the circumstances Sir Keith and Mr Tebbit hope that the Prime Minister will agree not to pursue her factual enquiries of Mr MacGregor and will instead agree to write to Mr Campbell-Savours saying that, since her meeting with him, Sir Keith has spoken to Mr MacGregor, that Mr MacGregor has (as demonstrated by the (stolen) document supplied by Mr Campbell-Savours) considered his decision again and that the Government, which has approved the BSC Corporate Plan, will not intervene in the matter. The Prime Minister could go on to point out that extensive regional aids are available at Distington to mitigate the effects of closure and that the economic prospects of the area will be greatly enhanced if the workforce cooperate in bringing about a speedy and peaceful closure to the plant rather than persisting in blocking the decision.

Yours ever,

Ian Ellison

I K C ELLISON
Private Secretary

MR. VEREKER

ECONOMIC PRESENTATION AFTER THE BUDGET

I had hoped that we could find a window rather earlier than the 16 June but if we can't then that date will have to do. I am a bit concerned, on the other hand, because the CBI can hardly be regarded as a very serious forum. (It may well be that putting this to a CBI audience may be construed as casting artificial pearls to genuine swine.) I should have thought that a City or an academic audience would have been better. But you know more about this than I do.

I had in mind a speech which would not merely reiterate the old slogans but which would put the problem of economic policy, and in particular monetary policy, in a finely sophisticated, yet untechnical way.

AW

11 March 1981

cc Mr. Lankester
Mr. Ingham
Mr. Duguid

Econ Pol

Edward du Cann

PA (CF file)

MS

INTERVIEW BETWEEN SIR ROBIN DAY AND EDWARD DU CANN MP

Sir Robin Day: Mr. du Cann, putting it bluntly, does this report not drive a coach and horses through the Thatcher/Howe strategy?

Edward du Cann: No, I don't think it does that, but what it certainly does is to put a powerful searchlight upon it.

Sir Robin Day: You say it doesn't do that, but let me put to you one or two of your criticisms: you say the medium-term financial strategy is not soundly based. That is a fairly severe criticism, isn't it?

Edward du Cann: Yes, the Committee has said that for some time, Robin. We said it immediately after the Budget, we said that the figures for example on which the medium-term financial strategy were based were unlikely to be realised. We said they had not been prepared for instance for the substantial turn-round forecast in the financial results for the nationalised industries. We were attacked for that, we were right then, we are right now. That is not to say, however, that there is not virtue in having a medium-term financial strategy.

Sir Robin Day: But you also say that there has been no true monetarist experiment.

Edward du Cann: That is true.

Sir Robin: So you are saying the Government has not even done what it set out to do?

Edward du Cann: We said that money is tight. The Government has not used its chosen instruments as strongly as one might have supposed. For instance, it has not let interest rates go as high as it might have done; nor has it controlled the Public Sector Borrowing Requirement in the way in which it has said it would, and people like me hoped it would.

Sir Robin: But you go on to say that you appear to challenge the very basis of monetary policy, because you say you are not convinced of any direct connection between the growth of the money supply and inflation.

Edward du Cann: Well we have not received any evidence to prove it, and we have taken evidence from all over the world: practical and academic. What I think the keynote of the report is after much research and much really devoted labour is that monetary weapons are important. Monetary weapons are useful. They are not panaceas and they need to be operated flexibly.

Sir Robin: And you say the Government has treated it as a panacea and has not operated them in the right way.

Edward du Cann: We do say that.

Sir Robin: Well that, if I may put it to you again, is driving a coach and horses through the whole thing isn't it?

Edward du Cann: It is not driving a coach and horses through the idea of having a planned strategy; it is not driving a coach and horses through the idea of monetarism. But the idea is, Robin, as you who are so well informed know better I think than anybody, that we should use these Select Committees now to endeavour to make certain that discussion in Parliament and through Parliament outside is better informed.

Sir Robin: Well let me put to you another important conclusion of your Committee, and I summarise: that the cost in damage to industry and jobs of reducing inflation by the weapon of monetary control is far too high.

Edward du Cann: Well, that is right, and I am quite sure both the Chancellor and I are equally anxious about unemployment at its present frightening levels, and I am sure we are equally anxious about the way in which our industrial capacity is going to be very substantially reduced. And I hope very much that the Budget will do something about those things.

Sir Robin: One statement in the medium-term financial strategy was that control of the money supply will, over a period of years, reduce the rate of inflation. The Chancellor may reply to your report that is precisely what it has done, and is doing.

Edward du Cann: Well, I am inclined to doubt it. We have received no evidence to that effect.

Sir Robin: The reduction of the rate of inflation is taking place, isn't it?

Edward du Cann: Not only is it taking place but it is something to rejoice over. It is probably the most important aspect of Government's work, added of course to the new sense of realism that there is in the economy. Basically they are huge gains, Robin, and I would not for the least moment understate them in any way. On the other hand, however, it is my anxiety as a Member of Parliament and a Conservative to see that we do better than we are doing, and I welcome the publication of this report as means to see we do do better.

Sir Robin: You summarise its conclusions in moderate words Mr. du Cann. Is it not in the immortal phrase of Captain Bligh to Mr. Fletcher-Christian on the Bounty: This is mutiny?

Edward du Cann: No, it is not mutiny. One has a responsibility as a Member of Parliament to tell the truth as one sees it, and I would never apologise for doing that.

Sir Robin: But something should be done in the Budget, which is on Tuesday. What, particularly, to put these things right?

Edward du Cann: Well, one could talk for a long time about that. The Committee's responsibility is to monitor existing policy but my own view I will give you in a nutshell, and that is this: I would very much like to see, Robin, the Prime Minister give an instruction to her Cabinet secretariat to pull out from every department's pigeon-holes the capital schemes which have been lying on the shelves for a long time. We say in England, in the

United Kingdom, we have got the best financial mechanism in the world. Very well, let us see which of those projects - be they the Severn Barrage, the Channel Tunnel, or smaller essays - which of those capital construction projects could be private funded, and let the City of London get loose on that and start doing something practical to get unemployment down and get this country moving again. That is what I want to see.

Sir Robin: So that is in sympathy with the CBI request this morning to spend a huge amount of public money on projects to get the recession lower and to raise employment?

Edward du Cann: Absolutely not. I did not say anything about public money: I said let us get them funded privately. There is an enormous amount of scope for doing exactly that. Using public money is what I don't want to see done. What I would like to do there is this: get the cash limits divided into two, between administration on the one hand and capital items on the other. We are still doing two things, physical things: and spending too much money on administration. That is what I want to change, and that is what I think the Chancellor will change.

Sir Robin: Mr. du Cann, thank you and no doubt the Chancellor of the Exchequer in his Budget speech, if not before, will have some response to your Committee's report.

CONFIDENTIAL

PAY BRIEF - POSITION IN MID-FEBRUARY

SETTLEMENTS

1 Since the January pay brief 74 settlements covering 1,508,000 employees have been reported. The weighted average level of settlements over the last month in both the private sector and the public sector was just over 7½%. In the public sector (9 settlements covering 1,220,000 employees) the average was dominated by the settlement for LA manuals (1.1m at 7½%).

2 The cumulative average level of settlements for the whole economy this round is about 9½% (328 settlements covering 3,195,000 employees) compared with just over 11% last month.

3 In the private sector the cumulative average is just over 9½% (303 settlements covering 1,543,000 employees). About 4/5 of the settlements recorded so far have been in manufacturing, where the average level is just under 9½%. The average in non-manufacturing is just under 10½%, but the principal groups have yet to settle. There is a wide range of settlements (see Appendix 4). Most are between 8%-14% but recent settlements have tended to be at the lower end of this range. About ⅓ of settlements are in single figures.

4 In the public sector (25 settlements covering 1,652,000 employees) the cumulative average is just over 9% in both the trading and the service sectors.

NEGOTIATIONS

5 In the PUBLIC SECTOR, Civil Service non-industrials (1 April - 562,000) have submitted a 15% claim. An offer of 6% has been rejected. A meeting with Lord Soames has been arranged for 23 February and unions are to meet on 26 February to discuss industrial action. Similar offers have been rejected by NHS ancillaries (13 December - 211,000) and ambulancemen (1 January - 17,000). Teachers (E&W)(1 April - 480,000) have rejected an offer of 4% made in response to a claim for 15%. Next meeting will be 2 March. Unions representing Local Authority building craftsmen (4 November -76,000) have put an offer of 7.5% on basic rates to members, without a recommendation. Industrial action has been threatened by NHS craftsmen and maintenance workers (1 January - 14,500) over their claim for parity on basic rates with the electrical contracting industry, estimated to be worth 21%. An offer of 6% has been rejected. University Teachers (1 October - 38,000) have rejected a 6% offer but negotiations are to continue on a proposal by Committee 'A' for an 18 month agreement of 6% from 1 October 1980 and a further 6% from 1 April 1981. An improved offer worth about 10% for Water Service manuals (7 December - 33,000) has been rejected

cc Mr Walters
Mr Duguid
Mr Vereker

Econ Pol

2

PRIME MINISTER

It is still early in the pay round, but these figures are improving still
MS 23/2

PRIME MINISTER

PAY BRIEF

I attach my Department's Pay Brief for February. I am sending copies to members of E, E(PSP), and E (EA) Committees, and to Sir Robert Armstrong.

JP

MT.

J P
23 February 1981

by union negotiators and is being put to members without a recommendation. The result is expected by 24 February. Indications are that members will endorse rejection and renew the mandate for industrial action. The claim is costed at about 30%. Electricity Supply manuals (20 March - 92,000) have submitted a claim for substantial increases, a 35 hour week and other improvements. An offer is expected to be made at a meeting on 5 March. Unions for Gas Supply manuals (18 January - 41,000) are consulting members on an offer worth 9% on the paybill (10.3% in a full year). In British Steel (1 January - 140,000) a proposal to defer a settlement for 6 months with a 7% increase from 1 July has been accepted by the craft and general unions but rejected by ISTC. Negotiations continue at British Airways (1 January - 50,000) on the proposal for a 3 month pay freeze to be followed by an 8% increase. British Shipbuilders employees (1 April - 72,700) have submitted a claim for substantial pay increases and other improvements. Meeting arranged for 2 March. British Rail clerical and conciliation grades (20 April - 150,000) have submitted a claim for a substantial increase in pay.

6 In the PRIVATE SECTOR, industrial action by Merchant Navy seamen (2 January - 26,000) has been called off. The Seamen's Union has accepted arbitration on condition that the 12% offer is implemented as an interim measure. Officers (1 November - 36,000) have rejected an improved offer of 12%. The two unions (BIFU and CBU) representing London Clearing Bank staff (1 April - 146,000) have rejected an offer of 8.5% in response to claims for up to 20% and Trustee Savings Bank staff (21 February - 11,000) have rejected an offer of 8%. Their claim is for 23.5%. Newspaper Publishers Association production workers (1 January - 33,000) have rejected a 5% offer.

PRICES AND EARNINGS INDICES

PRICES

7 In January the year on year increase in retail prices was 13.0% compared with 15.1% in December.

EARNINGS

8 In December the year on year increase in average earnings for the whole economy was 19.4% compared with 18.9% in November. Excluding temporary factors the December figure was about 18½%.

REAL DISPOSABLE INCOME

9 The real disposable income of a typical family (described in the mid-September Pay Brief) rose by about 2½% in the year to November.

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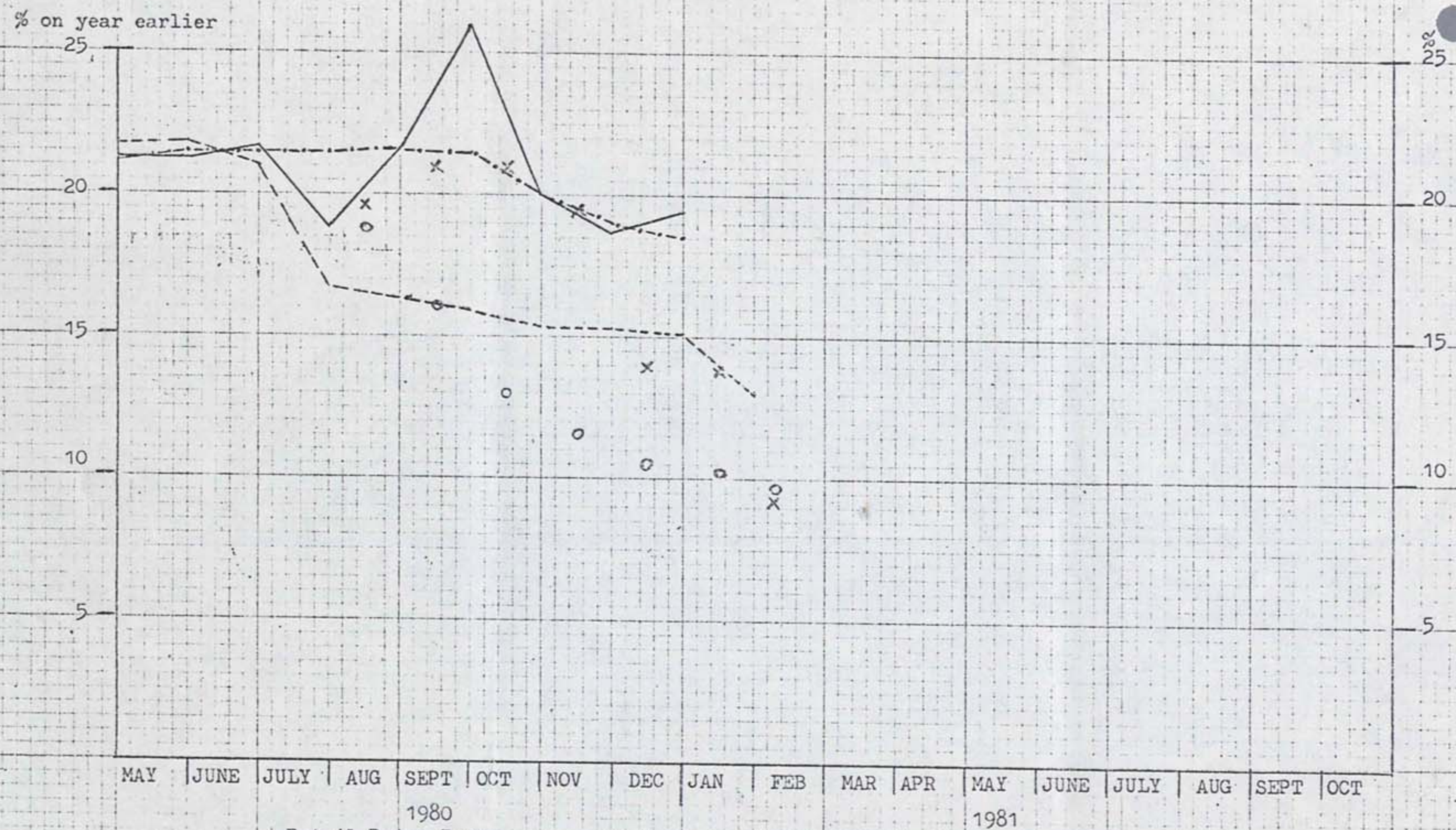
APPENDIX I

TRENDS IN EARNINGS AND PRICES



— — — — Retail Price Index

———— Average Earnings Index (whole economy)

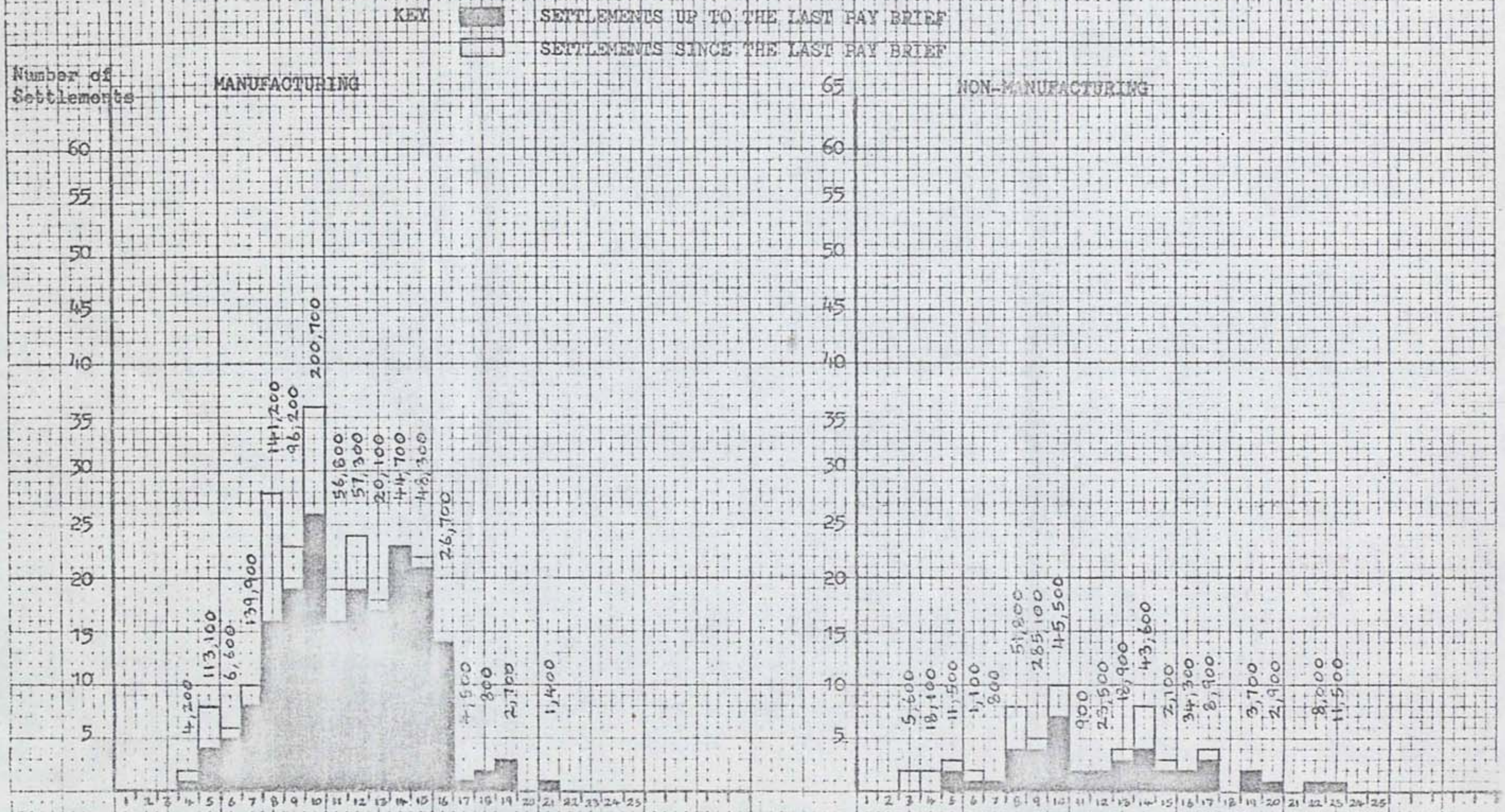
× Public Sector Settlements) Cumulative Average Increase in Earnings (effective after 31 July 1980)
o Private Sector Settlements)

—·—·—· Underlying rate of increase in earnings

CONFIDENTIAL

APPENDIX

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1980



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

NOTE - THE NUMBERS OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

Econ Pol
Pt 8.

Mr Ingham
Mr Vereker

MR LANKESTER

'SUNDAY TIMES' ARTICLE: "WRONG, MRS THATCHER, WRONG, WRONG, WRONG"

You asked for a note on the sources of the supposed quotes in this article (Annex A). These are listed below:

1. "These are the only policies that will succeed in the long run."

    Source: Economic and Industrial Policy debate

    "These are the only policies that will succeed in the long run."

2. "Every time governments have reflated to avoid unemployment, they have finished up increasing it."

    Source: 'Weekend World' interview

    "But the fact is that every time governments have reflated to avoid it they have finished up by increasing it, and that is why when I first came into Parliament we did not have very much inflation, equally we did not have very much unemployment.

3. "Every time governments have reflated to avoid unemployment they have finished up by increasing it. As inflation rose so unemployment followed."

    Source: as above

4. "Things are becoming more competitive in British industry."

    Source: 'Weekend World' interview

    "But things are becoming more competitive in British industry, and you know there'll be no hope for the future unless they are."

5. "I could have income tax 4p in the pound lower were it not for the amount we are having to pay out for nationalised industries."

    Source: 'Weekend World' interview

    "It's interesting, you see, people not only pay out of their price pocket, they then pay out of their tax-payers' pocket, and I could have income tax four pence in the pound lower were it not for the amount we're having to pay out for nationalised industries."

../....

6. "The money we spent on unemployment benefits this year and on associated social security benefits is £2.4 billion. Not nearly sufficient to create the necessary jobs."

   Source: Economic and Industrial Policy debate

   "However, the money that we spent on unemployment benefit this financial year - £1.2 billion - and on associated social security benefits - also £1.2 billion - is not nearly sufficient to create the necessary jobs. The costs of equipment, accommodation, supervisors, materials and other overheads would put the total cost of such a scheme far, far above £2.4 billion."

7. "Extra public spending would not reduce unemployment. It is a recipe for more inflation and even fewer jobs."

   Source: Economic and Industrial Policy debate

   "Their case is that extra public spending would reduce unemployment. But it would not work. That is not a recipe for more jobs; it is a recipe for more inflation and even fewer jobs."

8. "I never want to take on another British Leyland."

   Source: 'Weekend World' interview

   "I never want to take on another British Leyland, we shouldn't be in it at all, but now we're in it we have to choose the time, and we have to back Michael Edwardes' judgment."

9. "Where would the extra money for (public investment) come from? Would we borrow it or would we print it?"

   Source: Economic and Industrial Policy debate

   "Where would this extra money come from? Would we borrow it, or would we print it?"

10. We will not reflate ... Reflation is the polite word for pumping money into the economy."

   Source: 'Weekend World' interview

   "Where would this extra money come from? Would we borrow it, or would we print it?"

11. "M3 would not have been nearly as difficult, if government hadn't been spending as much money."

   Source: 'Weekend World' interview

   "But you know, that M3 would not have been nearly as difficult as it has been over those last few months, all [illegible]ight before, over those last few months, if government hadn't been spending as much money."

../....

12. "We shall come out of the recession with a substantial reduction in the underlying level of public spending. That will leave room for expansion in the private sector, where most of the new jobs will be created."

    Source: Economic and Industrial Policy debate

    "However, we shall come out of the recession with a substantial reduction in the underlying level of public spending. That will leave room for expansion in the private sector, where most of the new jobs will be created."

13. "Our aim is to encourage an economy that will stimulate the creation of wealth."

    Source: Economic and Industrial Policy debate

    "Our aim is to encourage an economy that will stimulate the creation of wealth."

14. "I am not concerned with economic theory ... I am concerned with what is happening in practice."

    Source: 'Weekend World' interview

    "I'm not concerned with the economic theory at the moment, I'm concerned with what has happened in practice as inflation has risen, and every time we've reflated we've finished up with higher inflation, as I say in Harold MacMillan's time we were worried about three to four and a half per cent."

I am also attaching extracts in context from the 'Weekend World' interview (Annex B) and the complete debate (Annex C).

Peter Ewing

PETER EWING
PRESS OFFICE

9 February, 1981.

A

Wrong, Mrs Thatcher, wrong, wrong, wrong

THE SUNDAY TIMES

BRITAIN is experiencing the worst recession of the century. In the Commons and on London Weekend Television last week, Mrs Thatcher made two major defences of her policies, replying to critics in the TUC, the CBI, and among Labour and Liberal MPs. One heard, said a commentator, the familiar O-level essay in monetarist economics. Not quite. It was a double-alpha performance for bravery and grit—but never has the wrong end of the stick been so vigorously and dramatically wielded. We analyse below some of Mrs Thatcher's remarkable misconceptions, her words in italic.

1. □ *"These are the only policies that will succeed in the long run."*

■ Faith rather than fact and against the evidence of history. The longest spell of prosperity, full employment, rising production and relatively low inflation was achieved in the post-war years by Keynesian policies of demand management—the opposite of present monetary policies. Sweden, Norway and Austria have succeeded today with similar policies.

2. □ *"Every time governments have reflated to avoid unemployment, they have finished up increasing it."*

■ Not true. Unemployment in Britain in 1966 was only 1.4 per cent after 20 years of the demand-management Mrs Thatcher attacks. The only plausible case she can cite was the period 1972-74, when government spending did fuel demand-inflation.

3. □ *"Every time governments have reflated to avoid unemployment they have finished up by increasing it. As inflation rose so unemployment followed."*

■ The connection between inflation and unemployment is not so simple as Mrs Thatcher says. In the Twenties and Thirties there was mass unemployment but on inflation. What does she think caused the unemployment then? It was lack of demand. She consistently fails to distinguish between inflation produced by cost pressures and inflation from excess demand.

4. □ *"Things are becoming more competitive in British industry."*

■ Not true. On the government's own figures, published in the Bank of England Quarterly Bulletin, British industry has suffered in the past three years the biggest loss of competitiveness we have ever seen.

5. □ *"I could have income tax 4p in the pound lower were it not for the amount we are having to pay out for nationalised industries."*

■ The prime minister has a curious view of government financing. Less borrowing by the nationalised industries would have made more people unemployed. That would have greatly increased expenditure on unemployment and social security. There would have been no prospects of the government keeping to its medium-term financial plan and cutting income tax by 4p. One unemployed married man with two children increases government borrowing by £6,006 a year. Taking into account the tax revenue lost, the unemployed are costing the government at least an extra £7 billion a year—and producing nothing.

6. □ *"The money we spent on unemployment benefits this year and on associated social security benefits is £2.4 billion. Not nearly sufficient to create the necessary jobs."*

■ Mrs Thatcher's figure is too low. She quotes only what government pays out and omits what it fails to receive as tax revenue. If that money were spent on better telephones, railways and roads, as well as Rolls-Royce and British Leyland, it would not only create more jobs but would strengthen Britain for economic revival.

7. □ *Extra public spending would not reduce unemployment. It is a recipe for more inflation and even fewer jobs.*

■ Mrs Thatcher consistently fails to distinguish between capital and current spending. "Printing money" to pay higher wages in the public sector would be wrong. But spending for investment is just what Britain needs.

She herself is fuelling inflation by failing to make the crucial distinction between investment and consumption. The money squeeze has reduced production, which is just as sure a way to increase inflation as an increase in money supply. Too few goods chased by too much money. Again economic history shows that you can have an increase in the money supply which does produce more production without inflation—provided the money is channelled to investment credit. The Japanese ran a money supply similar to our own between 1974 and 1977—an increase of 14.7 per cent. Theirs did not lead to inflation like ours. Why? Because the money went to investment credit which grew at 11 per cent, while government and local debt was limited to 3.8 and 0.8 per cent.

Investment credit need not be inflationary. The velocity of circulation of money in Japan in 1977 was 1.20, against 2.0 in Germany and 3.50 in Britain. By failing to distinguish between money for consumption and money for investment, and making a false distinction between public and private investment, Mrs Thatcher is guaranteeing inflation for the future.

8. □ *"I never want to take on another British Leyland."*

■ Why not? It is now a success story. Would it have been better massively to increase unemployment and import still more Japanese and German cars?

9. □ *"Where would the extra money for (public investment) come from? Would we borrow it or would we print it?"*

■ The printing of money in a modern economy means only the expansion of credit by the bank. Why should we be opposed to an expansion of credit for investment at this stage in the economic cycle when there is massive spare capacity? Secondly, why should Mrs Thatcher think that economic recovery will occur if ICI borrows to invest but that disaster will occur if British Telecom borrows to invest? What is the difference?

10. □ *"We will not reflate . . . Reflation is the polite word for pumping money into the economy."*

■ The prime minister says that reflation means "spending beyond our means." But what on earth does that mean? How can a country be spending beyond its means when there are more than two million people unemployed and nearly all firms are working with lots of spare capacity? We are not even spending beyond our means abroad, since Britain is now running a substantial balance of payments surplus.

11. □ *M3 would not have been nearly as difficult, if government hadn't been spending as much money."*

■ Not true. The overriding reason M3 grew so rapidly in 1980 was increased bank lending to companies—and why have companies been borrowing? Not, alas, for productive investment in the main. The major reason is that their cash position has been worsened by increases in taxation, reductions in government expenditure which carry through in orders to companies, and high interest rates. On present interest rates, even the top-class British firms lose £4 a year for every £100 of stocks financed by bank credit. With wholesale prices rising at only 11 per cent, firms are having to pay interest at 15 per cent. Why delay a cut in MLR?

12. □ *"We shall come out of the recession with a substantial reduction in the underlying level of public spending. That will leave room for expansion in the private sector, where most of the new jobs will be created."*

■ But by failing to distinguish between consumption and investment credit, Mrs Thatcher is obliterating productive capacity. The Governor of the Bank of England acknowledges that many well-managed companies are going to the wall.

13. □ *"Our aim is to encourage an economy that will stimulate the creation of wealth."*

■ There is work to do; there are men to do it. Why not bring them together? Mrs Thatcher says there are mysterious unintelligible reasons of high finance why this is impossible. But while we wait, the unused labour of the workers is not piling up to our credit in a bank ready to be used at some later day. It is running irrevocably to waste; it is irretrievably lost.

14. □ *"I am not concerned with economic theory . . . I am concerned with what is happening in practice."*

■ You could have fooled us.

things are becoming more competitive in British industry,

and you know there'll be no hope for the future unless they are. Can I just say one other thing? I think that it's just at this stage, when previous governments have begun to get things right but there too have been some adverse things showing, that they have cut and run. They've gone back to the old habits of reflation, which is a polite word for flooding the economy with money to try to get jobs quickly, regardless of the fact that they'd lose more later. This is just the time when we have to stay on course and say, we are a government that's set out to do long-term things, long-term improvements, we knew it would be painful, we knew it would be difficult, but we cannot evade that long-term issue if we want a good future for Britain.

BRIAN WALDEN:

Well, that's clear enough Prime Minister. You've identified some things that you think are going well, you also say there are some adverse factors. Naturally I want to question you about both.

MARGARET THATCHER M.P.

Of course.

BRIAN WALDEN:

But let's start with the things that you think are going well. The reduction in inflation. Now would you care to give a prediction of how you think inflation is going to go from now on?

important. Confidence is an important factor. Yes, we do look at monetary base, yes we do continue to look at M3 and all the other M's. But you know, that M3 would not have been nearly as difficult as it has been over those last few months, all right before, over those last few months, if government hadn't been spending as much money. And you know what happens when government spends large sums, it's not covered by taxation, you have to go to the market to borrow, and there are times, and there are months, and November was one, when the amount we needed to borrow was very much greater than the amount in that month that we actually borrowed and that put M3 all out. That's a technical factor, but it's because of that, that the Bank of England and Geoffrey Howe's announcement in November indicates that we are looking at different ways of raising the amount of money, that government needs to borrow, and you will already have noticed that taking effect. Because you have got to learn, all governments have to learn, you've got to learn from what didn't quite go right, and see if you can stop it in the future. Now we are doing that. You still have to get all of your indicators pretty well where you want them to be within your target area - some have been undershooting, some have been overshooting - and when you've done all that you still have to look to see what is happening outside. Let me make that absolutely clear. That is....

BRIAN WALDEN:

All right...

BRIAN WALDEN:

And the narrow money base has been under-shooting.

MARGARET THATCHER M.P.

Some of the narrow monetary bases, I'm not relying on M1, we've done that before....

BRIAN WALDEN:

Under the Heath government...

MARGARET THATCHER M.P.:

The monetary base, the narrower monetary base, which so many other people..., has been under-shooting. Now some of the narrower ones are rising, and I believe that some of the broader ones are falling. I am saying we must look at them all and see how they are reflected. We must in fact get M3 down, because if we don't and at the same time your narrower ones are rising, what you would be doing would be laying the foundations for a new bout of inflation. And that we will not do. Now can I get this absolutely clear. I said when we started that it is just at this stage that other governments have taken fright and they've cut and run, and they've reflated the economy, which is that nice polite word for saying you print a lot of money and pump it in. 10.
We will not do that, because if we do we take the same path that's been taken previously. You pump money in, you get a

extra jobs, but all your prices and all your costs ..., that affects the whole of your business, the whole of your industry, it becomes competitive and very soon the consequence is that you get increasing unemployment. And what do you do then? Pump a bit more in? That way lies madness, it, lies hyper-flation. We cannot do that. I am...

BRIAN WALDEN:

All right....

MARGARET THATCHER M.P.

I am here to change that, and if I could only get this message over, let everyone know I will not stagger from expedient to expedient, we will not reflate. We came in to put long-term things right. I will do selective things to help, I will help people through difficult times, but reflate? No. So yes, we shall continue to watch M3, we shall bring it down. But in deciding our policies, not only that, but looking at the others and what is happening on the real world outside. 10.

BRIAN WALDEN:

All right, now let's move to what is happening in the real world outside. I take it from that that there will be on attempt at claw-back. You said earlier that one....

MARGARET THATCHER MP (contd):

haemorrhage on expenditure. This year, for example, we've had to spend much, much more on nationalised industries. It's interesting, you see, people not only pay out of their price pocket, they then pay out of their tax-payers' pocket, and I could have income tax four pence in the pound lower were it not for the amount we're having to pay out for nationalised industries. And when I hear Michael Foot talk about a socialist transformation I think 'my goodness, if I hadn't had those number of industries nationalised we'd be very much better off than we are', so that's another haemorrhage. 5.

MARGARET THATCHER MP:

I do not think that at this moment we could have cut it off, but I disagree that we need to keep it going by government in perpetuity. It's being kept going so it can become very, very much nearer to complete efficiency, so that parts of it or the whole can be sold off, or we can get someone else to collaborate with the British government and become perhaps 51% owned, but we shall not in fact have all of the problems with it we have now. I never want to take on another British Leyland, we shouldn't be in it at all, but now we're in it we have to choose the time, and we have to back Michael Edwardes' judgement. He's the manager, I'm not the manager. 8.

BRIAN WALDEN:

You said something very interesting towards the end of that Prime Minister, there are a number of things I want to ask you on it....

MARGARET THATCHER MP:

Oh dear...

BRIAN WALDEN:

Well, it's an important issue as you know.....

Margaret Thatcher M.P.: You would understand if I don't quite put it in that way, because unemployment is the most difficult human problem we have to tackle and of course we feel about it deeply. But the fact is that every time governments have re-flated to avoid it they have finished up by increasing it, and that is why when I first came into Parliament we did not have very much inflation, equally we did not have very much un-employment. In the Macmillan period inflation was low, un-employment was low and then, somehow, you will remember we had the first pay pause, we got into difficulty after that, in-flation rose and as inflation rose so unemployment followed. And do you know what has happened? It has gone up over the last thirty years. Each government has re-flated to get out of its problems and each government has lifted the basic level of un-employment. So that, during Ted's time, the basic level of unemployment was about three-quarters of a million. During the lifetime of the last Labour government it went up to about 1.3 -

2.+ 3.

can't I quarrel with you on one thing you said right at the beginning? It is not a theory, it is borne out by everything that's happened in this country in the last thirty years...

BRIAN WALDEN

But half the .....

MARGARET THATCHER M.P.

Just forget the theory, just look....

BRIAN WALDEN:

Half the academics and half the politicians don't agree with it, they believe a different theory...

MARGARET THATCHER M.P.

I'm not concerned with the economic theory at the moment, I'm concerned with what has happened in practice. as inflation has risen, and every time we've reflated we've finished up with higher inflation, as I say in Harold MacMillan's time we were worried about three to four and a half per cent. 14.
Then it rose in the sixties, in Ted's time, it went up to about eight-nine per cent, the average inflation in the lifetime of the last Labour government was thirteen, round about thirteen per cent. Look, as inflation's gone up, so your unemployment has followed it, from three hundred thousand, which used to be the norm, it now went up to one point four million. It is that terrible, vicious thing that I am trying to break through.

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

House of Commons Handard	05/02/81
Economic and Industrial Policy	Columns 415-500

Signed *OMWayland* Date *15 March 2011*

PREM Records Team

10 DOWNING STREET

MR. SANDERS

You may care to have by you this summing up of the main Neddy debate by the Prime Minister.

B. INGHAM

5 FEBRUARY, 1981

PA (NEDC file)

MS

PRIME MINISTER'S SUMMING UP OF MACRO-ECONOMIC DISCUSSION WHICH TOOK UP 1 HOUR 45 MINUTES TO 11.45 a.m.

No doubt we all want same things and all think we could do better than we are doing now. Those two things not in any way in doubt.

All people believe that Britain could have a higher standard of living. All want less unemployment. All want people to fulfil their lives in work.

May be some disagreement on how we get there. Yet there does seem to be a tremendous amount of common ground.

Not going to get more jobs on higher standard of living unless we are competitive.

We shall not be competitive if our rates of inflation are worse than other countries. We shall not be competitive, by definition, unless our unit costs are the same or lower than others. No way out of that.

We shall not get our unit labour costs competitive unless we are prepared to raise productivity.

People can have high wages with high productivity. The link is high productivity.

But also need something left over for profits. Unless we have profits we shall not have investment which will keep us competitive in the future.

But we shall not have investment unless we get a return on investment with working practices which rival anyone else's in the world.

And part of competitiveness is innovation, and to keep us ahead of competitors we need a willingness to adopt innovation; to change.

/I recognise

I recognise unit labour costs are not all that matters. Product design, quality, delivery - we all recognise these things are necessary.

I was just a little bit alarmed that there is such an absence of total understanding between the several parts that make up industry.

I can only quote what Sir Ray Pennock said at the CBI conference. He did not regard reality as being what people would do on the brink. Reality is a complete understanding of what makes business prosperous and competitive.

I am very worried indeed that we are not taking steps to get that larger understanding of the role of profit, of unit labour costs, productivity and innovation. If we are not, we are all guilty in not doing it.

I hope you will take up the suggestion of Jim Prior to set out at an early meeting an agenda for a new understanding by everyone in industry of how we achieve this cost competitiveness and good job prospects for the future.

Finally, I do not think we can negotiate properly in the absence of facts. Without them you are not going to come to a reasonable conclusion. So I do support fully the suggestions we have had to set out the facts to get the full cooperation we need. I do hope you will take up that idea and sort out between you and with Government what has to be done to get that total understanding without which we shall not be able fully to use the potential in Britain.

COVERING CONFIDENTIAL

cc Mr Duguid
Mr. Vereker
Mr. Walters

Prime Minister

PRIME MINISTER

27/1

I attach my Department's pay brief for January.

I am sending copies to the members of E, E(PSP) and E(EA) Committees, and to Sir Robert Armstrong.

J P
27 January 1981

PAY BRIEF - POSITION IN MID-JANUARY

SETTLEMENTS

1 Since the December pay brief 70 settlements covering 277,000 employees have been reported. In the private sector the weighted average level of settlements over the last month was just under 9½%. There were only 4 settlements (10,000 employees) in the public sector averaging 5½%.

2 The cumulative average level of settlements this round in the private sector is just over 10% (238 settlements covering 1,239,000 employees). Most of the settlements recorded so far have been in manufacturing industry, where the average level is just under 10%. The average in non-manufacturing is just over 10½%, but few settlements have been made in this sector and the average is heavily biassed by the low settlement in Agriculture (9%). There is a wide range of settlements (see Appendix 2). About a third are in single figures, almost all in engineering and clothing industries. A quarter of settlements included improvements in holidays.

3 In the public sector (16 settlements covering 432,000 employees) the cumulative average is just under 14%. The average for the trading sector is 9½% and for the services sector - mainly Police and Firemen - is 19½%. If the LA manual settlement at 7½% is ratified this will reduce the average for the services sector to about 9%.

now. ratified TL

NEGOTIATIONS

4 In the PUBLIC SECTOR, agreement has been reached for a 7½% increase for Local Authority manuals (4 November - 1,100,000), subject to ratification by workers. Negotiations have not yet begun on claims for substantial increases and reduction in hours for NHS ancillaries (13 December - 213,000), Ambulancemen (1 January - 17,000) and Local Authority craftsmen (4 November - 95,000). Discussions are continuing on a claim by NHS craftsmen and maintenance workers (1 January - 14,500) for parity with the electrical contracting industry estimated to be worth 20%. University teachers (1 October - 38,000) have rejected an offer of 6%. Committee 'A' are considering new proposals to submit to DES. In British Steel (1 January - 140,000) a proposal to defer a settlement for 6 months with a 7% increase from 1 July has been accepted by the craft and general unions but rejected by ISTC. Some British Airways employees (1 January - 50,000) are staging a one day strike on 23 January in response to a proposal for a 3 month pay freeze to be followed by an 8% increase. Unions for Water Service manuals (7 December - 33,000) are recommending industrial action following rejection of a 'final' offer of a 9.9% increase in rates, estimated at 7.9% on earnings. Gas Supply manuals (18 January - 41,000) have rejected an offer

costed at 8% on the paybill. Negotiations resume on 30 January. Employers are expected to reply on 5 February to a claim by Electricity Supply manuals (20 March - 92,000) for substantial increases and other improvements. National Bus Company platform and maintenance staff (1 March - 38,930) are considering an offer of 5% on rates and talks for similar grades on Municipal Buses (1 January - 20,750) are due to begin on 26 February.

5 In the PRIVATE SECTOR, Merchant Navy seamen (2 January - 26,000) have rejected an improved offer of 12% and mediation by ACAS has failed to stop industrial action being taken. Officers (1 November - 36,000) are considering an improved offer of 12%. The majority of Ford manuals (26 November - 57,000) have voted to accept an offer of 9.5% on rates. Negotiations in Road Haulage (November 80/February 81 - 200,000) are taking place on a regional basis. Over half of the regions have settled for between 3.0% and 6.8% on rates. Guardian Royal Exchange staff (1 January - 8,700) are considering a revised offer of 10% and Royal Insurance Group staff (1 January - 9,500) have voted to accept an offer of 14%. The two unions (BIFU and CBU) representing London Clearing Bank staff (1 April - 146,000) have presented claims for increases of up to 20%. Newspaper Publishers Association production workers (1 January - 33,000) have rejected an offer of 5%. The claim is for about 15% in line with inflation.

PRICES AND EARNINGS INDICES

PRICES

6 In December the year on year increase in retail prices was 15.1% compared with 15.3% in November.

EARNINGS

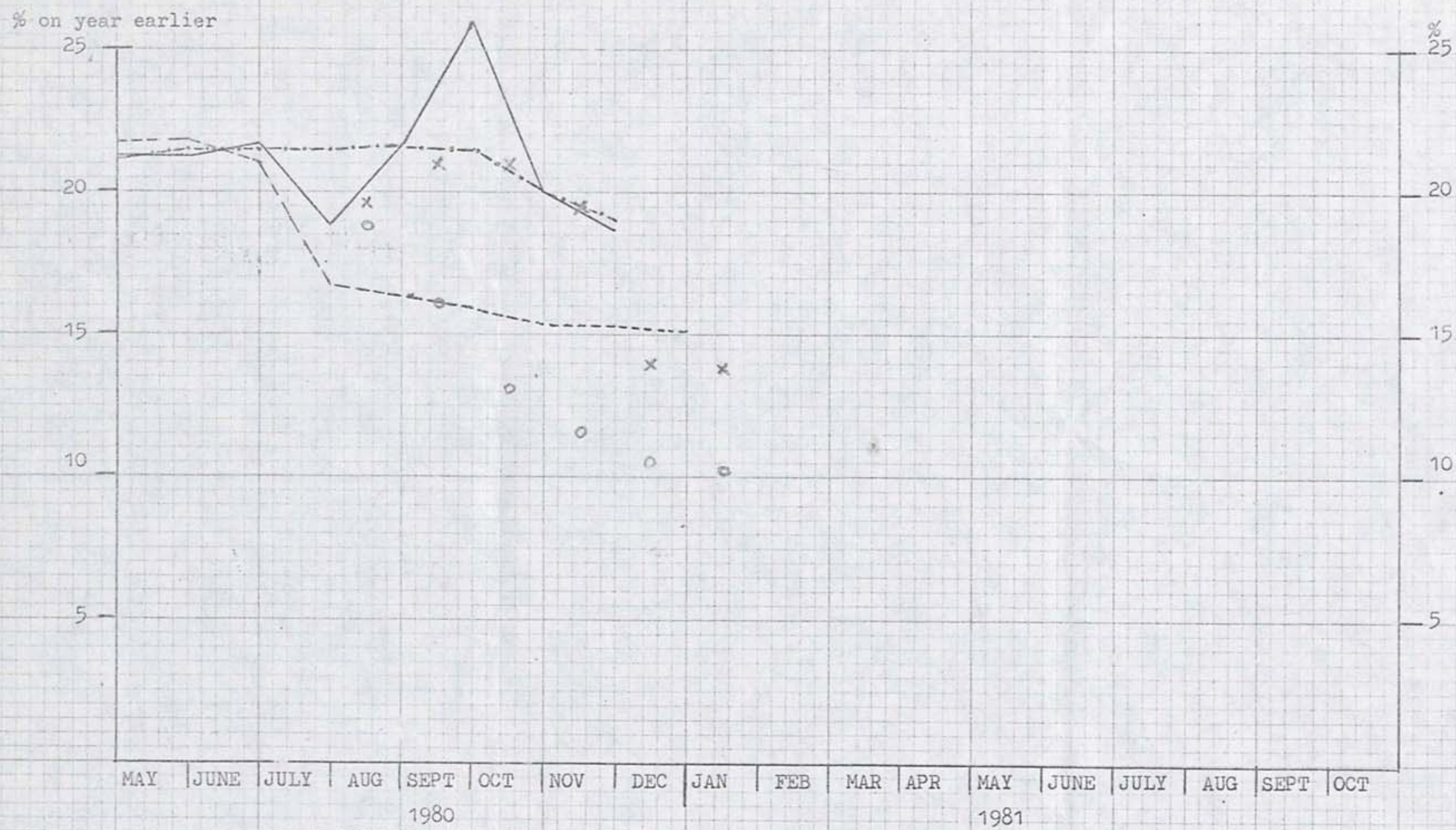
7 In November the year on year increase in average earnings for the whole economy was 18.7% compared with 20.1% in October.

REAL DISPOSABLE INCOME

8 The real disposable income of a typical family (described in the mid-September Pay Brief) rose by just over 2½% in the year to October.

CONFIDENTIAL

TRENDS IN EARNINGS AND PRICES



- - - - Retail Price Index

——— Average Earnings Index (whole economy)

× Public Sector Settlements)
o Private Sector Settlements) Cumulative Average Increase in Earnings (effective after 31 July 1980)

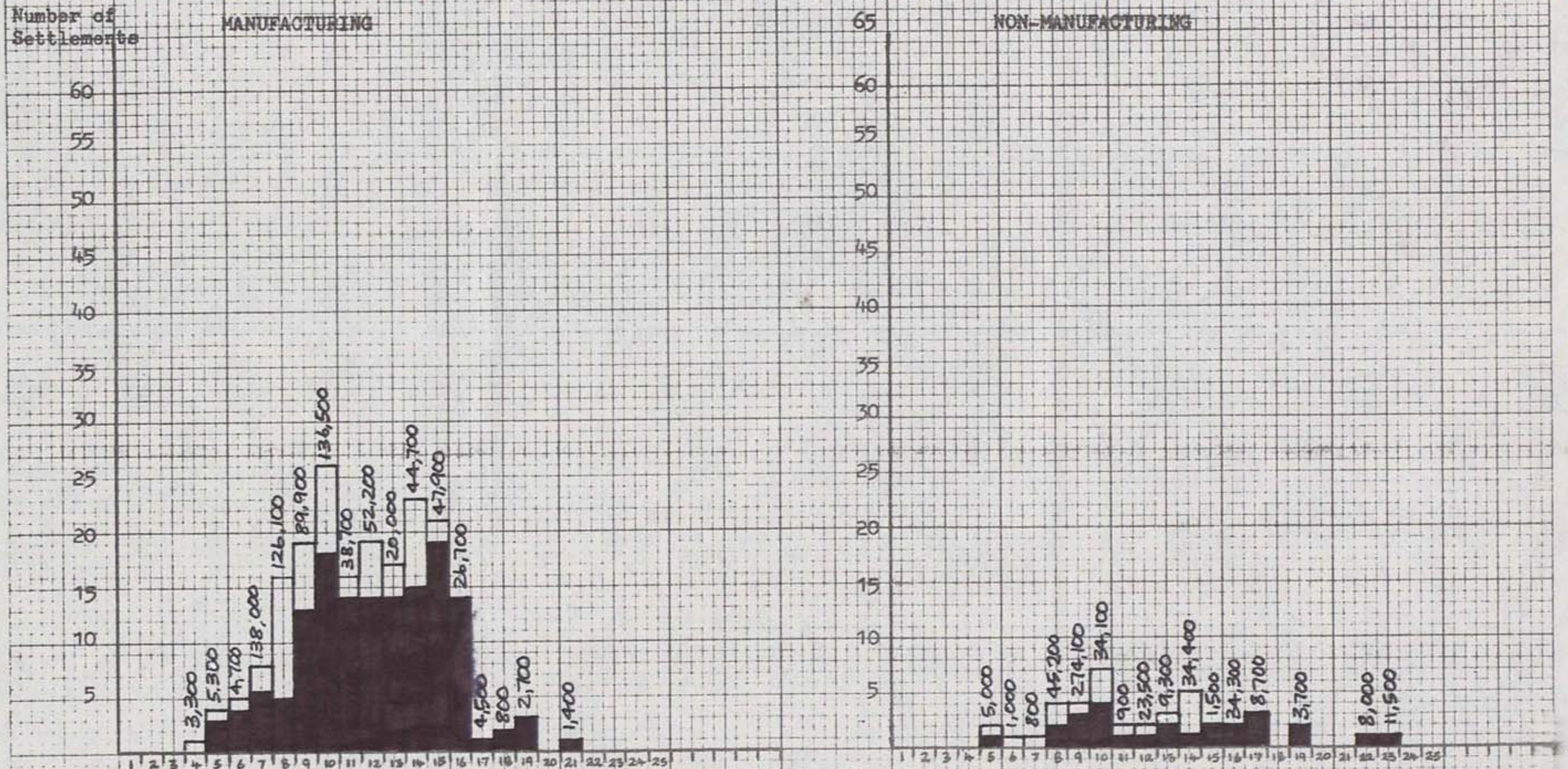
—·—·— Underlying rate of increase in earnings

CONFIDENTIAL

APPENDIX 2

DISTRIBUTION OF SETTLEMENTS IN THE PRIVATE SECTOR BY LEVEL OF SETTLEMENT FROM 1 AUGUST 1980

KEY ■ SETTLEMENTS UP TO THE LAST PAY BRIEF
□ SETTLEMENTS SINCE THE LAST PAY BRIEF



LEVEL OF SETTLEMENT (ROUNDED TO THE NEAREST WHOLE NUMBER)

E.R. NOTE - THE NUMBERS OF WORKERS (ROUNDED TO THE NEAREST HUNDRED) AFFECTED BY THE SETTLEMENT IS GIVEN ABOVE THE APPROPRIATE INDICATOR.

MR. WHITMORE
U.

10 DOWNING STREET

From the Press Secretary

CHANCELLOR OF THE DUCHY

Presentation

1. I promised a paper on the above in the light of last week's discussion chaired by the Prime Minister. This paper is intended as the first step towards a strategy paper (which I would draft) for you to put to colleagues.

Background

2. It is a familiar charge, made against and within all Governments, especially those approaching mid-term, that their presentation of policies and measures is wrong, poor or indifferent. We should be on our guard against believing that everything would be all right if only we could explain the Government's works better. All too often it is the pianist and not the composer who gets shot.

3. Notwithstanding the highest (and rising) level of unemployment since the war - historically a very sensitive nerve in British politics - the Government retains a remarkable degree of support. Britain is felt to count for something more in the world these days. Its Government is felt to mean what it says far more than UK Governments have done for nigh on 20 years. It is not all bad. We should resist going off the deep end.

Criteria

4. Any analysis of what is wrong (and right) with presentation and what needs to be done to improve it must take account of the:

/- Government's

- Government's objectives;

- climate in which those objectives are being pursued;

- condition of the Government in pursuing those objectives; and

- mechanics of presentation - are we doing it right?

5. I examine each of these points in turn before making some recommendations for your consideration.

Objectives:

6. The Government came to office pledged to discharge five main tasks:

- restore the health of the economy;

- restore incentives so that success is rewarded;

- uphold Parliament and the rule of law;

- support family life in a variety of ways;

- strengthen our defences and work with our Allies to protect our interests in an increasingly threatening world.

7. In fact these five tasks tend to mask the real objectives of the Government. These objectives are essentially to:

- halt and reverse the tide of corporatism which was sapping the national will;

- encourage self-reliance and reward enterprise and hard work;

/- restore

- restore the balance in our democracy as between Parliament, capital and labour; and

- raise the nation's status in the world community.

8. In short, this is a radical Government pledged to transform attitudes and habits in Britain. Its programme breaks with the failed post-war consensus on how Britain should be governed. Critics of its presentation often fail in turn to appreciate just what is being attempted. Similarly, they fail to understand the crucial nature of presentation, given that the Government is engaged (more than most over the last couple of decades) to change, as distinct from win, hearts and minds.

9. Against that background, it is important to appreciate the heavy burden which is being put on presentation as an instrument of Government policy. To repeat, this Government is not simply trying to win hearts and minds: if its policies are to succeed, it needs to change the way people think, feel and act.

Climate

10. Superficially, the Government could not be operating in a worse climate. Up to now it has been the conventional wisdom that recession, let alone slump, and high unemployment serve only to entrench negative, unco-operative attitudes. Current events, however, give the lie to this. Inflation is tumbling partly because pay settlements are much more modest and much more closely related to output and productivity. Management is re-asserting itself and claims to be finding it relatively easy to introduce efficiency measures. What is not clear is whether this is solely a function of high unemployment and whether, when the upturn comes, the unions will - as the Guardian puts it - go in for vengeance.

11. Internationally, the climate is much more favourable,

/especially

especially with Zimbabwe and the EC budget settlement behind us. The world has become much more dangerous over the life of the Government with Iran, Afghanistan and Poland the notable flashpoints. But a resolute and determined Government can win high marks in these circumstances. And the election of President Reagan is potentially another bonus.

12. In short, while the climate at home and abroad is bloody the political consequences are not necessarily as gory. British politics are in a state of evolution just as the Labour Party, so far a wholly ineffective Opposition, is submerged in revolution.

13. In this confused climate good presentation - the clear, certain and confident voice - is beyond price.

Government's Condition

14. Unfortunately, one of the weak links is the Government's performance. The following criticisms are justified:

- the Government does too little to remind the public of its overall objectives - what sort of a society it is seeking to achieve and the progress it is making to that end;

- it has allowed its economic battle (which is none the less crucial since it will decide the next election) completely to overshadow other presentational imperatives - for example, it has taken far too little credit for its successes abroad; it has allowed itself to appear far more uncaring than it is; in its understandable concern over unemployment it has been too prone to grab at whatever seems to be good news;

- it is obsessed with the short term, though in an entirely different way from, for example, the Wilson Government which was mesmerised by the media; this Government is in a curious way rather ascetic - it puts far too high a premium on hard work and far too low a one on imagination, flair and the broad view;

- it is prone to operate on the basis of that well-known hymn: you in your small corner and I in mine. It is often painful to persuade Ministers generally to act in the broader Governmental interest; and, perhaps all the above is a consequence of the fact that

- the Government is divided and seen to be divided; nothing has done the Government more damage than the 1981-82 public expenditure review. This was taken as a licence to hold the Cabinet in public. As I have told the Prime Minister, there is nothing I can do in these circumstances to carry conviction. Not to put too find a point on it, we need to restore honour and discipline at Cabinet level. Without this, the Government cannot achieve Nigel Lawson's objective of appearing competent. It is to be hoped that the reshuffle marks a point of departure.

15. I cannot stress too strongly the importance of the Government Information Service against the background of a manifestly divided and warring Cabinet. We can be technically perfect in our presentation but we shall carry no conviction if the Government as a whole does not present a strong and united front.

16. There are other weak facets of Government performance that I should draw to your attention. First, you are absolutely right in saying that Departments are responsible for the presentation of their own policies. But central co-ordination is essential from at least two points of view:

/- timing; and

- timing; and

- contributing a broader view.

17. The hardest battle we fight at the centre is:

    (a) getting to know well in advance what 'news' is in the pipeline;

    (b) having the opportunity to make a contribution to proposed announcements; and

    (c) influencing timing (which is important).

18. You need to crack the whip in these areas at an early date.

19. Second, presentation of Government policies suffers from inconsistencies and contradictions. For example, Govt. is castigated for cutting programmes even when it is actually spending more in real terms. This brings out the dilemma over whether the Government wishes to present itself as caring or as a master cutter. Its approach to financial discipline in the public sector, which ought to be seen as a positive and highly desirable development, brings condemnation for starving nationalised industries of essential capital and local authorities, however spendthrift, of essentials. And it is criticised at once for unfeeling monetarism while at the same time money supply, on one definition at least, is soaring along with the PSBR. We need to sort out our inconsistencies and decide just how we do wish to present ourselves.

20. Third, the Government (i.e. Ministers and officials) do not as a general rule take the Government Information Service seriously. It is regarded as a mechanical bit of the organisation whose value is in performing executive and clerical functions and erecting a defensive screen. This attitude

/is

is wrong. You need to fashion a positive, creative and virile Information Service not simply for the good of the Information Service but for the benefit of the Government.

The material is no worse and no better than the Civil Service as a whole, though I do not present that as a testament. It needs working and leading. And the best Information Ministers post-war have been those who have harnessed the latent enthusiasms of the Information Service to the greater glory of the Government.

Mechanics

21. The mechanics of presentation have to be considered at several levels:

- television (the most influential);
- radio (valuable in respect of housewives, motorists and more generally the thinking man and woman);
- national press (the ideal, especially in the pops, in terms of circulation);
- regional and local press (never to be sneezed at and much to be cultivated, given their basic sympathy);
- speeches (which will attract national publicity only if the timing is right (or wrong) or are controversial), their main value is in regional and local reporting and on local radio;
- newspaper articles; these should seldom, if ever, be turned down except in the context of supplements which are little read;

- speaking/background notes: these should not be judged by you as a Cabinet Minister; their value lies in the essentials and confidence they give to middle-rank and junior Ministers; we simply cannot expect Ministers as a whole to put over the Government's messages unless we give them ready-packed material;

- Parliament: in my view we have done far too little by way of oral and written Questions/Answers to go for the jugular;

- meetings with influential groups; at the centre it is difficult, if not impossible, to establish just how far the Government is carrying the fight to the enemy or the message to potential (or real) friends but this is a medium we need to give closer attention to.

<u>To summarise</u>:

22. More could be done to propagate the Government's message by means of TV, radio, the regional and local press and through Parliament. We should not under-estimate the value of speaking/background notes to middle rank and junior Ministers in getting over the Government's overall message.

<u>Conclusion</u>

23. This paper has been produced for the purpose of discussion. It makes the following points:

- the crucial nature of the presentational role may not be fully appreciated, given the Government's real objectives.

/- the

- the Government should remind the public much more of its overall objectives and the progress it is making towards achieving them;

- the Government should take greater care over its image as a caring administration; take more credit for its successes abroad; and be aware of what superficially appears to be good news; it should not be obsessed with the economic battle, crucial though it is;

- it should act more as a Government in the Government interest and should avoid appearing divided;

- it should sort out inconsistences in the interests of better presentation;

- it should reform its mechanical operations to ensure that you (and I) at the centre have the opportunity to influence events before they happen;

- more demands should be put upon the Government Information Service,and Ministers and officials should be asked to support the Service in meeting those demands;

- more could be done with TV, radio and regional and local press and in Parliament to get over the Government's messages; we should not underestimate the value of speaking/background notes.

22. I hope this is helpful in clarifying your views and contributing to a definitive paper to put to your colleagues.

B. INGHAM

26 January, 1981

PERSONAL AND CONFIDENTIAL

R H

Subject

FILE

Blind cc:- Mr Ingham
Mr Hoskyns
Mr Wolfson
Mr Gow

10 DOWNING STREET

File

From the Principal Private Secretary

21 January 1981

CS

Presentation of Government Policy

The Prime Minister held a meeting this morning with Lord Thorneycroft, the Chancellor of the Exchequer, the Chancellor of the Duchy, the Chief Secretary and the Financial Secretary to discuss co-ordination between the Government and the Conservative Party on presentation of Government policy.

Lord Thorneycroft said that he had asked for the meeting because the way in which both the Government and the Party were presenting Government policy was causing him concern. This was not just a personal feeling of his but a reflection of views which were being put to him in his contacts with all sections of the Party. At the moment there was a widespread feeling that the Government was not explaining clearly and forcefully enough to the public what they were trying to do and why. People saw the Prime Minister and her Treasury colleagues standing firmly for the Government's strategy but they did not get the feeling that the rest of the Cabinet was united behind them. The impression which the public had was that the Cabinet consisted largely of individual Ministers defending their own Departmental positions. What was needed was a strategy for presenting Government policy; and this, in his view, would require each Cabinet Minister to play his part within the overall framework. He hoped that the Chancellor of the Duchy would be able to develop such a strategy, in consultation with other Ministers and with him. In this way both the Government and the Party would be able to put over to the public as a whole, and to the Party's supporters in particular, a clear and consistent exposition of the Government's policies.

The Chancellor of the Exchequer said that he agreed with Lord Thorneycroft's analysis. The broad message which had to be conveyed should be a balanced one which did not shirk admitting the bad news such as the rising trend of unemployment and the prospective fall in living standards but which also pointed out the encouraging aspects of present policy such as the fall in the rate of inflation which offered hope for the future.

The Chancellor of the Duchy said that he felt strongly that the current presentation of Government policy was inadequate. The country was in a fog about the aims of Government policies and about how the Government intended to achieve them. The public did not understand what the Government was trying to do. He agreed

CONFIDENTIAL

/with the

with the Chancellor of the Exchequer that we should present the picture as it was - a mixture of problems and good news. At the moment we were not fitting all the pieces into a single, broad framework. He shared Lord Thorneycroft's view that we needed to develop a strategy for the presentation of Government policy, and because this task straddled so many Departmental boundaries, he thought that he would have to take the lead on it, drawing upon the help of his colleagues as necessary. If such a strategy was to be produced, Ministers would have to spend less time than they did now on today's and tomorrow's problems and would have to think much more about the broader, longer term issues. An approach of this kind would not, however, produce results quickly, and he would himself need time to think the problems through and to set action in hand. On a point of detail, he had reservations about the value of the weekend speaking notes for Ministers which his office circulated, and he believed that more might be achieved if he personally tried to direct in a more positive way the line to be taken by Ministers in public on the central issues of the day.

The Chief Secretary said that one of the Government's present handicaps was that the economic Ministers seemed to the public to be somewhat isolated from their colleagues. This was largely because the economic situation was so sensitive and complex that non-economic Ministers were chary about speaking about it. This attitude was understandable but it needed to be overcome. Ministers from all Departments should be encouraged to speak in public on economic subjects.

The Financial Secretary said that he agreed with Lord Thorneycroft and Mr Pym about the public's lack of understanding of what the Government was trying to do. The country needed, above all, to feel that the Government was competent; and being competent meant first, being seen to be united and second, being seen clearly to be on top of the job, whatever the obstacles in the way of achieving the Government's aims. But it was not enough for the Government to appear competent: the language in which Ministers presented Government policy was also crucial, for it was all too easy to use terms in speeches which left people in the kind of fog the Chancellor of the Duchy had mentioned.

In discussion there was agreement that we were not doing enough to get the terms of public debate on Government policy right. Many of the present yard-sticks of success were unfavourable to the Government, and they often reflected an approach to problems which had been overtaken by the march of events. This might well be true of, for example, the yard-sticks against which unemployment was discussed.

The Prime Minister, summing up the discussion, said that they were agreed that the Government's and Party's presentation of Government policy was not altogether satisfactory at present, and a new strategy for the presentation of policy should be worked out as urgently as possible. The Chancellor of the Duchy should take the lead on this, in conjunction with Lord Thorneycroft and consulting his Ministerial colleagues as necessary. One element in this new strategy might be a requirement for more frequent keynote speeches by herself and other senior Ministers in which they could show how all the Government's policies fitted together into a coherent whole. Another element might be the use to be made of major television appearances by Ministers. A fully integrated strategy had underlain the Manifesto, and broadly the same approach was needed now.

/I am

I am sending a copy of this letter to Lord Thorneycroft. I am also copying it to John Wiggins, Terry Mathews and Stephen Locke. I should be grateful if you and they would handle this letter with due discretion and, so far as possible, avoid copying it.

C. A. WHITMORE

R.A. Birch, Esq.,
Chancellor of the Duchy of Lancaster's Office.

Copy to Mr Ingham.

I.17

CHANCELLOR

cc Chief Secretary
Financial Secretary
Mrs Gilmore
Mr Whitmore, No 10

MEETING WITH THE PRIME MINISTER, WEDNESDAY 21 JANUARY

PRESENTATION OF GOVERNMENT ECONOMIC POLICY

I spoke this morning to Lord Thorneycroft who indicated roughly what he wanted to achieve at tomorrow morning's meeting. He does not want to talk about the substance of policy, or about matters that are any particular concern of the Treasury's. His concern is the presentation of the Government's economic policy and achievements, or rather its absence, in the country at large. Responsibility for this obviously straddles Central Office and Government. Now that the offices of Leader of the House and Paymaster General have been amalgamated, the way is open to Mr Pym to take a somewhat more positive role than Angus Maude was able to do.

2. At present the policy issues in the public domain tend to be rather technical and abstruse, relating to the PSBR, the monetary target and the rest. There are a whole range of other issues and arguments which need to be presented regularly, systematically and with one voice by Ministers and others.

3. At present the reports Lord Thorneycroft hears from the grass roots are a little depressing, and the Government's position is sliding. Since it has, in truth, a good story to tell now is the time to act. It is particularly opportune because the Government's policies differ so sharply from those of the Centrists (whose recipes are largely failed methods of the past, in particular income policy) and of the Socialists, who are inclining to more and more Left wing solutions under Michael Foot's leadership. A more conscious effort to defend and explain the principles lying behind them which does so by contrast with the other two main lines of political thought would give a considerable element of extra cohesion to the

Government's position.

4. In practical terms Lord Thorneycroft hopes that, busy though most of us are, Mr Pym and the Prime Minister will from time to time create opportunities to get together with key colleagues to decide in broad terms what should be said, how and by whom; and to bring about the sense of conviction and shared attitudes which is needed in practice to make a success of such a manoeuvre.

AR

ADAM RIDLEY
20 January 1981

CONFIDENTIAL

16 January, 1981.
Policy Unit

PRIME MINISTER

REVIEW OF GOVERNMENT STRATEGY

We are meeting, with Geoffrey and Keith, tomorrow at Chequers. The advisers present will be Robin Ibbs, Alan Walters, David Young, David Wolfson, Norman Strauss and myself. This note gives the background to, and purpose of, the meeting.

BACKGROUND

You will remember that you, David Wolfson and I had a long discussion one evening last spring about the general problems of "mode of operation", with special emphasis on policy-making, the Whitehall machinery, carrying colleagues on difficult issues etc.

During the summer, I discussed the problems of "organisation and method" with other advisers who had experience of the same problems in business, including all those coming tomorrow (except for Alan, who was not on board at that time) and also with Derek Rayner, Terry Burns, Peter Cropper and Peter Middleton.

There was a fair unanimity of views on the issues raised in our "Strategy Paper No.3".

PURPOSE OF THE MEETING

The meeting is NOT for the purpose of solving specific policy problems. (Nothing would be easier than to spend the whole afternoon on BL or the PSBR.) What the meeting is about is finding better ways of structuring the big policy problems, organising our resources to tackle them and ensuring that you are not then hampered by the difficulties of carrying the colleagues with you on the hard decisions.

In other words, the problem we are addressing is not BL, or energy prices, or monetary policy, or PSBR. The problem we are trying to solve (or at least start to solve) is "how to improve Government's performance at problem-solving".

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THE FORM OF THE MEETING

I would like to start with a fairly formal presentation by the advisers. This presentation will give you an idea of the way big business would approach the work needed to make the Government strategy happen. It will not be presented as the way to do it (there is no such thing); simply as an approach which may have something to offer.

We can then discuss the approach in more detail, and with relevance to specific problems. But the aim is to invest some effort in problem-solving capability, not to try to solve the problems themselves. Using the analogy from our Strategy paper, we are trying to build a factory to produce good motor cars; not to get the Board of Directors onto the shop floor to assemble the first motor car with their bare hands.

We will bring a few charts with us, tomorrow afternoon and I think the big table upstairs would probably be the best place, if that suits you.

I am copying this minute to Geoffrey, Keith and the rest of us who are attending the meeting.

JH

JOHN HOSKYNS

Econ Pol
Strategy

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~~PRIME~~ MINISTER
To see
MS

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ECONOMIC AND MONETARIST POLICIES OF HER MAJESTY'S GOVERNMENT

It is hoped that Members may find the following notes useful for the Supply Day debate on Thursday 15th January 1981, on the motion that "This House, gravely alarmed by the continuing decline in output, employment and investment in British industry calls upon HMG to abandon its disastrous economic and monetarist policies which are empoverishing the nation".

CONTENTS

Conservative Research Department,
32 Smith Square, London, SW1.

14.1.1981
AB/RH/DH/RN/LR/JV/CM/SP/ST-R/BB

ECONOMIC AND MONETARY POLICIES OF HER MAJESTY'S GOVERNMENT

Labour has no alternative policy

The Motion calls on the Government to abandon its economic and monetarist policies. Such a demand requires to be supported by alternative policy proposals. The Labour Opposition has none. Mr. Foot made this abundantly clear in his interview on BBC Radio 4, 'World this Weekend', on Sunday, 11th January.

Mr. Foot called for an end to the Government's present measures - "that deals with immediate questions like the maximum lending rate and the value of the £ and the way in which you manage the economy and the way you build up the demand ...... you've got to take Budgetary measures, fiscal measures and other measures to build up the market .... a whole series of projects for expanding and investing in British industry, "investment" on "a big scale" in British Rail for example .... " a whole series of proposals of that nature which could be put into operation".

Mr. Foot had no idea how this programme was to be paid for apart from the comment that "you would have to take some risks if you want to use such a delicate word, in seeing that you expand the economy". He had no suggestions for reconciling the lowering of interest rates with the surge in public spending and borrowing for which he called. Only on the exchange rate was he convincing : the collapse of confidence in sterling that would probably follow the adoption of his proposals might be expected to bring it down - at a time when rising commodity prices as the world recession abates could make the cushion of a strong £ most important to us.

Mr. Foot admitted the risk that inflation could start to rise again. His defence was consultation - "Of course we've got to make certain that we get agreements that can prevent the recreation of the inflation which does add to the difficulties". If Mr. Foot is assuming that the outcome of such consultations would be wage increases lower than some of those recently accepted - Leyland's 6.9 per cent or BSC's 6.8 per cent or the lorry drivers' 4 - 6.7% for example, his solution may not be very welcome or acceptable to some trade unions on whose support he depends. The record of Declarations of Intent, Solemn and Binding Agreements, Social Contracts and Concordats does not inspire confidence. Both the last two Labour Governments resorted to statutory or semi-statutory controls when consultations and agreements on voluntary restraint broke down. Over the last 18 months we have paid the price of the catching-up process that resulted, particularly in the public sector. The probable implication of Mr. Foot's spending intentions that there would have to be a substantial increase in direct and indirect taxes, would hardly make the restraint of wages easier or more acceptable.

Mr. Foot's call for "intelligent industrial negotiation" to bring about changes in British industry, and for the rebuilding of "a decent system of industrial relations" does not come very convincingly from the Party whose term of office ended in the winter of discontent.

The greatest irony of Mr. Foot's broadcast came in his boast of Labour's success in reducing inflation "from something like over 20 per cent" (in fact almost 27 per cent in August 1975) to under

...../

10 per cent. It was achieved by the measures of the kind he now wants to reverse; by Mr. Healey's cutting of public spending by £4 billion; halving the public sector borrowing requirement from £12 to £6 billion, and the use of high interest rates - (15 per cent in relation to the inflation rate was a higher real rate of interest than the present 14 per cent) - all at the behest of the IMF. Wage restraint, far from being achieved through common sense or consultation, was imposed - in the last resort by methods amounting to blackmail.

The damage Labour is already doing

Even in Opposition the Labour Party can, and does, damage our prospects. When a recession is drawing towards its end, as the present one probably is, it is all-important to foster confidence and thereby speed recovery. Too often in the past Britain has failed to recover as quickly or as effectively as other countries because confidence has been lacking - both on the part of industry to invest and seek new markets, and on the part of people unemployed or leaving school, who see no purpose in training or retraining.

At present there are signs of reviving hope. As the Prime Minister recently pointed out, last year the Industrial and Commercial Finance Corporation had the largest number of applications for assistance for expansion or new openings that it had ever had in a single year; and more new firms entered the VAT register than left it. Our export sales have held up remarkably well despite world recession and the high exchange rate. They may have been maintained on very low profit margins but footholds have been retained that can be expanded when recovery comes.

The Youth Opportunities Programme is providing an invaluable introduction to industry for large numbers of young people - 400,000 next year. They will represent a readily available pool for industry to draw upon for further training when the need comes. What is needed is confidence that the need <u>will</u> come, that recessions always end. Labour's prophets of gloom and doom can only make recovery less sure and more protracted.

Grounds for hope

Inflation is falling faster than the Government or independent forecasters predicted. Over the 12 months ending in November the RPI rose by 15.3 per cent; but over latest 6 months the increase was only 4.1 per cent - well under 10 per cent at an annual rate.

Standards of living rose last year to record levels - real personal disposable income rose in the 3rd quarter alone by 2 per cent. Calls for restraint in wages until output and productivity have recovered are entirely reasonable and should be accepted as such: there are increasing signs that they are being accepted.

Fewer days were lost through strikes last autumn than in any comparable period for 30 years.

Productivity is rising fast in some notable cases: in the mines, and - recently - in British Leyland, for example. Export sales have held up despite the strong £ and our balance of payments has been in substantial surplus for the past six months: even on visible trade we have been in surplus; the first time for many years that this has been achieved and sustained for so long.

..../

Unemployment is a matter of grave concern. But Government measures are keeping some 660,000 people in work or training who would otherwise by unemployed. As the Prime Minister recently pointed out, although certain areas of the country have particularly severe problems with which the Government's regional policies are designed to deal, overall the picture is far from static jobs are being found: one person leaves the unemployment register every 10 seconds.

PSBR and Money Supply

Both the borrowing requirement and the money supply have been running ahead of target in the first 8 months of the financial year. But, as the Chancellor of the Exchequer said in his statement on 24th November and in reply to a question on 11th December (Col. 1607), it is likely that monetary growth will decline as the public sector moves into surplus in the first quarter of the year. This, coupled with the sharp reduction in the rate of inflation which had caused an increase in the real rate of interest, made it possible to reduce the Minimum Lending Rate by 2 percentage points, to 14 per cent, in November.

The Chancellor's reply to Mr. Foot was given, in effect, in advance when he said, in reply to a question from Mr. Shore on 11th December:

> "We are not likely to succeed in restoring the health of our economy if we continue to deceive ourselves that we can do so by expanding demand within the United Kingdom. The crucial cause of declining prosperity in this country has been the continuing loss of competitiveness by British industry, attributing itself far more to high and rising wage costs than to any other cause. The right hon. Gentleman must cease deceiving himself in looking for an increase in demand as the right economic prescription" (Col. 1608).

INDUSTRY

i) The Private Sector

a) Encouraging Enterprise

The Government has given priority to the creation of a framework of taxes and laws encouraging to business. That is why the second Conservative Budget included an 'Enterprise Package'. This package:-

- helped Company Liqidity by allowing a major part of stock relief recovery charges, following on a reduction of stocks, to be deferred for a year. Many companies would otherwise have faced high recovery charges as their stock levels fell dramatically, because stocks are run down to improve liquidity and reduce dependence on bank borrowing, or because of the steel strike.

- On Capital Taxation, Sir Geoffrey Howe said: "We have, as I promised last year, subjected capital taxation to a thorough review . . . What I can do this year must be constrained by our financial position. I am, therefore, proposing changes that will be of particular help to smaller businesses. This is an earnest of out determination to make further progress when economic conditions permit". He announced that:

  (a) The threshold for Capital Transfer Tax (CTT) would be raised to £50,000 (taking at least two-thirds of otherwise liable estates out of tax altogether, and cutting up to 400 administrative jobs).

  (b) The £1,000 exemption for Capital Gains Tax (CGT) would be replaced by a straightforward allowance of £3,000. (This would remove half the cases then liable and cut administrators by 300).

  (c) The double charge on gifts resulting from the overlap between CGT and CTT would be removed by providing roll-over relief for the latter.

- On Development Land Tax. The first Conservative Budget reduced the rate of DLT and increased the exemption limit. However, the tax continued to discourage development because of uncertainty about the amount of tax payable. This and other points were dealt with in the last (1980) Finance Bill.

Special measures were brought forward to help small businesses (the job creators of the future) by: introducing a three-year Small Workshops Scheme which would enable 100 per cent industrial buildings allowances to be claimed on the construction of small industrial buildings. Industrial buildings allowance will now be given on the construction of the buildings, not just on their first letting.

By: introducing a new Venture Capital Scheme. Under this, losses on disposal of shares in unquoted trading trading companies after 5th April 1980 will be able to be set off against a person's income.

By: relaxing apportionment conditions relating to close trading companies - which cover many small firms so encouraging greater profit retention for growth.

By: cutting the small companies rate of Corporation Tax to 40 per cent - 12 points below the full rate - and raising the qualifying limits to £70,000 for the full relief and £130,000 for the marginal relief.

By: extending relief for interest on borrowing for investment in close companies generally to those who do not work for the company.

By: raising the present limits on retirement annuity relief and abolishing the ceiling on the premiums qualifying for relief, thus removing anxieties among the self employed about their retirement. Other minor changes affecting small businesses announced by the Chancellor included:

- Making the cost of raising business loan finance allowable for tax purposes:

- Giving relief for the pre-trading costs of a business where they would have been allowable during trading.

- Modifying the "714" certificate scheme by removing the unnecessarily harsh features in order to reduce the burden on subcontractors in the construction industry.

- Raising the exemption threshold fro VAT registration from £10,000 to £13,500, the maximum allowed under EEC regulations. The deregistration limit was also to be raised.

Finally the Chancellor announced the introduction of <u>enterprise zones</u>. For years the question of industrial and commercial renewal in some urban areas has appeared almost insoluble, largely because of the decline of small business activity. Almost two years earlier Sir Geoffrey Howe had suggested that "Enterprise Zones" should be set up in areas of dereliction. These areas will enjoy thefollowing advantages:

- Simplified planning procedures.
- 100 per cent capital allowances for industrial and commercial buildings.
- Complete exemption from Development Land Tax.
- 100 per cent derating of industrial and commercial property.
- A drastically simplified planning scheme.
- Exemption from industrial training board rules and levies.
- Swifter handling of applications for warehousing free of customs duty.
- Minimal requests from government for statistical information.
- Abolition of remaining Industrial Development Certificate procedures.

Consultation began immediately with local authorities responsible for sites already shortlisted by the Government.

On 29th July 1980, the Prime Minister announced that seven possible sites had been selected. They would be in the inner area of Belfast; in the lower Swansea valley; on Clydebank; in parts of Newcastle and Gateshead; at Speke on Merseyside; in the Salford Docks area and at Trafford Park industrial estate in Manchester; and in London's docklands. In view of the enthusiastic response, one or two additional areas would be considered, one of them in the Midlands.

An important part of the private sector - and the jobs which it provides - is partly dependent on the Government either for funding or as purchaser. It is important to recognise that the government has continued to support the private sector in a number of ways. The March 1980 Public Expenditure White Paper (Cmnd 7841) shows that £967 million in Regional and General Industrial support were allotted, including £337 million in Regional Development Grant alone (at 1979 survey prices).

Since then the Chancellor of the Exchequer has announced (on 24th November 1980) other measures which will have a positive effect on industry's prospects:

- On 24th November 1980 the Inland Revenue published proposals for a new scheme of stock relief which will largely remove from continuing businesses the threat of tax clawback and hold out the prospect of significant relief for companies and the self-employed.
- MLR was cut from 16 per cent to 14 per cent.
- The Government would increase the provision for selective assistance for investment and support for industrial research and development by £245 million and £50 million respectively in 1981-2.

b) <u>Regional Policy</u>

The Government's regional policy has also continued to be strong and effective.

The Government's regional policy changes announced in July 1979 and incorporated in the Industry Act have four principal characteristics:

1. They concentrate aid where it is most needed.
2. They avoid sudden disruptive change.
3. They are more cost effective than the old system.
4. They retain flexibility.

1. <u>Need</u>

Although the three tier system of SDA's, DA's and IA's has been retained, help will be concentrated on SDA's by retaining the present level of regional development Grant there and withdrawing it from the Intermediate Areas. Moreover, once the changes have fully come into effect, 25 per cent rather than 40 per cent of the working population will be living in assisted areas. Section 7 grants will still be available where genuine need is proven. Downgradings took place from 1st August 1980.

2. <u>Gradual Change</u>

RDG continues to be paid at 20 per cent in DA's and IA's on expenditure defrayed before 18th July 1979 and on assets provided before 1st August 1980. Where an Intermediate Area is now scheduled to become a non-Assisted Area, there is a three year transitional period. Where a place is to go down by more than one grading it retains its present grading for a year, then descends one grade -

which it retains for two years - before moving to its final grading after a review by the DoI. The Government promised to review after two years the progress of areas which become non-assisted as a result of a drop of two grade. This is in sharp contrast to the way in which the Labour Government cut out Regional Employment Premium in a matter of weeks in December 1976.

3. Savings

The new system will cost less than the old. The changes should by 1982-83 lead to a total saving of £233 million.

4. Flexibility

Not only are down-gradings subject to review (see above), but (i) also Section 8 grants are retained to steer internationally mobile projects to areas of the UK, and (ii) Government is prepared to be flexible, as with the up-grading of Shotton to SDA status, and as with the promise to spend £48 million over the next two years in order to develop new job prospects in the South Wales areas most affected by closures. Similarly, it has on 19th June 1980 announced help to areas affected by large scale steel redundancies at Llanwern, Port Talbot, Consett and Scunthorpe. Port Talbot becomes an SDA; the Scunthorpe and Newport TTWA's and the Cwmbran employment office area become DA's. Other extra measures were announced by the Manpower Services Commission to help train and retrain those involved. The English Industrial Estates' building programme is also to increase in these areas. (Hansard, 19th June 1980 Cols. 1784-1785).

The Government's determination to see that enterprise in the regions is not inhibited by a lack of suitable factories has also been shown by Sir Keith Joseph's recent approval of a £30 million factory programme (announced on 15th December 1980) for 1981-2 - in addition to the special five year programme for Consett and Scunthorpe noted above. The scheme will provide 1.5 million square feet of industrial floor space in the assisted areas of England. It is expected that emphasis will be placed on small units.

c) Private Sector Investment - and Profits

The Labour Party's new-found concern for the problems of British industry in general and its allegedly low level of investment in particular would be more convincing:

i) if the longer term trend of investment were not fairly encouraging

and

ii) if the historically low level of profitability which is the main cause of relatively low investment were not in part the result of Labour Government's anti-enterprise policies.

The following table shows investment by manufacturing industry since 1975: the figure inclusive of leased assets - which would otherwise appear under service industry investment - seems in fact reasonably healthy. See overleaf.

Investment by manufacturing industry

	Capital expenditure	Est. vol. of assets leased from service industries	£ million 1975 Prices
1975	3522	188	3710
1976	3326	204	3530
1977	3510	270	3780
1978	3773	367	4140
1979	3873	447	4320

(Source: British Business, 2nd January 1981)

In this series 1979 surpasses the previous highest peak of manufacturing (£4,177 million at 1975 prices) in 1970 when leasing was unimportant.

In the short run there are indeed greater signs of a drop off in investment. The third quarter of 1980 showed a fall on the second quarter of 4 per cent. However, it is worth noting that the drop in investment is not uniform throughout industry e.g. comparing the last two quarters with the previous two quarters (i.e. 2nd-3rd quarter 1980 with last quarter 1979 and 1st quarter 1980) we find:

- nearly 20 per cent fall in iron and steel, mechanical engineering, shipbuilding and metal goods and textiles, leather and clothing (all sectors with particular problems - above all ones of over-capacity which new investment might well worsen).

- seven and a half% fall in chemicals (again faced by special problems in the face of US competition).

- No fall in food, drink and tobacco, coal and petroleum products, vehicles and paper, printing and publishing industries.

(British Business, loc. cit.)

Admittedly, the outlook for "investment intentions" in 1981 and 1982 (ibid.) is fairly, but not excessively gloomy:- manufacturing industry expects a fall in investment in the series augmented by leasing (see above) of around 6 per cent in 1980 on 1979 and that for 1981 in the range of 11 to 16 per cent.

- no appreciable change in total investment by Distributive and Service Industries (excluding shipping) in 1981 or 1982. (the increase in investment in this area in 1980 over 1979 will be about 5 per cent).

However, the root of the problem is profits - an area in which management (through holding down wage costs and de-stocking) and workforce (by realism over pay) can improve industry's position themselves:

See table overleaf

Rates of Return at Current Replacement Cost

(manufacturing companies, based on national accounts data)

	Percent*
1960	11.1
1962	9.0
1964	10.0
1966	8.6
1968	8.7
1970	7.5
1972	7.9
1974	4.4
1975	4.9
1976	5.0
1977	6.1
1978	6.2
1979	5.0

* Gross operating surplus on UK operations i.e. gross trading profits less stock appreciation plus rent received.

(Source: British Business, 3rd October 1980)

ii) The Public Sector

No-one could claim that the public sector has been deprived of funds for investment (indeed some nationalised industries like British Steel are wrestling with the problem of over-capacity as a result of past ambitious over-investment). The following figures show the External Financing Limits of the nationalised industries this year. Figures in brackets show extensions to EFLs subsequently permitted.

Nationalised Industries External Financing Limits (as announced on 16th November 1979)	1980-81 £m
National Coal Board	834
Electricity Council and Boards	187
North of Scotland Hydro-Electric Board	59
South of Scotland Electricity Board	73
British Gas Corporation	-400
British National Oil Corporation	101
British Steel Corporation (+£400 million)	450
Post Office	65
British Airways Board (+£85 million on £219 million)	230
British Airports Authority	20
British Railways Board (+£40 million)	750
British Transport Docks Board	-10
British Waterways Board	30
National Freight Corporation	24
National Bus Company	85
Scottish Transport Group (+£3 million)	9
British Shipbuilders (+£65 million)	120

iii) Encouraging Signs in Industry

Amid the carefully contrived industrial gloom there are a number of obvious bright spots:

Telecommunications: There are now over 100,000 Teletext sets in use in the UK - the highest number in any country. The British Teletext system has been adopted by all Europe except for France and Italy, and 80,000 sets each with the UK teletext facility have been sold in Sweden and Germany. (DoI, Press Release, 25th November 1980).

Ship-repairing: Tyne Dock Engineering which closed in March 1980 with a loss of 350 jobs has been purchased by Zenta Engineering Holdings: the labour force may increase to about 300 in the next two or three years (Financial Times, 6th January 1981).

Electronics: British electronics is a booming industry. Interim results published on 4th December 1980 for the General Electric Company, Plessey and Ferranti show Britain's success in this field. All three showed profits above the same period in 1979.

Aerospace: The Society of British Aerospace Companies forecast in December 1980 that despite the world recession, British aerospace exports in 1980 would exceed 1979 record total of £1,269 million by as much as £500 million.

UNEMPLOYMENT

Unemployment has been on a rising trend in Britain, as in other countries, for many years, as Mr Prior pointed out in a Commons Debate on 25th June 1980.

At the time of the February 1974 General Election there were 577,700 (2.5%) out of work. By the May election in 1979, the number was 1,306,100 (5.4%): unemployment had more than doubled during the Labour years.

In each economic cycle both the low point and the high point of unemployment were worse than before. In 1963, the low point of unemployment was about 250,000: in 1969 and 1973 it was over 500,000, and in 1979 it was 1.2 million. The peak of unemployment was nearly half a million in 1963; by 1972 it reached 900,000, and in 1977 nearly 1.4 million. During the Labour Governments of 1974-79, unemployment more than doubled.

Unemployment under Labour peaked in November 1977 at 1,419,700, an increase of 146.8% in the 3¾ years since the Conservatives left office.

International Comparisons

At the end of November 1980 the number of registered unemployed in the EEC as a whole was around 7.6 million, a rate of 6.9%. In Belgium and Ireland the rate is over 10%. Unemployment in the Community was 24.5% up on November 1979.

Country	No. of Unemployed Nov 1980 (1,000s)	% Nov 1980	% Nov 1979
W. Germany	967.5	3.7	3.1
France	1613.0	7.2	6.6
Italy	1795.3	8.2	7.6
Netherlands	296.7	5.8	4.1
Belgium	425.3	10.5	9.1
Luxembourg	1345	0.9	0.7
UK	2162.9	8.3	5.2
Ireland	115.0	10.1	7.5
Denmark	202.6	7.8	4.8

(Source: Eurostat)

The European figures are not strictly comparable - different methods of computation are used. In the United States unemployment in October was 8,005,000 (7.6%) and in Japan only 1.15 million people were out of work (2%). The Government's ability to avoid or improve upon international unemployment trends is obviously limited during a world recession, but if Britain continues to price herself out of world markets, her position will only be exacerbated.

Abroad, pay deals have more accurately reflected productivity, but as the unadjusted (for exchange rates) table below shows, Britons have been overpaying themselves in relation to their competitors.

Change in unit labour costs in manufacturing 1975-80.
Percentage 1.3

UK[1]	US[1]	Japan[1]	France[2]	German FR
+85	+33	-2	+43	+11

1. OECD Main Economic Indicators
2. CSO Estimate
3. Mining and Manufacturing

The adjusted table - table 'C' - is less dramatic.

The Secretary of State for Employment, Mr Prior, made this plain on 21st October 1980:

> "We have to recognise why unemployment is rising. More than anything else it comes about from our inability over a number of years to produce the right goods at the right time and at the right price to sell in world markets and indeed in our own country. There are now a number of encouraging signs. Inflation is coming down and there is undoubtedly emerging a better understanding of the harsh reality that we must make ourselves more competitive. It is this which offers the best hope of producing real jobs for the future".

Labour Turnover and Vacancies

The monthly averages of labour turnover for the three months ending in the stated months have been: (Flows at Employment Offices, GB).

	Joining Register	Leaving Register
July	317,000	263,000
August	327,000	264,000
September	340,000	265,000
October	349,000	268,000
November	363,000	272,000

The number of vacancies at employment offices in December 1980 was actually 5,000 up on November (97,400) due partly, of course, to the seasonal upturn. Though still 120,000 down on December 1979, this is the first time the number of vacancies have substantially risen since September 1979. The fall in vacancies appears to have reached the low point. The MSC have estimated, following a survey, that only about one third of the total vacancies in the economy are actually notified. The Department of Employment estimates there were actually between 200,000 and 250,000 vacancies in the economy.

Table A*shows the numbers of unemployed and vacancies, and the ratio of unemployed per vacancy in November 1980, by region. The last column shows the ratio on the basis of the MSC estimated upward adjustment of vacancies.

*See Page 20

Regional Unemployment

All regions experienced sharp rises in unemployment over the course of 1980, and the largest increases were in Northern Ireland, South Wales and the West Midlands. The rises in the South East, South West and East Anglia were below the national average. It is worth recalling the unemployment record of the last Labour Government in certain regions:

Unemployment, Selected Areas, 1974-79

Local Area	March 1974	May 1979
Liverpool	39,126 (6%)	57,060 (11.8%)
Manchester	19,224 (2.7%)	36,634 (5.2%)
Birmingham	17,478 (2.6%)	40,027 (5.7%)
Coventry	6,049 (2.5%)	15,429 (6.3%)
Barnsley	2,670 (3.6%)	5,168 (6.4%)
Glasgow	28,764 (5.3%)	48,525 (8.2%)
Ebbw Vale	1,170 (3.9%)	3,511 (11.5%)
Port Talbot	2,514 (3.2%)	5,230 (6.5%)

Long-Term Unemployment

This description is used to apply to a variety of periods. The most commonly used are over 6 months, or over 12 months, and over age 19 and under age 60. In October 1980 those unemployed in these categories were as follows:

6 months and over: 574,000
12 months and over: 320,660

In 1973, when there were about 750,000 unemployed, 100,000 had been out of work for more than a year. Those unemployed for over a year in Great Britain alone in October 1980 break down as follows:

Under 25s - 68,900 (18%)
25-54 - 189,500 (50%)
55+ - 120,100 (32%)

Such a large number of people unemployed at the peak of their working lives is obviously a major source of concern, but Mr Prior has said:

> "It is unrealistic to suppose that special measures can do as much for (the adult unemployed) as for the young. For most of the unemployed, the only solution is the creation of lasting and viable jobs which will appear only as we establish a sound economy. Nevertheless, insofar as it is possible to ease the transition by special measures, we have a duty to do so, and the Government are convinced that more opportunities for useful activity could be provided if greater emphasis was placed on work of environmental improvement and if much greater encouragement were given for projects organised by voluntary agencies".

(See 'Special Employment Measures', below).

The over-6 months and over-12 months figures of unemployment of those between ages 25 and 59 in the following regional table*show the extent of longer term unemployment of those in their main working period of life.

*Table B. Page 21

SPECIAL EMPLOYMENT MEASURES

Mr Prior has said that his special employment measures are keeping some 660,000 people off the dole, but the expanded measures are also part of a positive programme to rematch skills with jobs in the future. These measures are not short-term palliatives, but an essential part of the Government's duty to ease the transition to a highly productive, highly competitive, high wage economy. In short, they show confidence in a future expansion of employment. The Secretary of State for Employment outlined his plans at Southend on 4th December 1980:

> "I do not believe that inadequate training is the only reason for shortages of skill that have in the past emerged as the economy got moving. But if we are to make the most of our opportunities we need to lay a sound foundation for the future. One aspect must be training... Industry will need a well trained workforce. Particularly in areas where technological development is of importance - and this is increasingly true of many parts of commerce as well as manufacturing".

The number of people covered by the special employment and training measures in Great Britain at the end of November is estimated as follows:

Temporary short time working compensation scheme	509,500
Job Release Scheme	63,300
Youth Opportunities Programme	155,000
Special Temporary Employment Programme	11,400
Training for Skills Programme	22,200

The total number of people covered by the schemes is estimated at 767,000, but the effect on the unemployment register is somewhat less, since the figure given for TSTWCS, for example, shows the number of workers on short time to avoid redundancies rather than the number of redundancies actually averted.

Youth Unemployment

a. School leavers

This year's peak of unemployed school leavers occurred as usual in July. The figure was 295,500. The July average in the previous three years was 237,400. The normal pattern of employment is a steady decline to about 30,000 still out of work by the following April.

The number unemployed in November this year was 111,000 after 146,000 in October. The average in the last three years has been 60,000 in November and 83,300 in October. It therefore appears probably that the number out of work next April will exceed the 30,000 average, and may well be over 50,000, subject to the effect of the improved Government schemes.

b. The school-leaving population

The total population of 16 to 19 year-olds is about 2.4m; at the end of the academic year 1978/79, about 1.5m were employed and 650,000 were still in schools or further education. The number unemployed was 161,000. The number of those reaching school leaving age (16) has been rising steadily in recent years at a rate of about 3% p.a. The peak is reached in 1981.

c. Youth Unemployment patterns (G.B. only).

In October 1980, those aged 16 to 19 unemployed from one to 9 months numbered 316,400, while those unemployed for more than 9 months numbered 36,000. The 3 year average at July, to July 1980 of those unemployed under 25 for up to 6 months was 575,000 (July 1980: 689,500), while those unemployed for more than a year averaged 56,000. (July 1980: 57,500)

Youth unemployment in recent years has therefore affected large numbers but for a relatively short period in the early adult formative years.

Special Employment Measures Review for 1981/82

The statements of the Prime Minister and the Secretary of Stat for Employment in the House of Commons on 20th and 21st November respectively contained the results of the review of the Special Measures promised earlier in the year. The announcements included:- increasing the scope of and "opportunities" provided by the YOP; the expansion of the Special Temporary Employment Programme into a wider scheme called the "Community Enterprise Programme" and the extension of the Temporary Short Time Working Scheme from 6 to 9 months, but with a reduction in the assistance to employers from 75% to 50% of normal earnings; the Community Industry Scheme is to have another 1000 places, and the Job Release Scheme is to continue to encourage early retirement on the present basis.

Mr. Prior stated that the total cost of all the Special Employment Measures (summarised below) including the changes now announced "in 1981/82 will be some £570 million, an increase over existing provisions of nearly £250 million".

The detailed changes in the Special Employment Measures are as follows:

1. Youth Opportunities Programme

The main improvements are:

a) Increase in Places

440,000 "opportunites" are to be provided by the Manpower Services Commission in 1981/82, 190,000 more than planned for the current year (about 250,000), and more than double those available in 1979/80 (about 180,000). The number of school leavers has increased by an average of 20,000 per year over the four years to '78/79, is now at 737,000 and reaches the peak in 1981/82.

b) Acceleration of Places

MSC is to undertake next year to offer a suitable opportunity to all unemployed school leavers by the following Christmas (ie. 1981) instead of the following Easter. MSC is also to make an offer within 3 months to any 16 or 17 years old whether or not school leavers, unemployed for 3 months (instead of 12 months). MSC is to offer place to those registered as unemployed in October 1981 by Easter 1982.

c) Extension of Courses

More emphasis is to be given to providing those who have completed a course but have no chance of a job to progress to another more advanced course or scheme, with the object of providing, when resources permit, that every 16 and 17 year old not in education or a job will have "vocational preparation" up to the 18th birthday.

d) Improvement in Quality and Scope of Training

Two thirds of the available places are to provide work experience on employers' premises of improving quality. Off-the-job training and further education facilities are to be increased; 12 local authorities are already taking part in major projects with this objective and about 40% of YOP trainees on work experience schemes already receive off-the-job training or further education. The target is 100%

Notes on YOP

The MSC has welcomed the Government's longer term objective of providing a comprehensive system of vocational preparation for 16 and 17 year olds, as they consider Britain "lags far behind its competitors in this respect."

Mr. Prior described his basic purpose as "improving preparation for and training in work of all young people, and not just unemployed".

It will be recalled that the present purposes of YOP are to provide unemployed young people with short full or part time training courses, including work experience schemes on employers premises, training workshops, community service and other special projects. In practice these courses offer an introduction to working life, including the problems of obtaining and changing jobs, how to face interviews with employers, to write letters and to work with other people, but are particularly intended as an introduction to learning skills for which each person is most apt. 16 to 18 year olds receive a tax free allowance of £23.50 per week.

Most of those in YOP at present go to Work Experience Schemes and within three months of completing the course 68% are either in work, in Further Education or undergoing further YOP training. The maximum of unemployed school leavers, in July 1980, was 282,100. In the previous 3 years the average highest number was about 225,000, of whom all but about 30,000 had found jobs by the following April. Throughout this period and up to July 1980 the average number of those under 25 who have been unemployed for more than one year is 56,000, while the number of unemployed under 25 for up to six months has averaged about 575,000; at July 1980 this figure was 689,500. Youth unemployment in recent years has therefore affected large numbers but for a relatively short period in the early adult formative years.

The total population of 16 to 19 year olds is about 2,400,000; in 1978/79, about 1.5 million were employed and 650.000 were still in schools or in further education. The number unemployed was 161,000, equivalent to about 225,000 at today's levels.

2. Community Enterprise Programme

Mr. Prior announced that the scheme called STEP (Special Temporary Employment Programme) is to be enlarged so as to provide 25,000 places by March 1982, more than double the present number. Although like the other Special Measures it is reviewed annually, the Government has assured the Voluntary Organisations involved that it will continue for at least three years - an assurance which they had sought.

Priority will continue to be given to the long-term unemployed, and 18 year olds unemployed for more than 6 months will now be admitted (the previous minimum age being 19). CEP will be nationwide instead of for the Special Development and designated inner city areas, but preference will be given to projects in areas of high unemployment anywhere. The purpose of the CEP is to provide full-time temporary employment with emphasis on work of environmental improvement. Under the new programme private sector sponsorship of projects involving community benefit is to be encouraged. Funds are also to be provided for partnerships involving the private sector and public and community bodies in the creation of new enterprises with the aim of further jobs.

In order to develop opportunities for voluntary work for those out of work, CEP is to provide many more opportunites for voluntary organisations to sponsor projects and to recruit full-time temporary employees to help volunteers to find part-time work in the local community; obstacles such as the present rules regarding loss of unemployment benefit for non-availability are being reviewed, and an element of private gain is no longer to be a bar to CEP projects. The budget is to be increased from £49 million in 1980/81 to £77 million in 1981/82.

3. Temporary Short Time Working Compensation Scheme

This scheme whose purpose is to encourage employers to adopt short-time working instead of redundancies in firms with 10 or more employees has hitherto only run for periods of 6 months.

Following widespread demand the period is to be lengthened immediately to 9 months, but the level of assistance to employers will be 50% of normal earnings instead of 75%. Those already in schemes will continue to the end of the 6 month period at 75% but can have an extension to 9 months at 50%. Payment by DoE of National Insurance contributions for the workless days is to conintue. The pre-requisite of at least one normal day's work after 7 Consecutive days without work is to remain

At the end of August 1980, 154,100 were covered by the scheme, increasing to 236,400 (53%) by the end of September.

4. Job Release Scheme

No change is to be made to this Scheme, which applies to about 65,000 and to continue for another year. Its purpose is to enable men and women to retire a year early (64 and 59 respectively) and the disabled to retire at 60, if the employer replaces the person retiring with one who is unemployed; replacement need not be in the same job, but simply in the same payroll.

5. Community Industry Scheme

This permanent scheme run by the National Association of Youth Clubs to provide temporary employment for personally and socially disadvantaged young people (including ethnic minorities) undertaking community benefit projects is to receive funds to increase its available places by 1000 from about 6000. In view of the nature of the scheme, more rapid increase in the numbers is not considered to be realistic.

General Notes

1) The Prime Minister said in the Queen's speech debate on 20th November (having been accused of a U-turn by Guy Barnett); "I hope that the announcement will be welcomed in all parts of the House; of course these are temporary measures to alleviate the present difficult position. They will not solve the longterm problem...."

2) At the Press Conference following Mr. Prior's statement in the House of 21st November he said that the effect of the revised Special Employment Measures on the unemployment register will be about 30,000 reduction. In the Unemployment Debate in the House on 29/10/80 he said that the figure at the end of September was 234,000, and that 477,000 people were then receiving help under all the Government's various arrangements; this figure is therefore likely to increase by upwards of 200,000.

3) The Chairman of the MSC commenting on the Government's new measures, said: "The MSC by itself can achieve none of the targets the Government is now setting for YOP or the new Community Enterprise Programme. Our role is to enable things to happen. That is essential. But we also need the unmistakeable commitment of employers, large and small, of trade union members throughout the country; of all those in positions of responsibility in local authorities ...."

4) The National Council for Voluntary Organisations was reported in the Daily Telegraph (22/10/80) as requesting that YOP places should be increased from 246,000 to 440,00 and that the total expenditure on the Special Employment measures should be doubled. As announced by Mr. Prior, the suggested increase in YOP has been accepted. The Prime Minister's statement showed that the budget is to be increased by nearly 80%.

The TUC in its "Rescue Plan for the Unemployed" (announced on 29/10/80) also asked for 430/440,000 places by 1981/82. One comment in the TUC's plan was:"... clearly more attention in the future will need to be given to greater investment in industrial training .... Instead of making more resources available to the MSC .... the present Government have been cutting back".

5. When Mr. Prior made his announcement in the Commons on 21st November, in answering Mr. Varley, he made the following points:

"(Mr. Varly) said that unemployment created in the last 18 months had been deliberately engineered; is he suggesting in those circumstance that the increase of 700,000 to 800,000 during the Labour Government's period of office was deliberately engineered?"

"The allowance (under the YOP) is still about £9 more than supplementary benefit"; the weekly allowance of £23.50 could not therefore be increase in view of the large numbers now being taken into the scheme.

"To reduce the qualifying ages (for the job release scheme) from 64 to 62 would cost an additional £200 million over three years."

Area U.K.	No's November 1979	Rise on November 1979	% November 1980	% November 1979	Notified vacancies November 1980	Ratio up/ vacancy	Ratio per MSC adjustment
N. Ireland	85,700	+25,600	14.9	10.4	700	122.43	40.81
W. Midlands	219,100	+69,100	9.4	5.2	5,200	42.13	14.04
North West	292,600	+105,100	10.3	6.6	8,100	36.12	12.04
Yorks/Humberside	186,200	+75,500	8.8	5.2	5,700	32.66	10.88
North	156,000	+46,700	11.3	7.9	4,800	32.9	10.83
Wales	123,900	+45,300	11.4	7.3	4,600	26.93	8.97
E. Midlands	121,900	+50,700	7.6	4.4	5,000	24.38	8.12
Scotland	238,800	+69,100	10.6	7.5	14,100	16.93	5.64
South West	127,200	+40,300	7.6	5.2	7,000	18.17	6.05
East Anglia	48,400	+18,700	6.7	4.1	3,200	15.13	5.04
Greater London	204,400	+170,800	5.7	3.4	18,200	11.23	3.74
S.E. (excluding London)	224,900				38,200	5.88	1.96

TABLE A — UNEMPLOYMENT AND VACANCIES BY REGION

	UP: 6 mths & over	Percentage of regional UP	UP: 1 yr & over	Percentage of regional UP	
N. Ireland	21,185	23.6%	13,658	15.2%	89,884
Scotland	52,510	21.3%	29,986	12.2%	246,138
N.W.	60,891	20.2%	35,870	11.9%	301,246
North	32,490	20.2%	18,967	11.8%	160,856
Wales	23,229	18.0%	13,145	10.2%	129,114
W. Midlands	39,070	17.6%	21,239	9.6%	221,914
Greater London	33,791	16.5%	16,871	8.2%	205,388
Yorks/ Humberside	30,528	16.1%	16,657	8.8%	189,965
S.W.	20,093	15.7%	11,336	8.8%	128,280
E. Midlands	18,788	15.4%	9,773	8.0%	122,272
E. Anglia	6,500	13.7%	3,321	7.0%	47,563
S.E. (Less g. London)	26,095	11.8%	12,343	5.6%	220,216
U.K. Total	365,170	17.7%	203,166	9.8%	2,062,836

DURATION OF EMPLOYMENT 25-64 AGE GROUP BY REGION

TABLE C.

MANUFACTURING LABOUR COSTS AND PRODUCTIVITY
OF TEN MAJOR COUNTRIES
Spring 1980

Country	Hourly labour costs*		Productivity**	Output value per labour unit costs†	Labour costs per unit of output††
	Col. 1	Col. 2	Col. 3	Col. 4	Col. 5
	DM	Index (Germany = 100)			
Belgium	22.80	103	93	90	111
Sweden	22.40	101	90	89	112
Germany	22.20	100	100	100	100
Netherlands	22.20	100	103	103	97
U.S.	17.25	78	95	122	82
Italy	17.25	78	56	72	139
France	16.70	75	80	107	93
U.K.	12.45	56	56	100	100
Japan	12.10	55	74	135	74
Spain	10.75	48	49	102	98

* Incl. social charges.
** Output value per hour worked, converted in terms of the same currency.
† Col. 3 divided by Col. 2.
†† Col. 2 divided by Col. 3.

Source: Dresdner Bank

As can be seen from this table despite the strong rise in the exchange rate from the beginning of 1978 the U.K.'s absolute costs, as measured by labour cost per unit of output (see column 5 above) were on a par, in the spring of 1980, with the majority of competitors. Whilst the relative position has deteriorated since then the level of the U.K.'s labour costs remains relatively favourable:

U.K. MANUFACTURING COSTS AND PRODUCTIVITY
Autumn 1980*

Hourly labour costs		Productivity	Output value per labour unit costs	Labour costs per unit of output
DM				
Co. 1	Col. 2	Col. 3	Col. 4	Col. 5
12.86	57.0	53.4	99.5	108.8

* *Definition as in previous table*
Source: Dresdner Bank, compilation James Capel

Source: James Capel

TRADE

Visible exports in the first eleven months of 1980 showed an increase over the average level for 1979 of 16.2 per cent by value, 2.1 per cent by volume and 12 per cent by unit value. Excluding trade in oil, equivalent increases were 12.8 per cent by value, 2 per cent by volume and 11.3 per cent by unit value. The UK's share of world trade (a term of art indicating the share of exports of manufactures of the twelve main industrial nations) rose from 9.7 in 1979 to 10.2 in the first half of 1980 - the highest ever since 1971. The current account in January - November 1980 showed a surplus of over £1.8 billion, confounding all forecasts made the previous year, and the sixth consecutive monthly visible trade surplus was an achievement likewise unparallelled since 1971.

The alleged incompatibility of export success with a strong floating currency has neither historical nor contemporary foundation. As a study by Mr. Stephen Waley-Cohen, the publisher of Euromoney, revealed, "There is no direct correlation between the strength of a currency of a country and the difficulty its exporters have in finding markets for their products. Indeed the evidence of this eight year period /1970-78/ tends to be that those countries with strong currencies are the same ones with good records in expanding the volume of their exports" (The Case for a Free Pound, September 1980).

The UK's experience conforms to this analysis. The latest unit value figures imply a reduction in the real sterling price of exports of some 3-4 per cent; and a study by James Capel & Co. ("Exporters can live with a strong pound", January 1981) shows that export margins, which have consistently exceeded overall margins in manufacturing since mid-1976, have fallen only modestly in 1980 as compared with the domestic market. Consequently, the suggestion that export volume has only been maintained by drastic cuts in prices and profit margins is fallacious. What has happened is that when the pound was weak in the past, exporters had little incentive to increase their non-price competitiveness. However, the strong pound now obliges them to improve the quality, design, reliability, delivery and after-sales service of their goods; and to reduce over-manning and restrictive practices. This has been started. As the James Capel study concluded: "The scope for improvement in the UK's export performance is still enormous. By doing a small amount industry has already significantly reduced the price sensitivity of its exports of manufactures and protected its export margins to a surprising degree. This improvement is likely to gather pace over the next two years enabling industry to live with a strong pound and maintain its share of world trade. This would buy vital time and provide UK manufacturers with the opportunity to bring productivity up closer to European levels".

While the benefits of a strong currency on industrial competitiveness are beginning to be recognised, the advantages resulting from cheaper imports have been less well publicised. It is estimated that a 10 per cent rise in the effective exchange rate knocks 2.5 per cent off the RPI, largely resulting from the reduced price of industrial raw materials and commodities. The 13 per cent rise in 1980 may be therefore assumed to have kept the inflation rate some 3.25 per cent lower than it would otherwise have been. The effects on commodity prices have hardly been noticed, because commodity prices rose by only 0.6 per cent in 1980, but had they risen by 34.2 per cent as in 1976 the rise in the value of the pound would have been more widely

..../

appreciated. And a barrel of oil which costs £14.58 today at 2.40 dollars to the pound would cost £22.29 (more than half as much again) at the November 1976 rate of 1.57 dollars to the pound. As it is, wholesale input prices (materials and fuels purchased by manufacturing industries) rose by 9.7 per cent in 1980 and 2.3 per cent in the last 6 months, and wholesale output prices (all manufactured products) by 12.6 per cent and 2.8 per cent in the same periods - which augurs well for retail prices in 1981.

There is nothing "artificial" about the present strength of the pound. It results in part from confidence amongst holders of sterling that the Government will not attempt to interfere with its market value by printing money (i.e. creating inflation) so as to reduce it. That indeed would be "artificial", and entirely ineffective in an open economy, as a recent GATT study has demonstrated: "Under floating rates, with capital moving relatively freely across frontiers, countries cannot maintain an artificially low exchange rate for a long enough period to affect trade flows noticeably, since any attempt to do so will seriously damage the domestic economy" (Trade Relations under Flexible Exchange Rates, GATT Studies in International Trade No. 8, September 1980) Given the fact that the pound is floating relatively freely, its strength is a benefit to the nation. It is not outweighed by the often exaggerated disadvantages resulting in particular industries which cannot or will not adapt; the price to be paid is simply the acceptance of a continuous and sometimes rapid alteration in the pattern of our activities.

Nevertheless, the Labour Party has promised to abandon the freedom of exchange of capital, goods and services, and to introduce instead the economic equivalent of the Berlin Wall. On the first point, Labour's Draft Manifesto 1980 stated: "We will introduce strict controls over international capital movements to prevent a flight of capital overseas and introduce new defences for sterling to help fight off any run on the pound". This admission that their policies would result in a withdrawal of foreign investment and a run on the pound is frank but hardly encouraging. Labour politicians used to protest at the accusation that they wished to bring about a siege economy; now they do not bother to disguise it. The GATT Study No. 8 (ibid.) commented: "As for official control over capital movements, at the degree of inter-dependence the world economy has achieved by now, there does not seem to be any reliable, politically feasible method of implementing such controls. Capital movements as such can be controlled only within a comprehensive scheme of direct quantitative controls over all international transactions, merchandise trade in particular. For the time being at least, no legislature of any advanced industrial country appears even remotely willing to contemplate the delegation to the executive of the discretionary economic power of this extent."

Needless to say, Labour's policy of trade restriction (referred to euphemistically in the Draft Manifesto as "management") runs entirely counter to the methods employed by Western industrial nations to increase economic growth and living standards since the war. The OECD Declaration on Trade Policy, adopted by the 24 member countries on June 4th 1980 (superceding the OECD Trade Pledge), reaffirmed their "determination .... to reduce or abolish obstacles to the exchange of goods and services .... to maintain and improve the open and multilateral trading system ... to avoid internal measures which have protectionist effects", and the present Government remains firmly committed to these ends.

ENERGY PRICES.

The arguments about UK energy prices have been widely reported in the press. Initially, industry seemed to believe that average industrial prices of gas and electricity were significantly higher here than elsewhere in Europe. There is now, however, agreement that these are not generally out of line. However, certain of our energy intensive industries face particular problems which go wider than energy costs alone. The Government has always made it clear that it is willing to look at these, and a task force of representatives of the Government and the NEDC has recently been set up to quantify the energy-related problems of this sector of industry.

International Comparisons.

Since January 1979, Sterling has appreciated by more than 27 per cent against the Deutsche Mark and the French Franc. Thus, even if energy prices here and in Europe had remained unchanged for these two years, UK prices expressed in European currencies would have appeared to have increased by 27 per cent. The effect on competitiveness is obvious, but this component of the problem is an exchange rate problem, not an energy problem. As such, it affects all UK industry. A compensating factor arises because imported raw materials for which industry pays in Sterling (inclusing crude oil, priced internationally in dollars) become cheaper as the pound rises.

Other factors further complicate international comparisons. Contract terms and periods vary considerably, even within countries. Production and distribution costs vary; for example, French electricity is produced relatively cheaply from that country's ambitious and extensive nuclear programme, and Dutch offshore gas is relatively cheap to produce and bring ashore. Market conditions vary; for example, European oil consumers pay prices which are very dependent on the Rotterdam spot price, and hence relatively volatile. UK prices are much more stable and supply more secure. The glut in some months of 1980 did depress prices in Europe for much of last year, but the Iran-Iraq war has now changed this situation, and UK after-tax prices are not now out of line.

Energy efficiency is as important in maintaining competitiveness as energy prices. Statistics comparing energy consumed per unit of output are not available beyond 1978 for most countries. It is clear, however that, between 1974 and 1978, the UK was outstripped by her major competitors. Energy efficiency in the UK has historically been low, and still remains close to the 1974 level. Yet since 1974, the Germans have improved by 16.6 per cent, the US by 14.5 per cent and the French by 7.8 per cent. Japanese efficiency fell in the period 1974-6, but has improved greatly in recent years (eg by almost 10 per cent between 1976 and 1978)

There is no doubt that all European industry faces unfair competition from Canadian and US industries, which have access to oil and gas at controlled prices. Price decontrol is underway in the US (in order to stimulate home production of oil and gas, and aid conservation) and the UK Government continues to press vigorously for international adherence to the Venice Summit commitment to market pricing of fuel. For example, Mr. Howell made strong representations on this subject of the latest meeting of the International Energy Agency.

Help with industrial energy costs.

There are a number of important constraints on the way in which the Government is able to help industry with fuel bills.

1. The nationalised energy industries price their products at long run replacement cost, in order to ensure that future energy needs are not prejudiced by wasteful use of scarce resources now. Relaxation of this policy simply stores up problems for the future, and wastes valuable resources unnecessarily and the benefit would be slight. Since energy costs account for only 4% of industry's costs on average, a reduction of

20% in fuel prices reduces total costs by less than 1%. Yet, apart from the damage to future energy security (and hence cost), there would be an immediiate charge to the PSBR of £1,000 million.

2. Selective help to large users of energy, if it is not to add to Government borrowing, has to add to the costs of smaller users (domestic consumers, private motorists, smaller businesses etc.). The Government has already allowed domestic gas prices to rise steadily towards the replacement cost. (When the government took office, BGC's return on assets derived exclusively from industrial sales). However, there are obvious difficulties in moving too rapidly in this direction.

3. Heavy fuel oil tax is higher here than in other European countries. However, the tax raises over £300 million each year. Any reduction would either add to the PSBR, or to the general tax burden, and in the present economic climate, either would be damaging.

4. There is the ever-present danger that industrial demand for gas would seriously exceed supply if the price on new contracts was allowed to fall significantly below that of the competing oil product. Gas meets about 30% (on the basis of heat supplied) of industry's energy needs, while oil meets about 40%. Clearly, a flight from oil to gas would overload the gas supply system. During the cold winter of 1978/9, when oil prices moved rapidly ahead of gas, industrial users on interruptible contracts faced unusually long and damaging interruptions, and new would-be customers could not buy gas at any price.

Within these constraints, some positive steps have been possible:

1. The Government has requested that the bulk electricity supply tariff should be reviewed, and has urged the industry to adopt a flexible approach to the prices charged to large users in temporary financial difficulties.

2. The Government has endorsed the BGC decision to relax its earlier policy (which applied under the last government) of oil parity on renewed gas contracts. Renewal prices are now oil-related, but at 75% of the price of the competing oil product. The Government has asked the BGC to review the policy of charging full oil-equivalent prices on new contracts, although the problem of potential over-demand is appreciated.

3. The Government has asked the oil industry to apply pressure to its own costs, in order to ensure that British industry obtains the best possible price when buying refined oil products.

4. As stated earlier, the Government is maintaining international pressure on other Governments to avoid unfair energy pricing policies which damage world trade.

SMALL BUSINESSES

The four main components of Small Businesses Policy comprise:-

1. Reducing hurdles and burdens faciing new and small firms.

2. Improved motivation, encouraging start ups and growth by lower personal taxes.

3. Increasing resources within firms enabling them to weather inflation and to grow.

4. Improved counselling services to help start ups and to reduce failures.

Over fifty measures have been achieved so far, many of which have gone un-noticed because of the pre-occupation of small firms with inflation and the level of MLR.

A selection of these measures, apart from those included under "Encouraging Enterprise" in this brief is as follows:

1. Premises and Planning

   (a) Swifter planning decisions, right of appeal after eight weeks with many decisions announced at public enquiries not months later.

   (b) New guidelines on Development Control which should make it easier for "inoffensive" small firms to use existing non-business premises.

2. Employment

   (a) The qualifying period for alleged unfair dismissal claims extended from six months to twelve. Firms with 20 employees or less - the period has been extended to two years for new employees (an important simplification since redundancy had a similar two year qualifying period).

   (b) Industrial tribunals to take account of the size and resources of the employer - frivolous claims deterred by a liability to costs.

   (c) Post maternity re-instatement waived for firms of five employees or less; if re-instatement not practicable.

3. Rates

   (a) Right to pay rates by instalments conferred on small firms.

   (b) Right to more domestic rate relief given to owners of "mixed heriditaments".

4. Threat of Unfair Competition to Private Builders from Direct Labour Departments of Local Authorities

   (a) DLOs are being established as separate trading organisations.

   (b) A proportion of contracts must be put out to tender.

   (c) DLOs must trade at a profit - three years of failure to do so risks being closed down.

5. Paperwork Burden

   Over 1 million questionaires have been cut out.

Current Matters

1. The self-employed and national insurance.
   The promised discussion document has been issued and views have been invited on this contentious topic by 31st March 1981.

2. Payments during initial sickness.
   Following consultations with small firms groups the following amendments to the proposals have been made.

   (a) 0.6 per cent reduction in the employers' rate of national insurance contribution (previously 0.5 per cent) - additional cost £100 million.

   (b) reimbursement to small firms of 50 per cent of statutory sick pay paid out for each employee above a certain level (100 per cent for new employees with less than eight weeks in the job).

   (c) small firms defined by reference to annual payroll (of previous year but one) on which employer paid NI contributions - generally will mean firms employing 7-10 but will be higher where earnings below national average.

   Ongoing criticism from small firms relates to the proposals to abolish doctors' sick notes to substantiate sickness by the employee, the method of reimbursement to small firms by way of claim (they want to deduct from monthly PAYE/NI payments) and the additional administrative burden. It is probable that further consultations will take place before legislation is put before Parliament.

3. The purchase by a company of its own shares.
   The Green Paper has been generally welcomed and the proposals, if enacted for private companies will help to overcome the reluctance of small company proprietors to accept outside investors (particularly institutions) and will provide additional stimulus by private individuals for investment in independently owned companies.

Conservative Research Department,
32 Smith Square, London SW1

Economic Section
13.1.81

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

9th January 1981

T. Lankester Esq.
10 Downing Street
LONDON
SW1

PL.

Dear Tim,

ECONOMIC FORECAST

The report on the winter economic forecast has just become available. The Chancellor has not yet studied the report but he thought the Prime Minister would like to see it now. A separate copy is being sent to Professor Walters.

The forecast is based on what may be described as a continuation of existing policies i.e. it makes no attempt to anticipate Budget judgements. It is too early to consider what forecast should be published at Budget time: that will depend on the policy decisions of the next few weeks, as well as on revisions to forecasting judgements.

Yours ever,
Peter.

P.S. JENKINS
Private Secretary

Rl to see + PA
MS

PRIME MINISTER

R. cc. Chancellor of the Duchy
Mr. Wolfson
Professor Walters
Mr. Duguid
Mr. Gaffin
Mr. Vereker
Ms. Drummond

MT

You should see the attached note by John Vereker who is worried that we may be making too much of the positive elements which are working in the economy; and whether some of our particular pieces of good news stand up to close examination.

The reality, of course, is that the only good news for the media is bad news. And given the continuing rise in unemployment and the existence of a new growth industry - the forecasting business (the constituent parts of which compete almost daily in gloom and doom) - the British people would rapidly become demoralised if Government did not explain why we are going through this transition - i.e. our clear objective - or failed to engender reasonable hope.

We have two major presentational problems:

- in the short term, how to counteract the gloom industry without losing touch with reality; and

- in the longer term, how to hold on to our gains in attitude and behaviour when the economy starts to grow again.

The former is basically a question of balance so that credibility is not undermined.

I am proposing to set in train some work to establish, first, the up-to-date facts about a number of potentially positive elements at work in industry and commerce so that we might have a firmer base to our presentation.

/I have

I have also had a word with the office of the Director General of the BBC making the point that the "Today" radio programme might do less to propagate gloom and more the generate hope and brighter prospects where the facts allow.

B. INGHAM

9 January, 1981

cc Mr Vereker
Mr Duguid

2

PRIME MINISTER
To see.
MS
8/1

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

8 January 1981

The Rt Hon James Prior MP
Secretary of State for Employment
Caxton House
Tothill Street
LONDON SW1N 9NA

Dear Jim

EFFECTS OF INCREASED NATIONAL INSURANCE CONTRIBUTIONS ON PAY BARGAINING

(attached) Thank you for your letter of 15 December.

Of course we must stand firm on the decisions we have taken. As you know, the Social Security (Contributions) Bill has now gone to the Lords as introduced; none of the Opposition amendments in the Commons passed, and no amendments at all were put down by our own backbenchers. This is very satisfactory.

As for the future, although the examples you give are rather selective (and seem to me to run together this year's tax regime with next year's National Insurance contribution regime), I will naturally take what you say fully into account in preparing the next Budget. We should not, however, overestimate the room for manoeuvre. The economic situation dictates that there should be a fall in real personal incomes; and a major effect of the decisions we announced in November was to shift part of the burden of taxes and contributions from firms to employees. This is bound to show up in the pay packet in one way or another. Certainly it cannot be accepted as a valid reason for higher pay settlements.

I am sending copies of this letter to the other recipients of yours.

Geoffrey

GEOFFREY HOWE

RESTRICTED

cc Mr. Wolfson
Mr. Walters
Mr. Duguid

MR. INGHAM

GOOD ECONOMIC NEWS: REALITY AND ILLUSION

As we enter the New Year, Ministers, and the Prime Minister in particular, are making much of the positive elements in the economy. But I think we must look carefully at whether this is the right time to do so, and at whether the particular pieces of good news being quoted stand up to closer examination.

2. As to the timing, of course the Government should take every opportunity of quoting evidence that its policies are working, and of dispelling any impression that manufacturing industry is grinding to a halt. But that is not the same as implying either that the worst is over, which it isn't in terms of output and employment, or that the effort made so far will bring about industrial regeneration, which it won't because nobody can yet see where the new employment generating industries are going to come from. It is essential that the changes in attitudes towards pay and productivity which have been achieved in the last six months are held for long enough to enable the foundations to be laid for a more competitive and productive economy - and that means continuing with the present prescription of regular doses of reality, sweetened by a clearer exposition of why they will work and what life will be like when the patient is healthy again. The danger of referring too often to the good news in the economy is that it will cloud public understanding of the sacrifices that still have to be made if the objectives of the MTFS are to be achieved.

3. And there is the further danger of losing credibility with the public if developments in the real economy do not correspond to the picture being drawn by Ministers. Because of the effort the Government has made to explain its economic strategy and because it has never tried to disguise the difficulty of implementing the MTFS, its credibility at present is probably high: but if it starts painting a brighter picture too soon, that will change. So I think we should wait until the real economy is growing again before we start talking about good news in anything other than the sense that we are making progress towards the objectives of the strategy.

/ 4. Such

4. Such good news is indeed real, if not abundant. Progress towards singe figure inflation, low numbers of days lost through industrial action, and the widespread acceptance of pay settlements well below the RPI, are not only achievements in themselves but are also the necessary foundation for future growth. We should go on saying that as often as possible. And the sooner we can say something comparable about the control of the money supply, the better.

5. But certain other developments need to be handled more carefully. Peter Riddell's article in today's FT (on which I have commented separately) is misdirected, but it does show the need for any good news to be watertight. In particular:

- Exports are declining in volume, and we must expect that decline to continue. We should certainly go no further than saying they have held up well given the competitive pressure.

- VAT Registrations - don't reflect the establishment of new companies or businesses. I have been into the figures at some length with Customs and Excise. The net increase in registrations in 1980 (some 10,000) is an extension of what is now a 10-year trend bringing registration to its present level of 1.3m (many of whom are individuals). This growth is attributable to many factors apart from new businesses - inflation (the threshold was last raised in March 1980), increased turnover of existing businesses, reluctance to deregister and lose the ability to reclaim input tax, and even status - VAT registration may conceal a small turnover. C&E say that no inference can be drawn from the figures as to the growth of new enterprises.

- The unemployment register. It is correct that about ½m leave the register each month. That has been the case for many years. But a proportion of these - unknown, but of the order of one third - are retiring or otherwise leaving the labour force. The remainder are taking jobs: but a large number come on and off the register for short periods. The most one can say is that the figures indicate that labour mobility in the UK is still high, with a job turnover of 8-9m a year.

- ICFC. Lord Caldecote's letter about the ICFC's recent level of business does indicate an impressive level of lending to new enterprises. It can certainly be quoted as evidence of continuing entrepreneurial activity in the economy; but we should not be surprised that in the current business climate of high risk and low profits, small businessmen are turning to a financial institution which does not seek personal guarantees.

6. Then there are the individual success stories - companies, such as those mentioned in the Sun and Daily Telegraph this week, who are doing well despite all the problems. Here again it is certainly useful for the public to be aware of them as evidence of life in the economy, but we must not give the impression that they indicate a substantial degree of industrial rejuvenation, because they are an unrepresentative sample of British business. I do think that the best way of holding them up as examples and encouragement to others is to include as many as possible in the Prime Minister's regional visits, and I have given Mr. Pattison a list of widely different and geographically spread companies for this purpose.

7. In short, some of the evidence we have been quoting gives an illusory picture of the new vigour in the economy, which the unemployment, bankruptcy and company profit figures are unlikely to sustain over the next few months. They do indicate that in a large and well-developed economy such as ours, some new enterprises will be established and some existing ones will flourish, notwithstanding the recession and severe competitive pressure. That is not particularly surprising, and does not indicate the success of the economic strategy in the same way as progress on inflation, industrial relations, and pay expectations.

JV.

John Vereker

8 January 1981

Econ Pol

RH.

PRIME MINISTER

cc:- Mr Gow

Termnce Higgins would like 10 minutes with you to have his usual chat about the economy. I have put him in the diary at 2130 hrs on Wednesday, 14 January. There is a vote at 2200 hrs.

CS

7 January, 1981

PART 7 ends:-

CAW to Walters 30.12.80

PART 8 begins:-

E(81)1 2.1.81

10 DOWNING STREET

CAROLINE

Terence Higgins rang, seeking 20 minutes of PM time in the next couple of weeks. I committed you to ringing him back (sorry!)

He will be on x 3285 at the House until 3.30 today.

MS

[illegible] -