PREM19

25

ECONOMIC POLICY

(Strategy)

(Part 2)

PART 2

179.

MT

Confidential Filing

Economic Strategy.
Pay and Prices
The Monthly Economic Report

ECONOMIC POLICY

Part 1 May 1979
Part 2 June 1979

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~19.6.79.~~							
~~22.6.79~~							
~~26.6.79~~							
~~29.6.79~~							
~~5.7.79~~							
~~9.7.79~~							
13.7.79 ends.							

5B 830

PREM 19/25

Dd 533270 5M 2/78 8362633 JET

PART 3 begins:-

TL to Berrill 16.7.79

—

PART 2 ends:-

TL to PM 13.7.79

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
E(EA)(79) 12	26/06/79
E(EA)(79) 5th Meeting, Minute 1	28/06/79
E(79) 12	02/07/79
E(79) 13	03/07/79
E(79) 17	05/07/79
E(79) 4th Meeting, Minute 2	09/07/79

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 OWayland Date 24 October 2009

PREM Records Team

PRIME MINISTER

c.c. John Hoskyns

STRATEGY MEETING: PROPOSALS BY MINISTERS

At the Strategy Meeting last month, you asked Ministers to send in their specific proposals for regenerating industry. Ministers have now submitted their proposals, and John Hoskyns and Sir Kenneth Berrill are working on them with a view to producing a paper for E Committee on 24 July.

I had not intended to bother you with these proposals until their paper was ready. But various Ministers have referred to them at Cabinet and in E Committee over the last ten days; and I am therefore attaching to this minute a composite list which you might care to glance through. The Hoskyns/CPRS paper will provide an assessment of this list.

J M Sargent
p.p. TPL

13 July 1979

There just aren't any magic solutions

Cc Mr Hoskyns

Prime Minister

This could go on the agenda for the Strategy discussion in E on 24 July.

Agree?

JL 13/7

1

CONFIDENTIAL

Qa 04189

To: MR LANKESTER

From: SIR KENNETH BERRILL

The Role of the Institutional Investor

1. At the Prime Minister's recent meeting on Strategy there were a number of references to the need to encourage institutional investors to play a dynamic and constructive role in the affairs of the companies in which they invest.

2. The CPRS has interested itself in this area for the past seven years and has had numerous discussions with the financial institutions, with some of the companies they invest in, and with the Bank of England.

3. Over these years there has been some progress. In 1972 the institutions, particularly the insurance companies, were adamantly opposed to taking an active interest in particular companies. The tide is now flowing in the right direction but there are still many laggards. What the more dynamic institutions need is encouragement from Ministers which they can use to whip their more slow moving colleagues along.

4. I attach a note by the CPRS on the subject which the Prime Minister might like to introduce at some stage into the Strategy discussions.

5. I am sending a copy of this minute and attachment to Sir John Hunt.

KB

11 July 1979

Att

Yes – but it is not an 'action' paper and need not be taken as the next item. The need [illegible] with the [illegible] [illegible] in that area 'correlation' outside [illegible]. [illegible]

CONFIDENTIAL

THE ROLE OF THE INSTITUTIONAL INVESTOR

Note by the Central Policy Review Staff

---

1. In the position of the United Kingdom capital market today the pension funds and life offices and, to a lesser degree, the unit trusts and investment trusts cannot fulfil their fiduciary duties to their pensioners, policy-holders, etc. unless they keep their finger on the pulse of most of the companies in which they have large investments and unless they are prepared to take remedial action, e.g. replace some or all of the Board of the Chief Executive, if the company is performing unsatisfactorily for reasons which are remedial.

2. Such a proposition would not have been valid in the early 1960s, when the institutions only held some 25 per cent of the ordinary shares quoted on the Stock Exchange and if institutions did not like a company they could 'vote with their feet'. But it is valid today when the financial institutions hold more than 50 per cent of all ordinary shares - a proportion that is likely to increase ineluctably unless the Government decides to remove the great fiscal attractions of investing through intermediaries rather than directly, which still exist after the Budget. The large financial institutions cannot normally now 'vote with their feet'. They can only divert the flow of their <u>new</u> funds away from particular companies or try to sell their large blocks of shares to other institutions.

3. Any large public company is likely to have a majority of its shares held by long-term institutional investors. The institutions are therefore in a position to exert pressure on companies if they so choose; individual private investors, on the other hand, are de facto powerless.

4. A number of arguments have in the past been advanced against greater involvement by institutional investors, e.g. that it prevents them 'voting with their feet'; that institutions know about investment/insurance not about managing industry; problems of inside knowledge: that shareholder power will encourage Government regulation (perhaps nationalisation) of the financial institutions: that some interventions could result in closures/ redundancies which will give the institutions a bad image. There are good answers to all these points but to rebut them one by one here would take too long.

5. In 1972 the then Governor of the Bank of England, Lord O'Brien, launched his initiative for an Institutional Shareholders Committee to try to increase the involvement of the financial institutions with the companies in which they have had large investments. For some years the initiative seemed a failure but now there is considerable movement. This is clear from the actions of the institutions as well as from the evidence of such bodies as the British Insurance Association (BIA) to the Committee to Review the Functioning of Financial Institutions (CFFI). Many of the large institutions, e.g. the Prudential and Commercial Union, the National Coal Board and Post Office Pension Funds, M & G Unit Trusts, have regular contact with the managements of most of the companies in which they invest and this practice is spreading. The institutions have, on occasion, flexed their muscles publicly but more frequently and often more effectively they have exerted their pressure privately - they rightly do not want to undermine public confidence in the company they are trying to turn round. Sometimes the pressure is brought to bear through the Investment Protection Committees of the BIA, Unit Trusts Association, etc: in other cases by an ad hoc group of institutions and more rarely through the Institutional Investors Committee. Somewhat similar work is done very effectively under Sir Henry Benson's leadership in the Bank of England.

6. Non-Executive Directors (NEDs) also have an important role in bringing outside influence and discipline to bear on management. Their use is also spreading. They should be seen as complementary to the role of the institutional investor not as an alternative. The task of an effective NED is a very difficult one. Boards with blue-riband NEDs did not prevent some major debacles in the 1970s. (To improve their effectiveness it is for consideration whether steps should not be taken to limit the number of NED directorships any individual should hold in quoted companies, say a maximum of six. To take on more would normally mean they would have inadequate time to carry out their functions effectively, especially if they formed part of Audit Committees.)

7. While the CPRS believes a degree of institutional interest and, notably when things go wrong, of more active involvement in management is healthy and desirable, it is clearly necessary to avoid undue interference, particularly of well-run companies and certainly any attempt by the institutions to usurp the functions of management. When problems arise the institutions' normal approach should be to give management time to put its house in order and, failing that, to bring about changes in management.

8. On the other hand, as in the United States, modern and efficient managements are likely to welcome an informed dialogue both with their institutional investors and with their bankers. It can provide management with support and indeed the necessary confidence to weather the difficult period ahead and to plan for the upturn. The immediate past Chairman of the Engineering Employers' Association (who is also Chairman of two major British companies) recently told the CPRS how little interest his major institutional investors took in his companies' affairs and that he personally would welcome greater involvement.

Possibilities for action by the Government

9. Ministers might consider the need -

(a) to make it clear in speeches that they are looking for an active interest by institutional investors in the companies in which they have large investments and that they support the work of the ISC and the various investment protection committees - the lack of overt Ministerial support was probably one of the reasons for the failure of Lord O'Brien's initiative:

(b) to invite the Chancellor and the Secretary of State for Industry to make this clear personally to the current Chairman of the ISC and his three fellow members:

(c) to invite the Chancellor to instruct his officials to make similar points at the next in their series of meetings with the Investment Management Community, which were recently instituted following a proposal put forward by Mr P Moody, Investment Manager of the Prudential and President of the Institute of Actuaries:

(d) to advocate the wider use of NEDs and Audit Committees, but consider the possibility of limiting (perhaps via the Council of the Stock Exchange) the number of such directorships any one person can hold in large publicly-quoted companies.

MR. HOSKYNS

STRATEGY - PROPOSALS BY MINISTERS

1. Ministers' proposals for initiatives to advance government strategy have been amalgamated where possible and grouped under the following classification:-

I. LABOUR
   (a) SKILLS
   (b) WORK INCENTIVES
   (c) LABOUR RELATIONS
   (d) EMPLOYMENT PROTECTION
   (e) MOBILITY

II. CAPITAL
   (a) INDUSTRIAL POLICY (including Corporate Taxation)
   (b) REGULATORY CONSTRAINTS
   (c) COMPETITION POLICY
   (d) FINANCE
   (e) SMALL FIRMS

III. LAND

IV. PUBLIC SECTOR
   (a) EFFECTS OF THE NATIONALISED INDUSTRIES AND OF PUBLIC SECTOR PURCHASING POLICY ON THE PRIVATE SECTOR
   (b) PUBLIC SECTOR EFFICIENCY

V. EDUCATION OF THE PUBLIC (EXHORTATION)

2. In the attached lists, after each proposal is shown:

(a) The Minister or Ministers making the recommendation (KJ = Sir Keith Joseph, GH = Sir Geoffrey Howe, MH = Michael Heseltine, JN = John Nott)

(b) The lead department(s) (underlined) and any other departments involved.

We have in some cases added an introductory paragraph drawing attention (a) (to existing work both in departments and by the CPRS, and (b) to one or two possible gaps. The asterisks against the paragraphs show the proposals which the CPRS considers to be most important.

3. The proposals have a number of features in common:-

(a) They operate on the supply side of the economy rather than on demand.

(b) They are almost exclusively concerned with the domestic economy.

(c) They concern the economy as a whole and not specific policies for the different sector (e.g. energy).

(d) Relatively little is said about research and development and technological change.

CPRS

3 July 1979

1. LABOUR

(a) SKILLS

This is an area of high priority, although none of the initiatives promises to yield significant results in anything but the long term. The CPRS is already doing some work on the ways in which education and training can help to improve industrial performance.

* 1.1 Review training arrangements and effectiveness.

Negotiate

(i) Overcome, (perhaps through EITB) AEUW opposition to dilution and replace the apprenticeship system by certification rather than entry to craft only through time serving (a) KJ, GH, JN. (b) DE.

in hand

(ii) Review the structure of the Manpower Services Commission and their training centres, and the effectiveness of the ITB's (a) KJ (b) DE.

* 1.2 Examine the relationship of industrial needs and attitudes at all stages of the educatinal system. Although government has little direct influence over the educational system, it can achieve a lot by sustained pressure. (KJ, MH, GH).

[illegible] £ to secondary [illegible]

(i) Change priorities of system: raise the status of managers, engineers and entrepreneurs; specific grants and programmes to relieve known shortages, e.g. electronic engineers (a) GH (b) DES, DOI, DE.

(ii) Get into curricula importance and attractiveness of industry (especially change attitude of teachers) (a) KJ (b) DES, DOI, (c) CPRS study (as (i) above.

Change school governors

(iii) Instil economic realities (having to earn a living) (a) KJ (b) DES, DOI, DE.

(iv) Stress need for greater relevance (e.g. maths and computer services) (a) KJ (b) DES, DOI, DE.

1.3 Encouragement of able women to enter industry as a major source of untapped talent (a) KJ (b) DOI, DES, DE.

) WORK INCENTIVES

There are three main problems: first, to improve incentives generally, and to make skilled people in particular better off; secondly, to reduce the "poverty trap" as it affects those in work; and thirdly, to reduce the "poverty trap" so as to encourage more people to take up work.

* 2.1. Continue to widen differentials in net earnings through taxation system to encourage acquisition of skills and acceptance of responsibility; a. KJ, JN; b. Inland Revenue, Treasury

[illegible]

* 2.2. Continued action to reduce the poverty trap; a. KJ, b. Treasury, DHSS, Inland Revenue.

2.3. Clamp down on malingering–tighter control of eg, the issue of sickness certificates before strikes and periods without benefit before claim a. KJ, b. DHSS, D Employment.

What

2.4. Examine the Truck Acts; a. GH, b. Treasury, D Employment.

2.5. Reduce the discouragement to women to take technical and industrial jobs where skills are in short supply; a. GH, b. D Employment.

Lead-time [illegible]

i. Allow women to set child-minding expenses against personal taxation; a. KJ, b. Inland Revenue, Treasury DHSS.

[illegible]

ii. Allow working wives to be taxed separately without husbands losing the married person's allowance; a. KJ, b. Inland Revenue, Treasury

* 2.6. Undertake a comprehensive review of all forms of employee profit sharing and develop programmes for implementation; a. MH, b. Treasury, Inland Revenue, D Industry.

i. Encourage share options for senior executives by tax exemption; a. KJ, b. Inland Revenue, Treasury

(c) LABOUR RELATIONS

We note two possible omissions: first, action to reduce perks (especially following the recent tax cuts); and secondly proposals concerning industrial democracy.

3.1 Government campaign to increase the attractiveness of productivity and the unattractiveness of restrictive labour practices; a. KJ, b. D Industry, D Employment.

* 3.2. Consider establishment of body to enquire into and publicise restrictive labour practices; a. KJ, b. D Employment, D Trade, D Industry,

i. Tackle restrictive labour practices by being ready to refer them to the MMC under the Fair Trading Act, a. GH, b. D Trade, D Employment, D Industry.

Links to [illegible]
TU Reform

3.3 Measures to improve the structure of trade unions, including mergers of the smaller ones; a. GH, b. D Employment.

* 3.4 Consider the extent to which i. closed shop legislation, and ii. ACAS act as supply constraints, (the latter by making it easier for unions to establish themselves in new firms, thereby reducing productivity; a. JN, b. D Employment,

3.5. Initiate comprehensive programme to stimulate a better climate of communication in British industry between managers and men; a. MH, b. D Industry, D Employment

i. Promote the election of worker, not trade union, representatives to the boards of pension funds; a. MH, b. Treasury

ii. Encourage visits by shopfloor workers (and shop stewards) to plants in main competitor countries; a. KJ, b. D Employment, D Industry.

3.6 Improve morale of supervisors and managers as opportunity offers (eg in both the public and private sectors by discouraging compromise in industrial disputes at the expense of managerial authority); a. KJ, b. D Employment.

3.7 Consider the case for encouragement of better conditions at work as a real incentive to higher productivity; a. KJ, b. D Employment.

) EMPLOYMENT PROTECTION

* 4.1 Review Employment Protection Act etc. (a) JN, KJ (b) DE.

No.

4.2 Give industrial tribunals power to award costs where frivolous cases have been brought by employees (a) KJ, (b), DE, Lord Ch.

urgent — the cost limits safeguarded

* 4.3 Good redundancy schemes for overmanned nationalised industries (a) DOI, Dept. of Energy, Dept. of Transport, Dept. of Trade.

MOBILITY

It is not clear how important constraints on mobility are in inhibiting industrial performance; they may be a lot less important than is sometimes suggested. But in any case there are many things other than housing policies which constrain mobility, not all of which are susceptible to changes in policy. The CPRS is trying to establish some facts.

* 5.1 Examine labour mobility in depth (a) MH (b) <u>DE</u>, DOE, DOI, DES, IR.

5.2 Sustained reform of housing policy to encourage labour mobility (GH, KJ, JN).

- Old rents politically difficult. S. Wales has a lot
- not complex.

(i) Phase out rent controls;

There is political pressure for this as [illegible] RIGHT

(ii) Remove all rent controls from new housebuilding for rent;

(iii) Systematically dismantle rent control and tenure in areas where housing supply and demand in balance;

(iv) Examine tenant security.

(i)-(iii) (a) GH, KJ, JN. (b) DOE..

(v) Immobility created by Council Housing System (a) JN, (b) DOE.

(vi) Take special steps to facilitate mobile homes sites in areas of skill shortages (a) KJ (b) <u>DOE</u>;

(vii) Housing (Homeless Persons) Act 1976 (a) JN (b) <u>DOE</u>;

(viii) Reduce stamp duty and other costs of movement (including legal fees, house agents' fees etc) (a) KJ, (b) <u>IR</u>, Dept. of Trade, DOE.

(ix) Increase supply of building land by short suspension of DLT (a) KJ (b) <u>IR</u> DOE;

(x) Increase land supply by maximum disposal of public sector land (a) KJ (b) <u>DOE</u>, all depts.

CONFIDENTIAL

CAPITAL

(a) INDUSTRIAL POLICY (including Corporate Taxation)
An inter-departmental review of the important subject of corporate taxation is already under way.

6.1 Define what the government wants from the little NEDDIES and Sector Working Parties. We should work to create the climate, provide the incentives, remove the constraints, and ask the uncomfortable questions, all with the purpose of improving the performance of British industry (a) MH (b) HMT, DOI.

6.2 Carry forward work already in hand on marketing, product development and import substitution, including the improvement of collaboration between buyer and seller sectors. Encourage companies and nationalised industries to emulate Marks & Spencer in promoting British suppliers (a) MH, (b) HMT, DOI, Dept. of Trade.

6.3 Devise urgently a range of incentives as part of our regional and industrial policy to ensure that our new and future tax reductions go into increasing wealth creating activities. The basic concept should be tax rebates - PAYE, corporation tax and investment income surcharge - to those who have shown by the fact that they paid such taxes that they are likely to be able to use such rebates more effectively than those currently receiving industrial aid for projects, many of which would go ahead anyway (a) MH, (b) HMT, IR, DOI. ?

6.4 Structure tax and depreciation provisions for companies so that a higher proportion of reinvestment capital is, in effect, subject to competitive capital market tests of profitability (a) MH, (b) HMT, IR, Dept. of Trade.

* 6.5 Review the system of corporate taxation with a view to encouraging real profitability and adequate investment in fixed assets and stocks (a) KJ GH, JN, (b) IR, HMT, DOT.

* 6.6 Review effects of regional policy in preventing natural expansion and fragmenting industrial development (a) JN, (b) DOE, Dept. of Industry.

6.7 Phase out NIS (as a tax on employment) (a) KJ, (b) HMT, DE.

front the

(£3bn loss

6.8 Encourage better manpower planning by firms (e.g. use of skilled and highly qualified manpower) (a) KJ, (b) DE.

) REGULATORY CONSTRAINTS

The CPRS study on planning procedures is relevant to most of these proposals.

* 7.1 Review planning procedures, including local authority controls, IDC's and ODP's (a) GH, JN, (b) <u>DOE</u>, DI

7.2 Review (i) environmental controls, (ii) building regulations and (iii) health and safety regulations including the procedures by which they are introduced and implemented (a) GH, also KJ (i) and JN (ii), (b) <u>DOE</u>, <u>DE</u>.

7.3 Reduce over-sensitivity to environmental considerations (e.g. Moss Morran and Whitby Potash) (a) KJ, (b) <u>DOE</u>.

7.4 Review role of Health and Safety Executive (and Commission) (Chief Executive of HSE publicly asserts that industrial efficiency is no concern of HSE). Ask CBI to play more positive part in the Commission (a) KJ, (b) <u>DE</u>.

7.5 Removal of the present need for separate application procedures for Industrial Estate Corporations and Investment Grants (a) JN, (b) <u>Dept. of Trade</u>.

(c) COMPETITION POLICY

* 8.1. Need for a strong and effective competition policy; a. JN, b. D Trade. but multi-national reality.

8.2. Recognise that tougher competition policy is wholly compatible with less obstructive attitude to some (many?) take-overs; raise thresholds for referring to MMC; a. GH, b. D Trade.

8.3. Remove or reduce possible encouragements to merge caused by present tax system, and consider removing tax and ~~alter~~ other obstables to companies which want to demerge; a. GH, b. Inland Revenue, Treasury D Trade.

8.4. Enable MMC to examine large holding companies which have become insensitive to commercial pressures; a. MH, b. D Trade

(d) FINANCE

The CPRS believes that much can be done to stimulate the institutional investor to play a bigger role in improving the standard of management. It would also be possible to work up a proposal concerning the clearing banks.

[illegible]

*9.1 Reduce the bias against investment in productive assets. Look at the tax treatment of financial institutions and the tax incentive to various forms of personal savings, including the building societies, with the aim of removing any bias against the flow of savings into small businesses (a) GH, KJ (b) IR, HMT.

9.2 Extend favourable taxation treatment for gilts to long-term corporate debentures (a) KJ, GH (review position (b) IR, HMT.

9.3 Possible equity guarantee scheme for institutional investment (a) KJ (b) HMT, Dept. of Trade.

[illegible]

9.4 Eliminate distinction between earned and unearned income. (a) KJ, (b), IR HMT.

*9.5 Stimulate the small and large shareholder to play a proper role in the dialogue with government and in the performance of the companies they own (a) MH (b) Dept. of Trade, HMT.

9.6 Promote use of non-executive directors to encourage spread of mor open and enlightened management practices (a) KJ (b) Dept. of Trade.

[illegible]

9.7 Elimination of exchange controls (a) KJ, JN (b) HMT.

(e) SMALL FIRMS

* 10.1 Eliminate undue obligations and burdens on small firms; a. JN, CPRS, b. D Industry, Inland Revenue, Customs and Excise (and others).

10.2 Draw up comprehensive programme of technical tax changes to benefit small firms; a. KJ, b. Inland Revenue, Customs and Excise, Treasury, D.Industry.

* 10.3 Give tax relief for individuals investing in small firms' equity; a. KJ, b. Inland Revenue, Treasury, D Industry.

10.4 Encourage big firms to help small firms with advise and expertise, (examine precedent of the London Enterprise Agency); a. MH, b. D Industry.

10.5 Slant Government contracts for supplies and services in favour of small and medium sized firms, (though still with competitive trading) eg break down contracts into smaller amounts; a. MH, b. Treasury, CSD, Ministry of Defence.

10.6 Initiate a dialogue with local government on stimulating new and small businesses; a. MH, b. DOE, D Industry.

10.7 Review rapidly the "enterprise zone" concept; a. MH, b. DOE(?), D Industry, Treasury, Inland Revenue, D Employment.

10.8 Involve the leaders of the new immigrant communities in a dialogue to see if anything more needs to be done to harness the range of entrepreneurial skills widely spread amongst these people; a. MH, b. DOE, D Industry, Home Office

LAND

11.1 Review Land Taxation (a) JN (b) IR, DOE, Treasury

11.2 Review Land Commission (a) JN (b) DOE.

11.3 Inadequate supply of suitable premises and sites (particularly for small firms) (a) JN, (b) DOE.

11.4 Public Sector Land Holdings (e.g. London Docklands) (a) JN (b) DOE.

IV PUBLIC SECTOR

(a) EFFECTS ON THE PRIVATE SECTOR OF THE NATIONALISED INDUSTRIES AND OF OF PUBLIC PURCHASING POLICY

* 12.1 Increase enlightened clientship by public purchasing of micro-electronics, science and technology etc; a. KJ, b. D Industry, Ministry of Defence.

* 12.2 Consider the effects of the imposition of arbitrary technical standards by nationalised industries (eg nuclear power, telecommunications a. JN, b. D Industry, D Energy.

12.3 Consider how public sector agencies can make their skills available to the private sector for international trade purposes (eg BAA, CAA); a. MH, b. D Trade, D Industry.

Delays: 12.4 Raise non-tariff barriers to imports by concentrating public sector staff cuts so as to increase administrative delays; a. GH, b. CSD, D Trade, D Industry.

* 12.5 Develop an energetic nuclear power programme (using PWR if necessary a. KJ, b. D Energy.

(b) PUBLIC SECTOR EFFICIENCY

* 13.1 Consider monopoly power of nationalised industries (eg supply of power, telephones); a. JN, b. D Industry, D Energy, D Transport, D Trade, Treasury.

* 13.2 Review scope for, and stimulate, private sector competition to supply public sector services (eg transport, refuse collection, housing and maintenance); a. MH, KJ, b. D Transport, DOE.

13.3 Examine the possibility of City financial institutions entering into partnerships with educational establishments for the building of universities, polytechnics etc; a. MH, b. DES, Treasury. Education as a whole

13.4 De-privilege the Civil Service (and Academia?) by reducing security, greater ruthlessness in use of premature retirement, etc; a. KJ, b. CSD, DES.

13.5 Diminish power of Civil Service unions by reducing "facility" time, withdrawing (or threatening to withdraw) willingness to deduct union dues from wages and salaries, reasserting managerial authority (eg in reporting standards) etc; a. KJ, b. CSD.

V EDUCATION OF THE PUBLIC (EXHORTATION)

The following list deals with a series of proposals to change public attitudes. But one of the most important ways in which the Government will establish the credibility of its policies is by standing firm through the inevitable initial difficulties. Indeed this will be an essential part of public education; serving both decisively to alter expectations, and to demonstrate the mechanisms by which the policies are expected to operate. The immediate problem of public education is, of course, to convince workers that tax cuts are better than wage increases; and in particular to persuade people the cost of the recent increase in VAT has already been covered by income tax cuts, and that compensating wage increases are not therefore needed.

14.1 Draw up and orchestrate a continuing programme to articulate the profound nature of the individual resurgence we are seeking to create; a. MH.

14.2 Seize every opportunity to put across to public opinion the gravity of our industrial situation and the fact that the world does not owe us a living; a. KJ.

14.3 Promote greater awareness of the role of profit; educate those engaged in collective bargaining to relate pay to company performance; accelerate the introduction of inflation accounting to help destroy "money illusion"; a. GH, KJ.

14.4 Seek to change public attitudes to Europe, to become more positive and less grudging; a. KJ.

14.5 Launch a nationwide debate about the opportunities for improved productivity; a. MH.

14.6 Consider how to publicise the effect of the recent VAT increase on the attractiveness of exporting; a. GH.

14.7 Encourage (by speeches and contacts) the city institutions to look beyond the end of their noses and to protect their members' interests in the broadest sense by encouraging enterprise and growth in the UK economy. Ministers to make clear that the Government expects the City generally to bestir itself; a. KJ.

14.8 Ask Lord Jellicoe as the new President of the Association of British Chambers of Trade to recruit the Director General of the NFU to show him how to turn the inarticulate voice of a small industry into a vociferous and influential and political force; a. MH.

Geoffrey Goodman had highly professional unit in communications

MR LANKESTER

I note the "Action Programme" will be taken at E Committee on 24 July. I would like Norman Strauss to sit in at that meeting as it is important that he has a feel for the way its members are thinking. This would simply be to continue on the same basis that we followed in Opposition, where he and I sat in at all meetings on Stepping Stones strategy.

CF. with BF on 20 July

TL. 9/7

JOHN HOSKYNS
9 July 1979

JRB

MR. HOSKYNS

We are suggesting in the Business Note to the Prime Minister tonight that your paper on the "Action Programme" should be taken in E Committee on 24 July. You suggested that Angus Maude be invited to the meeting. We will take that up with the Prime Minister nearer the time.

I have shown the note which you had planned to put to the Prime Minister to Sir John Hunt so that he knows what you are planning for this meeting.

TPL

6 July 1979

CONFIDENTIAL

Ref. A09923.

PRIME MINISTER

Pay: Some Current Questions

(E(79) 13 and 17)

BACKGROUND

You agreed on Thursday that Sir Kenneth Berrill's general paper on pay dated 4th July should be circulated to the Committee (E(79) 17); at the same time, the Chancellor decided to circulate one by Treasury officials (E(79) 13). The two cover much the same ground and can be taken together. The CPRS paper is however the shorter one, and might provide the more convenient framework for the discussion.

2. It might be worth reminding the Committee that they took some preliminary decisions at their meeting on 1st June (E(79) 2nd Meeting, Item 1). But a lot of flesh needs to be put on the bones. Some very big issues, particularly over the settlement of next year's cash limits, have to be taken quite soon. Public sector employers, and to a lesser extent those in the private sector, are looking to the Government for a lead. There will not be sufficient time at this meeting to take all the necessary decisions, and you will probably need a further round before the Recess. By that time, too, the paper which you commissioned from the Home Secretary at the first 'Hoskyns Group' meeting, will be ready, and this will give the Committee some feel for the individual problems to be expected in the next round. Given that the time available at this meeting has, necessarily, had to be curtailed, it would also be possible to defer lesser specific issues like Civil Service Pay Research and the Government evidence to the Standing Commission on Comparability to a later meeting.

HANDLING

3. I suggest you might begin yourself, by making the points in paragraph 2 above. You might then ask the Chancellor to introduce his paper, and (if you think this appropriate) invite Sir Kenneth Berrill to add anything else about his. Then, taking the CPRS paper as a framework, you might get through the main headings as follows:

(a) Climate. (paragraphs 2 to 4; also paragraphs 26-32 of the Chancellor's paper). The main issues here are: what can be done in the present round to improve the climate and the general awareness of the problem? And what can be done to redress the balance of power? You have postponed the discussion of specific papers on the Forum and the Council of Economic Advisers to a later meeting, pending a talk with the Chancellor. But both these ideas are floated in the Chancellor's paper. The Committee will probably feel that, while these are useful, they will not significantly affect the position next winter. They may also feel that the various changes in industrial relations law planned by the Secretary of State for Employment, while also useful, will not make a big shift in the power balance this year though they could have important psychological effects. Nevertheless, there are important questions of presentation: does the Committee feel that the Government should mount a major educational effort, and if so how and when? What more should be done to influence employers - for example, to take full advantage of their existing and future legal rights vis-a-vis the employees?

1

(b) The next pay round (paragraphs 5 to 7; no corresponding section of the Chancellor's paper). There seem to be three issues here:

(i) Is it agreed that the Government must avoid anything which can be interpreted as a norm (which then inevitably becomes a floor)? - presumably so.

(ii) Should the possibility of a freeze be allowed to lurk in the background, particularly as a means of encouraging early settlements? Or should it be killed to avoid pressure to get through the gate before it closes? And would a denial be believed?

(iii) Does the Committee agree with the CPRS that, in the end, a cut in real earnings will be necessary before inflation can be halted? If so, how does the Government get the message across?

(c) Private sector (paragraphs 8 to 9; also paragraphs 5 to 8 of the Chancellor's paper). The issues which arise here are these:

(i) How tight will the squeeze really be next winter? (Your discussions about mortgages will have given you an idea of the likely monetary climate, although you will not yet have had your planned talk with the Governor about interest rates, etc.).

(ii) Which will hurt companies more - a squeeze on their liquidity, or a squeeze on their profitability? (The former may actually tempt them to dash for a quick settlement, at a price, rather than stand a strike: the CBI is thinking in terms of financial assistance for firms which decide to sit out a strike. Should the Government help?)

(iii) Is the Government prepared to stand aside from key negotiations like Ford - despite their knock-on effects - and to refuse to bail out companies who get into difficulties?

(iv) Conversely, what does the Government do about a really crippling strike in the private sector (BOC or Road Haulage)? Stand back or lean on the companies to settle quickly? (This question may not be capable of answer in advance of an actual situation arising on the ground but the tone of Government thinking will be important).

(d) Public services (paragraphs 10 and 11; also paragraphs 16-25 of the Chancellor's paper). I assume that the Committee will earlier have ruled out any possibility of establishing a 'norm'. In that case, decisions revolve around 'fair comparisons' and 'cash limits'. There are separate papers on each of these; and there are ways of reconciling them:

(i) If it is agreed that 'fair comparisons' is bound to survive in some form in the public services then the problem becomes one of imposing discipline on the system and ensuring that it works in ways fair to both sides. The papers on pay research (Item 4) and the evidence to Clegg (Item 5) both deal with this. Comparability, sloppily applied, can of course be highly inflationary: but Governments, like other employers, have, in the end, to pay the market rate to obtain the labour force they need.

Structured and disciplined comparability is an attempt to measure the market price in an acceptable way and as an alternative to confrontational negotiations.

(ii) But acceptance of 'fair comparisons' as a long-run system raises acute questions for the operation of cash limits, particularly in the short run. The Chancellor's separate paper (Item 2) deals with this point. It poses a stark choice between using cash limits to set, in effect, a public sector pay norm (with the employees faced with choosing between higher pay and lower numbers) or of using them as a monetary expression of the Government's need for staff, combined with a realistic assessment of the outcome of pay negotiations, and with a relatively small negative margin to exert pressure for economy and efficiency. (In this latter formulation there is an analogy with the old farm price review system where farmers were reimbursed their extra costs less a margin for assumed higher productivity). There is a good deal of disagreement within the Treasury on these matters and you may well find the same disagreement surfacing among your colleagues. But there is a sense in which the argument is one of degree, not substance. Whatever assumptions about pay the Government builds in to its cash limits, the pay of individual employees is bound to be settled in negotiation. The question is not therefore whether the Government reserves the right to cut functions as well as improve efficiency - it has that freedom anyway - but whether it is prepared to say in advance that it will regard its budgeted total wage bill as determining the functions it will carry out. Seen in this light the argument about cash limits and their relationship with pay is really one about the degree of freedom the Government is prepared to permit itself in deciding the functions it will perform.

You might defer detailed discussion of both sets of problems till we reach the respective papers.

(e) Local government (paragraphs 12-13; and paragraphs 16-25 of the Chancellor's paper again). Much the same problems arise. The particular problem is how to put pressure on the local authority employers. The CPRS paper implies that, once decisions have been taken on next year's public expenditure levels in volume terms, these could be translated into Cash Limits and Rate Support Grant quite quickly. But the CPRS formula (paragraph 13) involves making a forward estimate of the rate of inflation, and setting cash limits which allow for it in full. This puts no further squeeze on local authority employment on the grounds that the appropriate cuts have already been imposed through the public expenditure decisions. Is this what Ministers want? If so, should the Secretary of State for the Environment bring forward detailed proposals for this year's Rate Support Grant negotiations before the Recess? Without a clear lead from Ministers, there is a danger that the Government will become committed in informal negotiations with the local authorities, and its room for manoeuvre in the autumn limited. In any case, final decisions have to be taken well before the 'statutory meeting' in November. You might also in this context raise a more general issue of timing. Whatever approach Ministers adopt they will need to take a view on the pay assumptions to be built into the RSG negotiations. But forecasting is an inexact science. What margin of error or uncertainty attaches to forecasts made this year about the pay, or inflation, outturn in 1980-81? Does this in itself pose problems and are there means available to narrow the gap?

(f) Clegg. Is he to continue? The Cabinet has reserved its position so far. But E(EA) has now decided that the local authority APTC Groups can be referred to Clegg if both sides agree (as being preferable to an 'in house' local government comparability review and less expensive than an immediate full scale settlement). While this will give Clegg a very full programme for the next year it also brings to an end the list of potential major clients for this year, and thus gives the Government time to determine its longer term attitude to Clegg in the light of his performance - which will begin to become apparent very soon as his first reports reach Government.

(g) Nationalised industries (paragraphs 16-19; also paragraphs 9-15 of the Chancellor's paper). There is a separate paper (Item 3) on the nationalised industries. But the Chancellor's paper raises a number of important points not fully treated there: on timing, on cash limits, on efficiency targets, on limits on the Wage Bill, and on limits on prices. You might say that these points must be considered under Item 3. But at the end of the day, hard decisions have got to be taken industry by industry. One possibility would be to commission a paper for the Committee, either before or immediately after the Recess, setting out a game plan for each industry, showing what would be involved in terms of wages, levels of employment, levels of service, prices, and borrowing, from the kind of policy outlined in the CPRS paper. This could serve as very useful background to the operational decisions as they arise.

CONCLUSIONS

4. You may prefer to leave summing up until the end of the meeting. The main conclusions to emerge at this stage will, I think, be:

(i) To agree that the Government's general policy remains the control of inflation through its general monetary and fiscal policies, without the establishment of a separate pay norm.

(ii) That in the private sector, the Government's intervention should be confined to the creation of the right climate of opinion, and the provision of information. (Noting that you will arrange a further discussion of ways of doing this, including the proposed Council of Economic Advisers and Forum).

The remaining conclusions can be picked up under the later items on the agenda.

John

(John Hunt)

6th July, 1979

File

Econ Policy

SIR KENNETH BERRILL

PAY

The Prime Minister was grateful for your note of 4 July and the accompanying paper on pay. She has asked that it be circulated to E Committee.

I am sending a copy of this note to Martin Vile.

T. P. LANKESTER

5 July 1979

GB

PRIME MINISTER

Tim Lankester

GOVERNMENT STRATEGY

As you know, we now have laundry lists in from the Departments. I am working through these with Sir Kenneth Berrill and Norman Strauss.

My aim, obviously, is to reduce these lists to something more concrete, so that we can:

1. Start design work on measures which may be difficult (administratively, legally, politically, etc) or which have long lead times, but which nevertheless promise a high pay-off.

2. Prepare for early implementation of the simpler measures which promise benefits.

3. Drop those which don't look worth the trouble.

4. Get a rough timetable so that we know who is to start doing what, when, for 1. and 2. above.

Could we set up a 2-hour meeting (same colleagues as before) towards the end of this month or early August, before people disappear to their constituencies? This would allow us (Departments, CPRS, Policy Unit) to get moving during the summer lull.

I would prepare an "Action Programme" for consideration at that meeting, to be circulated in advance.

This note, attached to a minute from you, could be used to explain the purpose of the meeting.

Tim

The [illegible] note [illegible] suggests that all this should be brought into the orbit of E and that E should meet on 24 July for this purpose.

[illegible]

JA

Clive

John Hoskyns

This is the note which with John Hoskyns's agreement, I took out of the box.

JOHN HOSKYNS
4 July 1979

Tim Lankester

PRIME MINISTER

GOVERNMENT STRATEGY

With reference to my note of today's date, suggesting a second Strategy Meeting towards the end of this month, I wonder if Angus Maude should attend it.

JH

JOHN HOSKYNS
4 July 1979

10 DOWNING STREET

PRIME MINISTER

The Governor of the Bank of England is in Basle next Monday so will not be able to lunch with you. As you do not have another free day for lunch before the House rises I have fitted him in for half an hour on Friday 13.

C. L.

4 July 1979

~~B/F 12 - 7. 79~~

(No briefing required)

1

Covering CONFIDENTIAL

Prime Minister

This is another excellent pay paper from CPRS. Can we circulate for E Committee? for Monday?*

TL

4/7

Qa 04173

To: MR LANKESTER

From: SIR KENNETH BERRILL

Yes M

Pay

1. The Ministerial Committee on Economic Strategy (E) is due to return soon to its discussions on the next pay round. I attach a note by the CPRS on this which the Prime Minister may care to read. It has been written in a form which is suitable for circulation as a paper to the E Committee, if the Prime Minister thought that appropriate. It might help to provide a framework against which the more detailed papers could be discussed.

2. I am sending a copy of this minute and attachment to Sir John Hunt.

KB

4 July 1979

Att

* E is taking pay on Monday — so we must get this circulated tomorrow.

TL.

PAY: THE NEXT ROUND

Note by the Central Policy Review Staff

1. The Ministerial Committee on Economic Strategy intends to return to its discussion on the next pay round in the context of the following papers which have been commissioned:

(i) the possibility of a 'forum':

(ii) cash limits for central and local Government and the nationalised industries:

(iii) pay, prices and efficiency in the nationalised industries.

This present note by the CPRS looks at these issues in the context of the next pay round: and raises some of the practical questions which Ministers will have to deal with in the coming months.

Climate

2. It is difficult to judge at this stage the climate of the next pay round. Adverse factors include the following:

(i) The Government has forecast that the year-on-year inflation rate will be $17\frac{1}{2}$ per cent by November. After that the rate is forecast to fall but such a fall may seem more speculative.

(ii) Large public sector awards have been agreed and others will be emerging from the Clegg Commission. This may well raise expectations generally.

(iii) The cutback on public expenditure and public service manpower will add to union hostility.

(iv) The attitude of employers is ambivalent. Some will be prepared to pay up rather than face a strike.

3. On the other hand, some things are working in the Government's favour:

(i) There is a greater public awareness of the dangers of inflation, and of the futility of paying ourselves more than we earn.

(ii) The Government's monetary targets will help to dampen expectations. The trade-off with unemployment is now more widely appreciated. Unemployment may well be rising.

(iii) The unions are in some disarray and have forfeited public sympathy in recent months.

(iv) Substantial tax cuts will be coming through in October.

(v) There is likely to be some pressure on company liquidity and profitability. This is particularly in view of the world market prospect for those firms who rely on exports. The high exchange rate poses an additional problem for such exporting firms (and for those competing in the home market with imports). The threat of bankruptcy and redundancy may be a restraining influence.

4. It will be important for the Government to reinforce the favourable factors at every opportunity. This will require a continuous effort in public education. A 'forum' could be useful, though in the short run its effect is unlikely to be great. Equally important is for Ministers to ram home in speeches, and in discussion with both sides of industry -

(a) that there really has been a decisive break with past policies;

(b) that the Government is resolved to squeeze out inflation, if necessary at the expense of short-term unemployment;

(c) that individual earnings must depend on performance - not national wage rates or existing relativities;

(d) that only this approach will create the conditions in which living standards in this country (and employment) can start to rise more in line with those of other countries;

(e) that tax cuts are better than pay increases (they do not add to unit costs) but we cannot have both.

It is very important that these points should be kept continuously in the public eye. A campaign on these lines should be co-ordinated - perhaps by the Paymaster General.

The Pay Round: General

5. The Government will wish to avoid, so far as possible, setting a wage norm. Experience has shown that a norm becomes a floor, not a ceiling; and it does not allow for market conditions and variations in performance. In the absence of a norm, however, what can the unions be expected to aim for, on the most favourable assumptions?

6. It is possible that the unions will enter the next round believing that the Government will soon be forced into a pay freeze. This may not be a bad thing. It could mean that negotiators would be anxious to settle early, rather than stick out for the biggest gains. The most favourable outcome within the likely range would be for the unions to attempt merely 'to preserve the real value of their members' incomes intact'. But this would secure only a small reduction in the annual rate of inflation (depending on the rate of increase in productivity, the terms of trade, the exchange rate and perhaps income tax cuts not matched by offsetting increases in indirect taxes).

7. The reason why this apparently modest trades union objective (maintain real incomes for their members) means a continuance of rapid inflation is that on past experience 'maintaining real incomes' is equated with wages increasing at the previous year's rise in the retail price index. Anything less than this is regarded as accepting a fall in real income - even if there are good reasons for believing that next year's inflation rate will be less than last year. Squeezing inflation out of the economy over a period of two to three years will require acceptance of such a 'fall in real incomes'. At present we do not have means of determining that this will happen in the next pay round. Indeed we cannot be sure of making even modest progress. The remainder of this note seeks to identify some of the problems which will need to be tackled.

Private Sector

8. In the private sector the Government's strict monetary and fiscal stance will dampen expectations and reduce company liquidity. But some of the problems are bound to remain and now is the time to consider the Government's response. For example:

(i) One of the earliest negotiations will be Fords, who may be able to meet large pay increases, despite continued overmanning (multinationals can, if they wish, escape the domestic monetary squeeze). Up till now, the Ford settlement has set the pace for British Leyland. But certainly the volume car side of British Leyland cannot afford to pay Fords wage rates, and maintain its investment, without Government support. Has the time come to withhold this support, and what would be the consequences? How can the management and unions be persuaded that the Government will not in the last resort again come to the rescue?

(ii) Another early settler is the British Oxygen Company, which has much of British industry in a stranglehold. Can a large settlement here be prevented from setting the pace for other negotiations? Again, this raises questions of publicity and public education.

(iii) Other obvious candidates for high settlements are road haulage (the employers will not want to risk another dispute), tanker drivers and refinery workers.

9. The logic of free collective bargaining should be pursued as far as possible. Major variations in pay settlement from area to area and from company to company must be allowed to develop. The Government should not step in to help those who settle at rates they cannot afford. But there could be a good deal of disruption in parts of industry, and our contingency plans should be made as ready and as effective as possible. Can employers be helped to withstand strikes? What emergency and voluntary support could be mobilised? These questions need to be examined urgently by the Departments concerned.

Public Services

10. The Clegg awards are meant to correct the anomalies in the current round: it is important that they should not be allowed to affect the climate of the next.

11. If the most serious anomalies are eliminated by Clegg, it may not be too much to hope that there will be relatively few public service pay disputes in the next round. However, the problems will not disappear altogether. The groups involved will want their awards topped up by something approaching the 'going rate', and the Government, as principal paymaster, has to take a view on what it will afford.

Local Government

12. The first major problem arises in October/November when the level of rate support grant must be settled for local authorities. This will necessarily include some allowance for pay increases. The Government cannot avoid giving a fairly clear indication about the level of pay settlements which it thinks employing local authorities could reasonably concede.

13. Local authorities will, of course, already be under considerable pressure to reduce their expenditure programmes. The further cuts envisaged as part of the public expenditure review can be thought of as the counterpart to the gradual reduction in the money supply targets affecting the private sector. In these circumstances the aim should be to allow for cash limits which are tight, but realistic. One possibility might be to take the estimated inflation rate minus Budget-induced price increases for which compensation has already been received through tax cuts. This would preserve real income.

Central Government

14. Cash limits for central Government services (including the National Health Service) do not have to be set until February when the Parliamentary estimates are prepared. However, if the Government wished to reinforce

the formula applying to the Rate Support Grant, it could take an earlier and public decision that these cash limits would be based on the same formula. This is, of course, setting a norm for the public services, but in the view of the CPRS, this is at some stage unavoidable.

15. A decision will also be needed on whether the Clegg Commission is to continue, once its current work is completed. This will depend, to some extent, on its early performance: but the CPRS believes that a system of periodic references to the Commission, or something like it, may well be the best way of preserving a reasonable balance between the public services (for whom there is no market determined rate) and other groups.

Nationalised Industries

16. Some of the most difficult pay problems are likely to arise in the public trading sector. When these industries and services are subject to market competition (e.g. British Airways) it may be possible to treat them more or less like the private sector. But -

(a) some have monopoly power (e.g. British Gas, CEGB) and are able to increase prices to meet 'excessive' wage settlements without a significant loss of market sales;

(b) some are highly capital intensive (e.g. CEGB, telecommunications) and the wages bill represents a small proportion of total costs;

(c) some have a declining unit cost technology and can afford large increases (e.g. telecommunications);

(d) some are loss makers (e.g. British Rail, British Steel) to which the Government is committed to maintain some form of subsidy.

17. With such differing circumstances it is unrealistic to look for a single, common approach on pay. But it is worth considering whether there are any underlying principles which should be taken into account in judging each case separately. These might be as follows:

(i) Comparability as such should not be adopted for the public trading sector.

(ii) Less weight should be given than in the past to comparisons with other groups, to past relativities, etc.

(iii) Wage bargaining should be influenced by demand and supply of labour in the industry (and in the area); and should take into account manning levels.

(iv) It should take account of productivity (or profitability where appropriate).

(v) Wage settlements should not be at the expense of essential investment.

18. The extent to which nationalised industries can be allowed to negotiate their own settlements varies with their individual circumstances. For the most part, as with the public services, the Government will have to take a broad view about what is appropriate. The elements from which the Government might construct its pay policy in the nationalised industry field are -

(a) some idea about the average out-turn for the round (fortunately the main nationalised industry settlements do not take place until the Spring);

(b) cash limits on borrowing;

(c) financial targets; and

(d) control of prices and investment.

19. The question is to what extent these elements can be adjusted to meet the varying circumstances of the different industries. It is possible to think of the Government keeping out of individual negotiations; setting (b), (c) and (d) so as to circumscribe what the industries can afford; and to do so in such a way as to take some account of the 'going rate' and of the

underlying principles in paragraph 18. But the margins of error would be substantial and the effects uncertain. Also if there is a strike in an essential service, it is difficult for the Government to stand aloof for long. It is therefore likely that the Government will be drawn, however reluctantly, more directly into the negotiations.

Conclusion

20. It would be foolish to think that the Government can prepare itself for every eventuality in the coming wage round. But some preparation is possible and it is important to settle the general approach.

21. There are some things working in the Government's favour and the unions may want to avoid confrontation. It will be important to reinforce the favourable factors by a co-ordinated campaign of public education, of which a 'forum' would be only a part.

22. It will be possible, at best, to secure only a gradual fall in the rate of inflation. Even this will be difficult.

23. In the private sector the policy will rest on tight monetary policy and a squeeze on liquidity. Much greater variations in pay must be expected from company to company and from area to area. As far as possible, problem points should be identified well in advance.

25. In the public service the Government will need to build an allowance into cash limits - perhaps based on estimated inflation minus Budget-induced price rises.

25. Similarly for the nationalised industries, though the allowance should, so far as possible, pay some regard to market factors and the performance of the industry. Some direct Government intervention will probably be unavoidable.

PRIME MINISTER

The Governor of the Bank of England was to have seen you tomorrow morning (Wednesday 4 July). He was cancelled because of the meeting tomorrow afternoon to discuss mortgage rates. Tim Lankester wonders whether you would like to give him lunch alone next Monday 9 July. You have an 1145 meeting that morning with the Foreign Secretary and the Secretary of State for Defence to discuss The Queen's visit to Zambia and the CBI at 1500 hours followed by E Committee at 1600 but this would be possible if you agreed to it. Otherwise I could fit him in for half-an-hour sometime next week.

C.S.

Lunch

M.T.

3 July 1979

CONFIDENTIAL

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

Secretary of State for Industry

2pps

3 July 1979

John Hoskyns Esq
Special Adviser to the Prime Minister
10 Downing Street
LONDON SW1

Dear John.

GOVERNMENT STRATEGY

In my minute of 25 June to the Prime Minister, I said that I should be letting you have some ideas set out in more detail to help our recovery programme. These I now attach in the form of two papers, the first on the acceleration of enterprise and the second on the acceleration of de-manning.

Both papers involve many difficult issues, and officials have not been able to examine them in any depth either within the Department or more widely with experts in other Departments. But I believe that it is important for us to draw together as many realistic ideas as we can so that we can decide which ones we want officials to pursue positively and energetically.

I am sending a copy of this minute to the Prime Minister, the Chancellor of the Exchequer and the Secretaries of State for Trade, Energy, Employment and the Environment, the Lord President, Sir John Hunt, and Sir Kenneth Berrill.

Yours.

Keith.

CONFIDENTIAL

ACCELERATION OF ENTERPRISE

Note by the Secretary of State for Industry

This note puts forward five proposals for measures to help accelerate enterprise. I recognise that they involve difficult issues, but I think that it should be possible to overcome these if the will is there. I would hope that these proposals might be supplemented later by a comprehensive package of measures to help small firms.

KJ

29 June 1979

TAX HOLIDAYS FOR SMALL FIRMS

Under the existing system of taxation of business profits, a new small firm which invests in capital equipment and holds growing quantities of stock may be able to limit the amount of tax it pays in the early years to very low levels. However, this system, while it has been very helpful for small manufacturing companies and has attracted some inward investment is less attractive for many non manufacturing companies. Moreover, many firms, having grown quickly in their first few years, enter a period of consolidation in which they attempt to secure financial stability by retaining profits for the next stage of growth; such firms enter a period under the present tax system where they have to pay tax at that stage.

2. There is a case, which is worth careful examination, for a more overt incentive to new small firms in the form of tax exemption or business profits for (say) the first ten years - a "tax holiday". This would be readily understood by potential entrepreneurs, would remove uncertainty about the incidence of tax liability, and would extend to non manufacturing firms the advantages already conferred by investment allowances and stock relief. It would also be seen as firm evidence of the Government's commitment to creating conditions within which small firms can flourish.

3. Such a proposal would need to be looked at in the EEC context, but it is not felt that this would obstruct the proposal. There would be legislative and administrative problems to be overcome (including, for example, how to ensure that the "holiday" applied only to genuinely new business and not old ones re-incorporated to take advantage of the tax position). Moreover, it might be necessary to limit the relief to incorporated businesses. On the other hand, complete exemption from tax liability for a period of years could reduce the cost of tax administration in the small firm field to some extent.

"LOI MONORY" FOR THE UK?

Over recent years, UK financial markets have become increasingly "institutionalised" for a variety of reasons: one reason has been the series of tax advantages in routing savings through the savings institutions rather than into direct personal investment on the Stock Exchange. Because of the tendency of large institutions to concentrate their investments on a small range of major firms, this has led to a polarisation of the stock market between the 200 or so largest firms in which the institutions regularly invest, and the vastly larger number of smaller firms in which institutional investment is less frequent, and whose shares therefore are relatively lower priced so that the cost of capital to them is higher than to the large firms.

2. For this and for more general reasons, there is a strong case for seeking to encourage personal investment direct rather than through the institutions. There are compelling reasons against doing this by the withdrawal of existing tax concessions for institutional investment (eg for pensions) in particular the disruption to capital markets which this would cause. An alternative approach would be to extend similar advantages to personal investment which might not merely make it more attractive to invest direct where the individual has an option to do so but might also increase the actual volume of investment in company securities.

3. A year or two ago, the French Government introduced a tax concession to small investors (the Loi Monory) under which investors will pay no income tax on income devoted to new net purchases of French shares up to a limit of fr5,000 (£600) per household, with extra allowances in respect of children. It was hoped that, for a revenue loss of fr 1.2 billion, this measure could lead to the availability of an additional £5 billion per annum for investment in French industry. The immediate effect on the French Stock Exchange was substantial, though it is believed that a substantial part of that effect led to an increase in the price of existing shares rather than an increase in new issues. However, the scope for such a step in the UK is well worth examining in detail, taking account of the likely take-up of such a relief, its cost in revenue foregone, and the additional funds which might be made available for industrial investment. This initiative should apply to all incorporated businesses, whether quoted or unquoted, although small businesses, for which provision is made in Annex III, would not be included.

TAX RELIEF FOR DIRECT INVESTMENT IN SMALL FIRMS

It is generally recognised that the private investor has declined in importance as a source of finance for small firms. The reasons are complex, but they include the bias in the tax system in favour of routing investment through savings institutions. The recent budget measures will increase the attractions of investment generally, but a strong case still exists for introducing specific tax advantages for individuals investing in the equity of small firms.

2. There are various possible approaches to this. The most direct, and the most likely to have a substantial effect, would be to allow an individual to deduct from his taxable income the amount (subject perhaps to a specified limit) of any new investment in the share capital of a small company (which would have to be defined). Such a measure could have a major effect in encouraging the subscription of new equity in small firms, not only by existing proprietors but by other individuals.

3. Another, less direct, approach would be to allow realised losses from individuals' investment in small firms to be offset against personal income tax liability (instead of against capital gains tax) and to charge realised gains from small firms investment at a lower capital gains tax rate.

4. Both these approaches would entail considerable administrative difficulties and opportunity for avoidance. However, the potential benefits particularly of the first approach could outweigh these disadvantages.

INVESTMENT IN SMALL FIRMS: AN EQUITY GUARANTEE SCHEMES

The decline of the individual investor and the rise of the savings institution havemade it increasingly hard for small firms to obtain external equity finance. Nevertheless, one of the main objectives in the small firms field must be to increase the supply of risk capital to small innovative firms, preferably in the form of equity. So far as individuals are concerned, this is best approached by tax changes, including specific incentives to invest in small firms. However, for structural market reasons, the institutions are now overwhelmingly the main source of investment finance in the economy, and looking for profitable investment outlets. They are at present inhibited from playing a larger part in the small firms field for two reasons: the relatively high risk of such investment, and the high cost of portfolio management of such investment for an institution handling extremely large sums of money.

2. With the economy needing an expansion of the small firms sector as a source of enterprise, innovation and employment, there is an argument therefore that the state would be justified in providing modest incentives to the institutions to play a bigger part in small firms' finance. Such incentives would be, in effect, to offset existing distortions in market mechanisms which militate against the small firm. Since tax measures are unlikely to help in the institutional field, a possible approach would be an equity guarantee scheme under which the Government would accept a proportion of the risk, possibly linked with a small subsidy for administrative costs. Such a system would have negligible public expenditure costs, at least initially (it would operate by guarantee rather than direct participation); and it would preserve the plurality of decision making and avoid direct Government involvement in investment decisions. It is for consideration whether a small premium might be charged to cover all or part of the cost of meeting guarantees.

ANNEX V

ENTERPRISE IN THE MEDIUM-SIZE AND LARGE FIRM

Much of the thrust of the Government's proposals for encouraging enterprise is in the small firms field. No less important, however, is to ensure that existing medium sized and large firms make the most of entrepreneurial talents within their organisations. The shift towards entrepreneurship within such firms, and away from bureaucratic styles of management, could combine with existing market positions and manufacturing facilities, to create a major source of innovation and enterprising activity.

2. It is difficult to devise specific measures which could bring about such a shift. For example, tax measures or financial incentives would be very difficult to devise in a way which would accurately identify the kind of individuals and behaviour worth supporting.

3. However, the need to encourage enterprise within existing substantial firms ought to be a larger part of the Government's programme. One possibility would be the reinstatement of the share option tax scheme which was terminated by the previous administration in 1974.

4. There may be other steps to be examined, e.g. the establishment of an awards scheme for enterprising individuals and teams within existing substantial firms. We might also institute a series of consultations with top industrialists about how to pursue the general concept further.

ACCELERATION OF DEMANNING IN INDUSTRY

1. This note discusses how the necessary process of demanning in industry could be accelerated.

2. A definition of 'overmanning' and an analysis of its causes is necessary. The concept is not simple, and there is no single solution.

3. It is possible to define overmanning as 'inefficiency in the use of labour'. The concept comprehends:

   i) reluctance of management to shed labour when demand falls from its peak;

   ii) restrictive labour practices;

but the concept is closely allied with other factors relating to low productivity:

   iii) low rates of output (arising from factors as slow workpace, poor maintenance, poor quality control), shortages of materials because of external labour disputes or inefficient internal management, and poor management control;

   iv) under-investment in machinery and adaptation of new techniques.

RELUCTANCE TO SHED LABOUR

4. Employers' reluctance to shed surplus labour appears

/ to have

to have increased in recent years following the 1973/74 oil price crisis. The relationship between employment levels and GDP has certainly widened. When GDP fell in 1974, the combination of an increasing labour force would, on past modest productivity trends, have increased unemployment to over 2 million by 1977. In fact it peaked at 'only' 1.4 million because productivity was allowed to fall - at varying speeds in different industries - as the price for retaining labour. A subsequent pick up in GDP had comparatively little effect on employment / unemployment levels because there was more than enough slack available to take it up. There are grounds for believing that this reluctance to shed labour can mainly be attributed to political pressures to preserve jobs, particularly in the public sector.

RESTRICTIVE LABOUR PRACTICES

5. The most relevant factor affecting overmanning (as distinct from other productivity factors) is the demarcation of jobs. This appears to be an underlying weakness in British organisation of industry, at manager level as well as shop floor level. The TUC claim that the shop floor problem, which they recognise, is being brought under control. We cannot readily measure such alleged improvements, but the CPRS report in 1975 on 'The Future of the British Car Industry' gives a snapshot of the problem in that sector (which will not be typical of all sectors). Comparing a Mini plant in Britain with one in Belgium it showed (as a particularly bad example) higher British manning levels in plant maintenance of between 69% and 78%. This was partly attributed to trade demarcation: in Belgium one mechanical and one electrical would repair a multiweld machine, in Britain it required an electrician, a jig fitter, a pipe fitter, a mechanical fitter, a tool man and a repair man to do the same job.

/ LOW PRODUCTIVITY

LOW PRODUCTIVITY

6. The same CPRS report makes it clear that overmanning (in the strict use of the term) is not the sole reason for low productivity. Even given competitive manning levels (on paper) the British output was less than half its continental counterpart, on account of the slow work pace. Additionally, British car output suffered because it then had twice the incidence of quality faults; and, despite the 50-70% additional manning required on maintenance work because of the demarcation problem, twice the number of production hours were lost in Britain than the continent because of plant breakdowns. Low productivity is also attributed to factors not directly connected with manning. A survey of a broad range of industries indicated an even higher differential in productivity between Britain and the USA than between Britain and West Germany and France respectively, partly due to the higher scale of production in the USA.

SOLUTIONS

7. There is no single solution to the interrelated problem of overmanning and under-productivity. The range of Government policies aimed at increasing incentives should be allowed to work their way through, so that the market will suck unproductive labour into productive occupations.

8. The Government's aim is to dismantle the obstacles to the market. Any proposal to sort out the specific overmanning problem by an across-the-board market distortion (e.g. by increasing artificially the cost of labour) would be contrary to that broad objective.

9. The analysis in paragraphs 4 - 6 above suggests that:

i) a public presentation of the realities of the market would at least reverse the political pressures exerted by the previous Government in favour of preserving jobs irrespective of demand. The difficulties of such a presentation should not be underrated, bearing in mind the immediate economic prospects. Against that background Ministers would need plausibly to argue on the one hand that excessive wage settlement would mean lost jobs, and at the same time that increased productivity would not mean the same thing. Both management and unions will be reluctant to come out from their defensive attitude in a period of low demand. Yet the message needs to be conveyed that the maintenance of manning at levels not even justified by peak demand will lessen a company's competitiveness possibly beyond the point of recovery. Ministers should give point to the lesson by giving moral support to management during disputes, and by making it clear that the cost of an unjustified pay settlement will not be picked up by the taxpayer or the ratepayer.

ii) progress must be made on eliminating restrictive labour practices, but again the time is unpropitious. Such practices thrive in conditions of job insecurity and there are cultural attitudes to be overcome. For example in Sweden employers have ~~the~~ a clear prerogative for establishing manning levels, whereas in the UK it is a matter for negotiation (and therefore compromise) between employee and employer. A number of ideas have been put forward:

/ a)

a) a coordinated campaign to improve the public awareness of the cost of restrictive labour practices;

b) persuasion of the AUEW to abandon apprenticeship as the sole route for union membership with craft status, e.g. by acceptance of certification;

c) encourage discussion at plant level between employers and unions of problems of 'job utilization, resistance to dilutee labour, demarcation etc.

d) finding an independent body to report on restrictive labour practices and their economic effect.

10. Beyond these measures, we do not believe that there is much room for direct Government intervention. But the following ideas deserve consideration:

i) in the public sector, the process of demanning in the nationalised industries is closely linked with the process of instilling greater efficiency by means of cash limits, financial targets and performance targets, currently under consideration by Ministers. Excess labour should be shed by such means. There may not be much scope for creating new statutory redundancy schemes (e.g. steel, shipbuilding, coal already have them) but, subject to overriding PSBR considerations, Ministers could encourage the Corporations to give greater emphasis, if it is needed, to redundancies, e.g. by extending 'the step by step' approach adopted by British Steel in negotiating redundancy payments as each plant closes, and topping up as the situation demands.

/ ii)

ii) in the private sector, it could be counterproductive to assist demanning by any wholesale changes to redundancy payments, even on a temporary basis. First, some firms would be unable to afford a higher statutory level and secondly too high a level of redundancy payments (which are based on length of service) would encourage the best skills to leave and put the emphasis in industry on getting out of work and not on with it. But there may be scope for adjusting redundancy payments on a selective basis. At present, industry recoups 41% of its statutory payments from a Redundancy Fund held by the Government. One possibility relates to the defunct Employment Development Scheme, about which the Secretary of State has written to Mr Prior. If that scheme, or something like it, were resurrected, it could include a provision to increase the level of rebate to firms which satisfied the Government that they were undertaking structural or other changes which would increase productivity. If the rebate differential were sufficiently attractive, firms could thereby be encouraged to 'top up' redundancy payments beyond the statutory level, providing an incentive for union acceptance. An increase in redundancy rebate in approved schemes leading to higher productivity could be seen as a useful means of discarding without pain that proportion of the workforce that would be redundant after the restructuring has taken place. The skilled workers should be encouraged to remain by the prospect of stretching differentials made possible by the productivity scheme.

IC Division
29 June 1979

Secretary of State for Industry

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

John Hoskyns Esq
10 Downing Street
London SW 1

30 June 1979

12 6/7

Dear John,

In my minute to the Prime Minister of 25 June, I undertook to let you have some ideas for outside speakers who might help in putting our ideas across during the summer. I attach a short list, which could be extended substantially if we eventually concluded that it was right to try to encourage a programme of suitable speeches from outside the Government and from outside the ranks of our supporters in Parliament.

But as you will have recognised from my minute to the Prime Minister, I believe that there are dangers in your proposal which we ought to consider very carefully. I detect a similar uneasiness in John Nott's minute of 22 June. Although there are many in industry, in the City and in public life generally who are likely to be sympathetic to our broad policy aims, I do not think that we should assume that they would therefore necessarily wish to appear publicly to identify themselves with us. I know, of course, that you have in mind non-political reinforcement of the themes which we are seeking to put across - the need for higher productivity, readiness to accept change, the irrelevance of class divisions - but it is difficult to treat these issues without reference to policy instruments, and to invite help from anybody who is not an active party supporter must run the risk of misunderstanding. More than this, if our efforts to enlist outside speakers were made public, I believe that the media (not to mention our opponents) could make damaging misrepresentations of our intentions. And frankly, I find it difficult to believe that most of those who would be prepared to speak if nudged to do so could be expected to carry much weight with trade unionists or with the public at large. I hope, therefore that we shall have an opportunity to reflect fully on the implications of what is proposed.

I am copying this letter to the Prime Minister, the Chancellor of the Exchequer and the Secretaries of State for Trade, Energy, Employment and the Environment, the Lord President, Sir John Hunt and Sir Kenneth Berrill.

Yours,

Keith.

ANNEX

Sir Hector Laing
Sir Freddie Laker
Sir John Greenborough
Sir Arnold Weinstock
Mr Kenneth Corfield
Sir Terence Beckett
Sir Monty Finniston
Sir Marcus Sieff
Sir Michael Edwardes
Sir Frank McFadzean

Top Copy returned to J. Hoskyns
PA.

PRIME MINISTER

CBI

I saw Sir John Methven last Monday. He was extremely positive on the Budget and our well-judged attitude to the unions. He believes there are signs of a new and more positive mood in management because a Government has at last done something positive to help them.

He was emphatic that the union leaders were on the defensive, well aware that they had lost a great deal of their authority and moral credibility. They were anxious to be seen as responsible people co-operating with Government.

X. Methven wondered whether an "Economic Summit" in which Government, TUC and CBI tried to established a shared understanding of the UK economic problem, would be useful. He realised the overtones of corporatism etc, which he does not favour. But he felt that the monthly NEDC meetings were simply rituals in which nothing serious got discussed. I have since tried the Summit idea on Keith Joseph and Jim Prior, with guarded enthusiasm from the former but very little from the latter. I suspect that the trade union leaders are almost irrelevant, now, to the things we have to do. All we should be concerned with, therefore, is to keep them on the moral and economic defensive so that they can do little harm.

I see that you are meeting the CBI on Monday 9 July. Should I sit in at that meeting?

Yes - but I do not favour the summit idea.

MT

Prime Minister.

X| above is very much on the same lines as the Forum, on which we are due to discuss a paper by the Chancellor on 9th July.

2 vii

JOHN HOSKYNS
29 June 1979

Econ. Pol.

Telegrammed to Coulbeaux

PRIME MINISTER

PAY CLAIMS

23/6

QUOTE Following your reply to my earlier minute, I had further discussions with the Secretary of State for Employment last night. He feels that it is essential we should step up our efforts to communicate the message to the unions. However, he makes two points. First, he thinks that the message would have more impact if it could be linked to other positive proposals on pay bargaining, for example the forum. He feels that an isolated statement might make little impact. Second, he believes that a concerted effort over several weeks, with yourself, the Chancellor and himself repeatedly putting across the message, is required.

He would like to discuss this with you and the Chancellor as soon as possible, and will probably raise it at the next E Committee. Norman Strauss and I will generate some ideas on how we might give the message fresh impact. UNQUOTE

I have copied this note to the Secretary of State for Employment and also to the Chancellor and to the Paymaster General. UNQUOTE

JH

JOHN HOSKYNS
29 June 1979

BF 5/7/79 VLB

cc HO D/T
FCO D/N
D/I CST
LPO PGO
D/M CO
MAFF

10 DOWNING STREET

From the Private Secretary

28 June 1979

The Prime Minister has received the enclosed letter from Mr. Len Murray together with a copy of the General Council's statement on the Government's economic policy and a motion for submission to the 1979 Trades Union Congress. The statement follows Mr. Murray's presentation at the Prime Minister's meeting with the Economic Committee last Monday very closely. But I would be grateful for advice on whether the Prime Minister should send a substantive reply. I have, of course, sent a formal acknowledgement.

I am sending copies of this letter to the Private Secretaries to members of E Committee and to Richard Prescott (Paymaster General's Office) and Martin Vile (Cabinet Office).

T. P. LANKESTER

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

OO TOKYO

GPS 300

CONFIDENTIAL
FM F C O 271907Z JUN 79
TO IMMEDIATE TOKYO
TELNO 307 OF 27 JUNE

FOLLOWING FOR WHITMORE, PRIME MINISTER'S PARTY
FROM LANKESTER 10 DOWNING STREET.

JOHN HOSKYNS HAS MINUTED THE PRIME MINISTER AS FOLLOWS.

PAY CLAIMS.

''I TALKED TO THE SECRETARY OF STATE FOR EMPLOYMENT TODAY AND HE MENTIONED THAT HE HAD HAD INFORMATION (AT THIS STAGE UNOFFICIAL) OF A VERY LARGE AWARD BY THE RELEVANT EMPLOYERS' ASSOCIATION TO HEATING AND VENTILATING ENGINEERS. THE FIGURES WERE 30 PERCENT WITH A FURTHER 14 PERCENT NEXT SPRING. THIS AWARD IS RELATED TO RESOLVING PAST DIFFERENTIAL PROBLEMS RATHER THAN A DIRECT RESPONSE TO THE BUDGET. HOWEVER, THERE ARE OTHER STRAWS IN THE WIND SUGGESTING ATTEMPTS TO RENEGOTIATE EARLIER AGREEMENTS, IN THE LIGHT OF THE BUDGET.

I HAVE SINCE DISCUSSED THE PROBLEM, AND POSSIBLE WAYS OF HEADING IT OFF, WITH THE PAYMASTER GENERAL.

JIM PRIOR IS HOLDING A MEETING TO DISCUSS THESE DEVELOPMENTS TOMORROW (28 JUNE) . I HAVE SUGGESTED TO HIM THAT PERHAPS AN EARLY STATEMENT, AGREED WITH YOU AND THE CHANCELLOR, SHOULD GO OUT FROM HIM, SPELLING OUT IN WORDS OF ONE SYLLABLE WHAT THE IMPACT OF THE BUDGET WILL HAVE BEEN FOR DIFFERENT LEVELS OF EARNINGS: STRESSING THAT UNION NEGOTIATORS WHO TRY TO DISCOUNT THE VAT INCREASE, BY WAY OF WAGE CLAIMS, HAVE EITHER FAILED TO UNDERSTAND THE BUDGET OR ELSE ARE DELIBERATELY MISLEADING THEIR MEMBERS: AND EMPHASISING THAT THE ONLY RESULT WILL BE FURTHER UNEMPLOYMENT.

I HAVE COPIED THIS NOTE TO HIM AND ALSO TO THE CHANCELLOR AND TO THE PAYMASTER GENERAL.''

I THOUGHT THE PRIME MINISTER SHOULD SEE THIS RIGHT AWAY SINCE I VERY MUCH AGREE WITH JOHN THAT THE MESSAGE ABOUT THE TAX REDUCTIONS IN THE BUDGET IS NOT GETTING ACROSS, AND I HAVE ALSO HEARD OF PARTICULAR PAY NEGOTIATIONS WHICH ARE TURNING SOUR. IF THE PRIME MINISTER AGREES, I THINK IT WOULD BE A GOOD IDEA IF MR PRIOR WERE TO PUT OUT A STATEMENT BEFORE THE WEEKEND. DOES THE PRIME MINISTER AGREE? THE STATEMENT WOULD, OF COURSE, HAVE TO BE CLEARED WITH THE TREASURY AND WITH THE PAYMASTER. WOULD THE PRIME MINISTER LIKE TO SEE THE DRAFT?

CARRINGTON.

NNNN

Sending cable to Tokyo — T.L. P.A. 27/6

PRIME MINISTER

PAY CLAIMS

I talked to the Secretary of State for Employment today and he mentioned that he had had information (at this stage unofficial) of a very large award by the relevant employers' association to Heating and Ventilating Engineers. The figures were 30% with a further 14% next Spring. This award is related to resolving past differential problems rather than a direct response to the Budget. However, there are other straws in the wind suggesting attempts to renegotiate earlier agreements, in the light of the Budget.

I have since discussed the problem, and possible ways of heading it off, with the Paymaster General.

Jim Prior is holding a meeting to discuss these developments tomorrow (28 June). I have suggested to him that perhaps an early statement, agreed with you and the Chancellor, should go out from him, spelling out in words of one syllable what the impact of the Budget will have been for different levels of earnings; stressing that union negotiators who try to discount the VAT increase, by way of wage claims, have either failed to understand the Budget or else are deliberately misleading their members; and emphasising that the only result will be further unemployment.

I have copied this note to him and also to the Chancellor and to the Paymaster General.

JH

JOHN HOSKYNS
27 June 1979

CONFIDENTIAL

Econ Pol Strategy

PZ 27/6

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

26th June, 1979

Dear Tim,

SUPPLY SIDE MEASURES

In reply to your letter of 19th June enclosing a note of a meeting on Government strategy on 18th June, The Chancellor has asked me to send you the attached list of ideas for improving the supply side. They include not only Treasury suggestions but others deriving from the work of sector working parties and inter-departmental official discussions; but obviously, given the nature of the exercise, they in no way represent a 'departmental view'.

John Hoskyns' letter of 19th June asked for names of possible speakers to help get the message of the Budget over to trade unionists. Possible names are Lord George Brown, Lord Robens, Sir Richard Marsh and Sir Leonard Neal. However, the Chancellor wonders whether these former trade union officials, however distinguised, are likely to make much impact on the trade unions. In his view, the brunt will have to be borne by Ministers addressing the public over the heads of trade union leaders and employers appealing to their work forces over the heads of militant shop stewards. The CBI may be able to help on this latter point. I know that Treasury Ministers have further ideas on this point, and I may well be writing to amplify this paragraph after the Chancellor returns from Tokyo.

This letter is copied to the recipients of yours and to John Hoskyns.

Yours ever,

MAH

M. A. HALL

T. L. Lankester, Esq.,

SUPPLY SIDE MEASURES

(a) Finance (Suggestions being or about to be looked at in the Treasury and Inland Revenue): Reduce the bias against investment in productive assets. Look at the tax treatment of financial institutions and the tax incentive to various forms of personal saving, including the building societies, with the aim of removing any bias against the flow of savings into industry and small businesses. Review the system of corporate taxation with a view to encouraging real profitability and adequate investment in fixed assets and stocks. Remove or reduce possible encouragements to merge caused by the present tax system, and consider removing tax and other obstacles to companies which want to demerge. Consider the tax treatment of gilts relative to that of private sector borrowing. Look at Truck Acts. Consider how to publicise the effect of the recent VAT increase on the attractiveness of exporting.

(b) Review planning procedures, including local authority controls, IDCs and ODPs.

(c) Review environmental controls, building regulations and health and safety regulations including the procedures by which they are introduced and implemented.

(d) Carry forward work already in hand on marketing, product development, and import substitution, including the improvement of collaboration between buyer and seller sectors. Encourage companies and nationalised industries to emulate Marks and Spencer in promoting British suppliers.

(e) Increase non-tariff barriers to imports, by concentrating public sector staff cuts in areas where administrative delays were acceptable for that reason.

(f) Reduce Government regulations in consumer protection, form filling, employment protection and race relations.

(g) Reducing the discouragement to women to take technical and industrial jobs where skills are in short supply. A new balance in the role of the EOC.

(h) Tackle restrictive labour practices, by being ready to refer them to the MMC under Fair Trading Act. Possible measures against absenteeism.

(i) Improve labour flexibility: eg reform of the apprenticeship system and measures to overcome resistance to adult training.

(j) Measures to improve the structure of trade unions, including mergers of the smaller ones.

(k) Promote greater awareness of the role of profit; "educate" those engaged in collective bargaining to relate pay to company performance.

(l) Change the priorities of the educational system; raise the status of managers, engineers and entrepreneurs; specific grants and programmes to relieve known shortages, eg electronic engineers.

(m) Sustained reform of housing policy to encourage labour mobility; changes in rent control (beyond shorthold) and subsidy structure.

(n) Recognise that tougher competition policy is wholly compatible with less obstructive attitude to some (many?) take-overs; raise thresholds for refering to MMC.

COVERING CONFIDENTIAL

Econ Pol Strategy JS

Original Ind Policy meeting with TUC May 79

10 DOWNING STREET

From the Private Secretary

26 June 1979

I enclose a copy of the record of the Prime Minister's meeting with the TUC Economic Committee yesterday.

I am sending copies of this letter, and enclosure, to Ian Fair (Department of Employment), Andrew Duguid (Department of Industry), Bill Burroughs (Department of Energy) and Martin Vile (Cabinet Office).

T. P. LANKESTER

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

CONFIDENTIAL

6

RECORD OF A MEETING BETWEEN THE PRIME MINISTER AND THE TUC ECONOMIC COMMITTEE AT NO. 10 AT 1500 HOURS ON MONDAY 25 JUNE 1979

PRESENT

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

Lord Allen
Mr. David Basnett
Mr. Frank Chapple
Mr. Tony Christopher
Mr. Geoffrey Drain
Mr. Moss Evans
Mr. Alan Fisher
Mr. Joe Gormley
Mr. Tom Jackson
Mr. Clive Jenkins
Mr. T. Parry
Mr. Harry Urwin

Mr. Len Murray
Mr. Norman Willis
Mr. David Lea
Mr. Bill Callaghan
Mr. Cumming
Mr. Percy
Mr. Barber

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

Lord Allen said that the Economic Committee much appreciated the Prime Minister's willingness to meet them. Mr. Murray's letter of 13 June set out the main points which they wished to discuss, and they would welcome the Prime Minister's comments.

The Prime Minister said that she was delighted to receive the TUC Economic Committee, and she hoped that they would come back again when they wished. She believed that the aims of the Government were the same as the aims of the TUC, even though there might be some disagreement on the means. The principal objective must be to raise standards of living, but the Government could not achieve this on its own. This had to be done on the shop floor. The Government's role would be to create the right environment. The second aim must be to reduce unemployment. But genuine jobs must be created, and this could only be done if the jobs in question were profitable. She did not like low wages, but this could only

/be overcome

be overcome by increasing output. As she had said many times, if the people wanted a German standard of living, then they must have a German standard of output. There was no shortage of demand in the economy, as evidenced by the import figures for the past year. For example, car imports had increased very rapidly, while UK output had stagnated. The problem was that industry was not producing to meet the demand that was there.

Thus, it was vital to raise standards of living and to create more jobs. The Government could help with this by improving incentives, and that was what the Budget had set out to do. Better incentives were badly needed; for it was only reasonable that people should want to work for a higher standard of living for their families. Furthermore, it was essential that the "market sector" should be successful if we were to have expanding public services.

Mr. Murray welcomed the Prime Minister's opening comments. He said there was a fair amount of agreement amongst the TUC on the aims of the Government, but there was argument about the methods. However, whatever their disagreements with the Government, they were anxious to play an active role in solving the country's basic problems - for example in NEDC, through MSC and ACAS, and more directly by consulting with government. Successive governments had recognised the need for close consultations with the TUC, and they hoped this would continue.

As regards aims, creating more jobs and improving the standard of living were high on their list of priorities. But they were bound to say that the Government's proposed methods would not, in their view, meet these aims. In their view, the Government's approach represented a retreat to the financial orthodoxy of the 1930's. The TUC had hoped that the Government would continue to build on the policies set out in the 1944 White Paper but instead, the Government's approach would simply

/mean a

mean a decline in output, employment and living standards over the next year. Moreover, they could not see how the Budget would squeeze out inflation. Inflation was a major worry; and although there were arguments about the merits of the RPI as an inflation indicator, this was still the measure which trade union members looked at. The Budget and other recent price increases were incompatible with the struggle to keep inflation down.

Mr. Murray went on to say that if the TUC fears were realised, the country would be heading towards a situation of "dynamism" rather than a situation which needed "de-dynamising". The Government would inevitably have to account for this.

The TUC were concerned about the regressive nature of the tax cuts in the Budget. They were, moreover, sceptical of the incentive argument. The studies on this subject did not support the proposition that there would be a significant supply side response. Moreover, it seemed all too likely that inflation would more than take up the reduction in taxation. The cut in the social wage, which the public expenditure reductions implied, was also a matter of concern.

The TUC also had reservations about the decision to end the rating revaluation. This would mean the continuation of inequities in the rating system, and they hoped that the Government would reconsider the decision.

As for the public services, the TUC did not wish to defend waste and they were keen to see improvements in efficiency in the public services. But cuts of an arbitrary kind would inconvenience people and damage the services in question; and they could involve a net cost - for example, cuts in bus services could mean increased costs for the economy as a whole. Moreover, cuts in public services would have employment implications for the private sector as well.

/ The TUC

The TUC welcomed the pensions increase which had been announced for November, but they were apprehensive about the change to a simple prices basis. They were also concerned about the failure to uprate child benefit. The TUC understood that increased social security benefits must involve a re-distribution of income, and they had challenged their members to accept this.

Mr. Murray then reiterated the TUC's endorsement for the Prime Minister's view that the first essential was to have a more competitive economy. One aspect of this was the application and exploitation of new technology. The TUC were committed to this, but trade union members needed to be confident that they would not lose their jobs; and public expenditure in support of industry helped to provide that confidence. The present outlook for school leavers was particularly grim, given the cuts in the Youth Opportunities Programme and in the public services generally.

Mr. Murray continued that the Election had not changed the basic economic arithmetic. In particular, imports continued to rise. However, much of industry's equipment was obsolescent, and it would only be able to compete if given the necessary time to change. The Government's proposed "pull-back" from industry would make this more difficult.

The TUC were concerned about the proposed sale of the BP shares. In view of the current oil situation, it would be much better to retain our equity interests in oil.

They believed there was a role for the private and public sectors in the economy. But this required a flexible approach from government. The decision to cut back the NEB was not conducive to this.

The TUC claimed a right to advise and consult with government; and they hoped that the present Government would

/take advantage

[ta]ke advantage of this. The quality of the trade union relationship with government would be determined very much by the Government's own initiatives. The trade unions had their own responsibilities, for example in protecting jobs, just as the Government had its responsibilities. In advising their members, they would have to take into account the way in which the Government responded to their concerns. The Government had to take responsibility for its actions, and one of the purposes of the present meeting was to draw to the Prime Minister's attention the likely consequences of the Government's approach to economic policy.

The Prime Minister said that she agreed that the economic arithmetic had not changed. The fact was that the UK had not been living within its means - as evidenced, for example, by the massive increase in external indebtedness over the past five years. It was essential that our means should now be increased. This involved stimulating people so that the economy would expand. She had found in her visits around the country a general desire that the proportion of gross pay taken in taxation should be reduced - so that individuals would keep more of the fruits of their own labour. The Government believed that when the tax cuts came through, some people at least would respond positively - and especially so in the small business sector. It was clear that small businesses would have to provide the jobs of the future. Large-scale industry would continue to expand, but on the basis of improved efficiency rather than by creating new jobs.

The Prime Minister then turned to Mr. Murray's criticisms of the Budget, which she felt were rather unfair. In the first place, there were very few people who would not be helped by the Budget. The numbers who were not paying any tax before the Budget were very small, and many people would now pay no tax at all thanks to the Budget; and families which had not been helped by the tax cuts would stand to benefit from the 17½ per cent increase in Family Income Supplement.

/Secondly,

Secondly, she doubted what Mr. Murray had said about incentives. In the Government's view, the reduction in taxation would make a significant difference to the way people worked. By the same token, there was a limit to the extent to which social security benefits could be increased; for such increases had to be paid for out of tax.

Thirdly, as regards higher rates of tax, top management deserved to keep a fair proportion of their income. If the economy was to improve, management performance must improve, too; and managers must be persuaded to stay in the UK. It was necessary, moreover, that pay differentials be "pulled out" in order adequately to reward skills in general.

Fourthly, she admitted that inflation was accelerating. But this was partly due to price increases which had already been in the pipeline before the Election, and to recent oil price rises. The increase in VAT to 15 per cent would also have its own impact. However, this was a once-and-for-all increase; other countries in Europe had higher rates of VAT; and 50 per cent of household expenditure was not subject to VAT. One of the purposes of switching from direct to indirect taxation was to give people a greater choice - so that they could decide whether to spend and on what, or whether to save. This was what democracy was all about, and many trade union members supported it. The tax tables showed that at every level of income individuals would be better off as a result of the Budget. It would be highly desirable for there to be a new index which included tax as part of the RPI so as to provide a measure of the standard of living. It was only logical for taxes to be included in the index since they paid for government services and such an index would make it clear what were the true effects of the Budget.

The Prime Minister then turned to industrial strategy. She said that it was vital to create more wealth in industry

/and to find

and to find a way through the current problems which beset British industry. The Government wanted the trade unions' help in improving output per head. UK productivity was woefully low by international standards, as shown by a number of recent studies. Key problems appeared to be overmanning, restrictive practices, and failure to use equipment properly; but these could only be put right on the shop floor. If only industry were more productive, real earnings could go up; and the public services could be expanded again, too. But this required action by government, management, trade unions and shareholders. There was no point in talking about more pay unless there was more output. Otherwise higher pay for one group could only mean taking it away from other groups. The Prime Minister said that she was appalled by the capacity of people in Britain to injure one another through pay leap-frogging.

The Prime Minister then said that higher pensions could only come out of higher output. But the Government had improved the position of war widows; in addition, improvements in the earnings rule would benefit pensioners.

Mr. Murray replied that the basic issue was whether people would respond as the Government hoped. In his view, the Government were taking a big gamble. Just as workers showed their pay cheques to the Prime Minister to show how much tax was being taken away, so they also pointed out to trade union negotiators how much was being taken away in higher prices. The TUC could only express their apprehension on this matter. They agreed that society needed more choice but they were worried about the timing of the present approach. For the standard of living over the next year was bound to decline. Mr. Murray went on to say that the Committee very much welcomed what the Prime Minister had said about industrial strategy. This was most constructive, and they agreed that all parties must work together to produce an adequate response in industry.

/Lord Allen

<u>Lord Allen</u> said that the Committee now understood the Government's aims and the way in which they intended to achieve them; but only in general terms. There still remained serious questions about the "nuts and bolts". He could not see that people would respond to the tax cuts if their standard of living was falling. The <u>Prime Minister</u> interjected that 50 per cent of goods were not VATable, and that the Government had no intention whatever of imposing VAT on them. <u>Lord Allen</u> said that a small proportion of the population would benefit from the Budget; therefore the approach was divisive, and would lead to the existence of two nations. The <u>Prime Minister</u> said that she could not accept this charge. Moreover, it would only be possible to help those at the bottom of the income ladder if the economy produced more.

The Prime Minister added that we should try to return to the era of steady growth of the 1950's. Although this had been called a period of "stop-go", we had achieved growth in every year and at an average of nearly 3 per cent. This had been achieved by reducing the bureaucracy and by de-control measures, and by allowing the people to keep more of their gross pay. As a result of this, expenditure on social services had been enabled to rise. The Germans had pursued policies of this kind, and we ought to emulate them. <u>Lord Allen</u> interjected that the trade unions were interested not only in wealth creation but wealth distribution as well.

<u>Mr. Evans</u> said that he was interested in the Prime Minister's proposition that there was no shortage of demand in the economy. But it did not follow that the Government's policies would solve our difficulties. Lack of investment was one reason for the increase in imports; and even if people did respond to the Budget as the Government hoped, productivity would not change overnight. In these circumstances, there was a need for selective import controls while the necessary changes took place. If it were not practical to impose import controls on Japanese goods, we should at least try to

/negotiate

negotiate a minimum UK content in imports. Rising import penetration was worrying and something must be done about it now. The Prime Minister referred to studies of the car industry One of these had shown that with identical equipment in the UK and Germany, producing the same vehicle, productivity in the UK was only half. She had also visited a car plant in Japan where they were unable to work three shifts because of the restriction on exports to Europe. By contrast, she had found on a visit to Halewood that the workforce there was only working one shift - and this despite a waiting list for their cars. On a visit to Cowley, she had been told by individual workers that they were sick and tired of interruptions; but stoppages still continued. Mr. Evans commented that, in his experience, shift working did take place at Halewood. As regards the comparative studies of UK and European plants, one reason why European plants did better was that they worked "back to back" shifts with no stopping of the production line throughout the day.

Mr. Jenkins said that, in his view, the economic arithmetic had changed. This was because of the recent developments in the energy market. He was surprised that the Government were contemplating selling off their equity in oil and gas. The Government's interest in oil and gas through BGC, BNOC and BP would produce huge revenues for the Exchequer in the years ahead. Moreover, the greater security of supply which ownership provided was an important factor. The physical control of our energy resources would become increasingly important: there was likely to be a shortfall of heating oil in the coming winter, and a Saudi collapse could not be ruled out.

The Chancellor said that it was possible to control the disposal of our energy resources without owning them. As regards revenue, the important issue was how it was used, whether in public or private hands, to improve the performance of the economy. The Government's view was that investing

/ the resources

the resources from North Sea oil in small- and medium-scale businesses was more likely to succeed than investing through the public sector. The Government were not doctrinaire about this - simply practical. Mr. Murray then pointed out that the NEB was investing in small businesses.

Mr. Jenkins reiterated that the Government must have control over the disposal of oil supplies. At present, too much oil was being diverted overseas. The Prime Minister commented that she, too, was very concerned about having adequate security of supply. But state ownership did not necessarily solve the problem: BNOC were presently selling substantial amounts of oil abroad on the basis of contracts taken out last year without conditions which would have enabled them to secure corresponding amounts of crude for UK use. Security of supply would only be assured through co-operation with other countries. Asked to comment, Mr. Gormley said he did not wish to, since members of the Committee had not followed the procedure which they had agreed before the meeting.

Summing up, the Prime Minister said that the Government had a passionate belief in its methods and its approach. She hoped that the trade unions and others would judge the Government by its results over the whole period of Office. The Government were anxious to succeed, but could not do so in isolation. They needed to mobilise with others, including the trade unions. She hoped that the Economic Committee would come back for further meetings as and when they desired; and if they wished, she would willingly see a smaller group.

Lord Allen thanked the Prime Minister for the meeting. He hoped that it had helped to provide the Government with a better understanding of the TUC's views; it had certainly helped them to understand the Government's position better.

25 June 1979

TL.

Distribution:

Private Secretary to the Chancellor of the Exchequer
Secretary of State for Employment
Secretary of State for Industry
Secretary of State for Energy
Sir John Hunt

cc J. Hoskyns
Sir K Berrill

PRIME MINISTER

As agreed at our meeting of 18 June, I attach a list of specific ideas - divided into those on which Government can itself act and those on which Government can only try to encourage. The list includes some proposals which, as I mentioned at the meeting, are being developed further within my Department.

In his letter of 19 June to the Home Secretary John Hoskyns asks for a list of outside speakers to help put across our message during the summer. I shall let him have my ideas shortly, but I think that he will agree that we shall need to be fairly subtle if any orchestration of outside help - as opposed to accepting spontaneous help by those who recognise the benefits of what we are trying to do - is to be effective.

I am copying this minute to colleagues who were at the meeting on 18 June.

KJ

K J

25 June 1979

Department of Industry
Ashdown House

ANNEX

POSSIBLE AREAS FOR ACTION

A. ACTION BY GOVERNMENT

1. Taxation and finance

(a) Phase out NIS (as a tax on employment).

(b) Tax relief for individuals investing in small firms' equity.

(c) Encourage share options for senior executives by tax exemption (proposals being developed).

(d) Increase personal share holding in industry by redressing tax balance as between direct personal and institutional investment (proposals being developed).

(e) Extend favourable taxation treatment of gilts to long-term corporate debentures (proposals being developed).

(f) Possible equity guarantee scheme for institutional investment (proposals being developed).

(g) Comprehensive programme of technical tax changes to benefit small firms.

(h) Eliminate distinction between earned and unearned income.

2. Incentives to work

(a) Clamp down on malingering - tighter control of, e.g., the issue of sickness certificates before strikes; periods without benefit before claim.

(b) Continued action to reduce the poverty trap more and more.

3. Incentives at work

(a) Continue to widen differentials in net earnings through taxation system to encourage acquisition of skills and acceptance of responsibility.

(b) Improve morale of supervisors and managers as opportunity offers (eg in both the public and private sectors by discouraging compromise in industrial disputes at the expense of managerial authority).

(c) Government campaign to increase the attractiveness of productivity and the unattractiveness of restrictive labour practices (proposals being developed)

4 Housing

(a) Phase out rent controls

(b) Remove all rent controls from new housebuilding for rent

(c) Systematically dismantle rent control and tenure in areas where housing supply and demand in balance

(d) Reduce stamp duty and other costs of movement (including legal fees, house agents' fees etc).

(e) Increase supply of building land by short suspension of development land tax

(f) Take special steps to facilitate mobile homes sites in areas of skill shortage

(g) Increase land supply by maximum disposal of public sector land.

5 Employment Protection

(a) Good redundancy schemes for overmanned nationalised industries.

(b) Weeding out of the employment protection legislation.

(c) Give industrial tribunals power to award costs where frivolous cases have been brought by employees.

6 Health and Safety

(a) Review role of Health and Safety Executive (and Commission). (Chief Executive of Health and Safety Executive publicly asserts that industrial efficiency is no concern of the HSE). Ask CBI to play more positive part in the Commission.

7 Training

(a) First priority: overcome - perhaps through EITB - AUEW opposition to dilution and replace the apprenticeship system by certification rather than entry to craft only through time serving.

(b) Review training arrangements and effectiveness

(c) Review the structure of the Manpower Services Commission and their training centres, and the effectiveness of the ITBs.

B ENCOURAGEMENT BY GOVERNMENT

16 Health and Safety

(a) Review pollution requirements

(b) Reduce over-sensitivity to environmental considerations (e.g Moss Morran and Whitby Potash)

(c) But (other side of the coin) consider the case for encouragement of better conditions at work as a real incentive to higher productivity.

17 Education

Although Government has little direct influence over the educational system, it can achieve a lot by sustained pressure:

Schools Curricula:

instilling economic realities (having to earn a living etc);

importance and attractiveness of industry (especially change attitude of teachers);

stress need for greater relevance (e.g maths and computer sciences);

importance of getting able girls into industry, etc.

18 Productivity

(a) Possible body to enquire into and publicise restrictive labour practices

(b) Encourage visits by shopfloor workers (and shop-stewards) to plants in main competitor countries.

(c) Encourage better manpower planning by firms (e.g use of skilled and highly qualified manpowers).

(d) Encouragement of able women to enter industry as a major source of untapped talent.

19 Europe

Seek to change public attitudes to Europe, to become more positive and less grudging.

20 The City

(a) Encourage (by speeches and contacts) the institutions to look beyond the end of their noses and to protect their members' interests in the broadest sense by encouraging enterprise and growth in the UK economy.

/(b)...

8 Energy

(a) Develop energetic nuclear power programme (use of PWR if necessary?)

9 Women

(a) Allow women to set child-minding expenses against personal taxation;

(b) Allow working wives to be taxed separately without husbands losing the married person's allowance.

10 Microelectronics, science and technology etc

(a) Increase enlightened clientship in public purchasing

11 Accountancy

Prepare to take power to accelerate introduction of inflation accounting to help destroy the "money illusion" in companies and to aid public (and Trade Union) understanding of reality.

12 Power of Unions in public sector

Diminish power of Civil Service unions by reducing "facility" time, withdrawing (or threatening to withdraw) willingness to deduct union dues from wages and salaries, reasserting managerial authority (e.g in reporting standards) etc.

13 Privatisation of public services

Embark on a systematic campaign to reduce dependence of individual on state employees for services (e.g refuse collection by private contractors).

14 Change style of Civil Service

De-privilege the Civil Service (and Academia?) by reducing security, greater ruthlessness in use of premature retirement, etc.

15 Europe

Systematic assessment of the burdens of EEC membership on industry - standards, product liability, pollution etc

(i) to identify and prevent "overkill"

(ii) to identify differential standards of compliance.

(b) Elimination of exchange controls

(c) Promote use of non-executive directors to encourage spread of more open and enlightened management practices.

(d) By speeches etc. Ministers to make clear that the Government expects the City generally to bestir itself.

21 Publicity

Seize every opportunity to put across to public opinion the gravity of our industrial situation and the fact that the world does not owe us a living.

IC Division

22 June 1979

25 JUN 1979

11 12 1
10 2
9 3
8 4
7 6 5

cc M J:le [illegible] (PJ).

COVERING CONFIDENTIAL

Bf= [illegible]
22/6/79
PJ

PRIME MINISTER

cc Mr Hoskyns.

GOVERNMENT STRATEGY

As agreed at the meeting held on 19 June I attach a list of specific ideas which could help in stimulating economic revival in this country. As you will see, most of the ideas are positive; we are already engaged in removing many of the negative constraints on activity.

I am copying this to those present at the meeting.

[illegible]

MH

22 June 1979

CONFIDENTIAL

GOVERNMENT STRATEGY

POSITIVE IDEAS

i. Examine the relationship of industrial needs and attitudes at all stages of the educational system.

ii. Consider how the public sector agencies can make their skills available to the private sector for international trade purposes. For example, the role of the British Airports Authority and the Civil Aviation Authority in helping our consultants and contractors to get part of the vast international airport construction market.

iii. Stimulate the small and large shareholder to play a proper role in the dialogue with Government and in the performance of the companies they own.

iv. Define what the Government wants from the little NEDDIES and sector working parties. We should work to create the climate, provide the incentives, remove the constraints, and ask the uncomfortable questions, all with the purpose of improving the performance of British industry.

v. Devise urgently a range of incentives of part of our regional and industrial policy to ensure that our new and future tax reductions go into increasing wealth-creating activities. The basic concept should be tax rebates - PAYE, corporation and investment income surcharge - to those who have shown by the fact that they paid such taxes that they are likely to be able to use such rebates more effectively than those currently receiving industrial aid for projects, many of which would go ahead anyway.

vi. Ask Lord Jellicoe as the new President of the Association of British Chambers of Trade to recruit the Director General of the NFU to show him how the job needs to be done of turning the inarticulate voice of small industry into a vociferous and influential and political force.

vii. Involve the leaders of the new immigrant communities in a dialogue to see if anything more needs to be done to harness the range of entrepreneurial skills widely spread amongst many of these people.

viii. Draw up and orchestrate a continuing programme to articulate the profound nature of the individual resurgence we are seeking to create.

ix. Initiate a comprehensive programme to stimulate a better climate of communication in British industry between managers and men. As a first step, copy the examples of some of our leading companies and promote the election of workers - not trade union representatives! - to the Boards of their pension funds. If we want them to understand capitalism let them be involved in influencing the destiny of their own savings. Nothing would so open people's ideas to the real nature of City and financial activity.

x. Launch a nationwide debate about the opportunities for improved productivity involving the unions and management - both public and private sector - in the range of inhibitions that now exist.

xi. A comprehensive review and programmes for implementation of all forms of employee profit sharing schemes.

xii. To encourage big firms to help small firms with advice and expertise, including examination of the precedent of the London Enterprise Agency.

xiii. Structure tax and depreciation provisions for companies so that a higher proportion of reinvestment capital is, in effect, subject to competitive capital market tests of profitability.

xiv. Encourage the small to medium firms by slanting Government contract arrangements for supplies and services in their favour (though still with competitive tendering).

xv. Break down contracts as far as possible into small amounts that smaller and new undertakings can cope with even if it might seem to cost more in the first instance.

xvi. Examine the possibility of City financial institutions entering partnerships with educational establishments for the building of universities, polytechnics and college buildings: for example, the City Polytechnic's latest building was built with bank money in a declining area of the City.

xvii. Review scope for, and stimulate, private sector competition to supply public sector services (eg transport, refuse collection, housing and maintenance).

xviii. Initiate a dialogue with local government on stimulating new and small businesses.

xix. Examine labour mobility in depth.

xx. Extend the scope of the Monopolies Commission to let them examine ineffective large holding companies in the private sector where these have become insensitive to commercial pressure.

xii. An interdepartmental review of the 'enterprise zone' concept should be concluded rapidly.

CONFIDENTIAL

cc M. Vile

BF Wednesday next

TL

PRIME MINISTER

GOVERNMENT STRATEGY

At your meeting of 18 June to discuss John Hoskyns' paper on Government strategy, you asked me to let you have a list of my ideas of areas where action could be taken to relieve constraints on the supply side of the economy.

The principal constraint on improving the competitiveness of British industry is undoubtedly the attitudes of management and unions. The lack of entrepreneurial spirit among the former, particularly in large companies, and the restrictive atitudes of many of the latter must be major factors in our inability to harness the latest technology, to improve productivity, and to seek out new markets for our products. Such attitudes are the product of history, culture, social structure and previous Government policy and will not, as we discussed, be changed overnight. British industry is also very production rather than marketing oriented. The tax reductions in the budget removed some of the disincentives to enterprise, but they will not be enough on their own. Similarly our intention to reverse the growth of the monopoly power of the unions will take time.

In the list attached (which can, of course be extended almost indefinitely), I have therefore concentrated on some areas of Government action which appear to me to have an impact on our industrial performance. I am not suggesting that action can or should be taken on all of these problems but on most I think we are clear about the direction in which we propose to move.

CONFIDENTIAL

I have seen a copy of John Hoskyns' subsequent letter of 19 June to William Whitelaw which asked us to add to the list the names of possible outside speakers who could put across our message this summer. I think we should continue to court the Conservative Trades Unionists - and you might consider asking them to a drinks party at No 10. If it became fashionable to join the CTU, the right sort of speakers might emerge from this nursery. We need to show that government Ministers are interested in their views. People like Lord Robens and George Brown are not likely to carry much credibility with the new generation of trade unionists. Obviously the primary responsibility must fall on Ministers themselves to continue to maintain the support of the large proportion of trade union members who voted for us at the election. I think this will be achieved by firm actions rather than fine words. As far as outside speakers are concerned, I am reminded that while in Opposition we in fact compiled a list of supporters who were prepared to take an active part in putting across our case. I suspect that they feel somewhat neglected at the moment and it might be a good idea if John Hoskyns were to liaise with Research Department who were, I believe, the repository of that list.

I am sending a copy of this minute to the Chancellor of the Exchequer and the Secretaries of State for Industry, Energy, Employment and the Environment, the Lord President, Sir John Hunt, Sir Kenneth Berrill and John Hoskyns.

T. Ables

1 Victoria Street
LONDON SW1
22 June 1979

JOHN NOTT
(Approved by the Secretary of State
and signed in his absence)

LIST OF SUPPLY CONSTRAINTS

LABOUR

(a) Housing:

- Immobility created by Council Housing system
- Rent Acts and tenant security
- Housing (Homeless) Persons Act 1976

(b) Employment:

- Employment Protection Act etc
- ACAS etc which make it easier for Unions to establish themselves in new firms (Unions = declining productivity)
- Closed shop legislation

(c) Skilled Labour

- Improved technical training and re-training for school leavers and adults. (Whole area of apprenticeship needs looking at and made more attractive)
- Effects of income policies/improved differentials
- Levels of income tax

CAPITAL

- Need for a strong and effective competition policy
- Need for further relaxation of exchange controls
- Company taxation
- Effects of regional policy in preventing natural expansion and fragmenting industrial development
- Removal of the present need for separate application procedures for Industrial Estates Corporations and Investment Grants
- Undue obligations and burdens on small firms

LAND

- Land Commission
- Land Taxation
- Public Sector Land Holdings (eg London Docklands)
- Extended Planning Procedures
- Building Regulations generally
- Inadequate supply of suitable premises and sites (particularly for small firms)

TECHNOLOGY

- Monopoly power of nationalised industries (eg supply of power, telephones, etc)
- Arbitrary technical standards by nationalised industries (eg nuclear power, telecommunications).

Covering SECRET

1

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

20th June 1979

Dear Tim,

R.

POST BUDGET FORECAST

..... The Chancellor has asked me to let you have for the Prime Minister a copy of the attached Treasury report which amplifies the economic forecasts in the Financial Statement and Budget Report.

This is the document which the Prime Minister asked that the Secretary of State for Employment should see before Questions yesterday.

Yours ever,

Tony Battishill

(A.M.W. BATTISHILL)

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

SECRET No. 4 2

POST-BUDGET FORECAST: THE ECONOMIC OUTLOOK TO END 1980

The attached report, which amplifies the economic forecasts contained in the Financial Statement and Budget Report, is circulated for information.

This report is for the personal use of the recipient and should not be shown to anybody else without authority from me.

H P EVANS
SD1
14 June 1979

PW.

CONTENTS

Prime Minister

This is the Treasury's "post-budget" forecast, which the Chancellor has asked me to show you. I suggest you just look at the figures at Flag A.

TL.
22/6

H M Treasury
Parliament Street
London SW1

Introduction

The relevant extract from the FSBR, showing the published forecast text and tables, is attached. The detailed tables of the public sector transactions shown in Parts II and III of the FSBR are consistent, except in some minor details, with the forecasts presented in this note. These discrepancies reflect difficulties in incorporating information from the sources used in compiling the FSBR whilst allowing the model to iterate, and they should not be regarded as significant.

This note presents fuller details of the forecast and policy assumptions and also covers the period to the first quarter of 1981. The second year of the forecast has not been subject to the same close attention as 1979/80. The economic effects of the budget, including the effects of the exchange control package are also described. It should be noted that certain aspects of this forecast, notably unemployment, the exchange rate, interest rates and the economic effects of the Budget are not being quoted publicly.

The post-budget forecast is compatible with the latest National Accounts' estimates to 1978Q4. Where it is available data for 1979Q1 has also been incorporated into the forecast. There have been substantial (and offsetting) revision to past data on investment and stocks. Also, the extent to which the trade balance deteriorated in the first quarter was not foreseen and is the main reason why GDP now seems likely to have been about 1½% lower than forecast in February.

The main features of the forecast are summarised in Table A. A selection of the usual print-out tables is attached.

SECRET

A.

TABLE A: June Post-Budget - Summary of Forecast

PERCENT CHANGE ON YEAR EARLIER

GDP Volume	June Post-Budget
1978 H2	3.0
1979 H2	-0.7 -
1980 H1	-1.0 -
1980 H2	-0.6 -
Manufacturing Production	
1979 H2	-1.4 -
1980 H1	-2.4
1980 H2	-1.8
Personal Consumption	
1979 H2	0.8
1980 H1	-0.5
1980 H2	1.0
Average Earnings	
1978 Q3	14.2
1979 Q3	14.1
1980 Q3	15.2
Retail Prices	
1978 Q4	8.1
1979 Q4	17.6
1980 Q4	13.3

LEVELS

Current Balance	
£bn 1978	0.3
1979	-0.5
1980	0.2
Effective Exchange Rate	
1979 Q1	63.9 -
1980 Q1	63.6 -
1981 Q1	60.2 -
Labour Cost Competitiveness (increase represent worsening)	
1979 Q1	96.8
1980 Q1	102.7
1981 Q1	103.8

Interest Rates	Short	Long
Average 1978/79	$10\frac{3}{4}$	13
Average 1979/80	$12\frac{1}{4}$	13
Average 1980/81	$12\frac{3}{4}$	14

PSBR £bn (in brackets % GDP at market prices)

1978/79	9.2(5.6)
1979/80	8.3(4.4)
1980/81	9.7(4.5)

Unemployment	Including school-leavers	Excluding school-leavers.
1979 Q1	1.4 m	1.4 m
1980 Q1	1.7 m	1.6 m
1981 Q1	2.1m	1.9 m

PL.

EXTRACT FROM FSBR

ECONOMIC OUTLOOK TO 1980

Introduction and summary

The prospect is for economic activity to decline slightly over the next year or so. Retail price inflation increases during 1979 and falls again during 1980. The current account of the balance of payments is forecast to remain close to balance. Public sector borrowing, as a percentage of GDP, is cut sharply from the 1978–79 level.

2. Tables 3 and 4 set out the forecasts and give some indication of the orders of magnitude of the errors which could be involved. These forecasts are used in preparing the projections for the public sector in Parts II and III of this report.

Policy assumptions

3. Monetary and fiscal policy assumptions for 1979–80 are determined by the Budget proposals. Growth of the money supply is assumed to be in the centre of the target range. In April 1980 all specific duties and income tax allowances and bands are assumed for forecasting purposes to be adjusted in line with price increases during 1979. Firm control of the money supply is assumed to continue during 1980–81. The Government has not yet reviewed public expenditure plans for 1980–81 and there is therefore no firm basis for a forecast. For present purposes the level of planned expenditure now decided for 1979–80 is simply extrapolated into 1980–81. The exchange rate is taken as determined primarily by market forces.

Domestic demand

4. The prospect is for rather little change in real personal disposable incomes over the next year. This reflects the lack of buoyancy in economic activity, and a number of specific factors tending to raise prices. The upward step in prices following the indirect tax changes reduces the real value of existing savings in money-denominated assets; there is evidence that this encourages consumers to save in order to re-establish the real value of existing savings. For this reason the fall in the personal savings ratio after the Budget is likely to be small and the impact on personal consumption to be correspondingly large. The savings ratio is forecast to stay close to the historically high figure of 15 per cent. The ratio of wealth to income will also remain low compared with earlier years. The forecast path of personal consumption is fairly flat over the next year. The variant in Table 3 shows the possible consequences of a lower outcome for savings. The savings ratio is assumed (before allowing for multiplier effects) to be 2 per cent lower than in the main forecast. This lower ratio would still be

very high compared to any year prior to 1974. The variant shows that this development alone could add some 1½ per cent to GDP by the first half of 1980, converting a small fall into a small rise.

5. The forecasts of private investment are largely based on intentions surveys, though it is likely that respondents did not allow for as sharp a check to activity as is now forecast. While there is some (highly fallible) econometric evidence about the scale and pace at which investment responds to changes in output it may also be true that monetary and fiscal policy will have relatively favourable effects on industry's confidence in the prospect for non-inflationary growth in the longer term. The recent high level of interest rates cannot, however, be favourable to investment. On balance total private sector investment is forecast to be roughly constant over the period of the forecast.

6. Stockbuilding, however, is forecast to decline and may become negative by the first half of 1980 since the starting point is one of high stocks in relation to output, particularly for manufacturing.

7. The forecasts of public expenditure provide for a full allocation of the (reduced) contingency reserve as well as for a likely level of shortfall. As a result of the cuts in programmes and the squeeze imposed by the Government's policy on cash limits there may be a small fall in general government expenditure on goods and services (both consumption and investment) over the next year.

Output

8. The prospect is for a small fall in the level of total output over the next year although the forecast change is well within the known margin of error. Domestic demand is weak because of the effects of the Budget and because private sector investment—both in fixed assets and stocks—is passing a peak. Moreover, export volumes—apart from oil—are held back by poor competitiveness, and the upward trend in the share of demand met by imports may continue. Within a total picture of slightly falling output, North Sea oil production will expand quite rapidly, while manufacturing output is likely to be weaker than output in total, reflecting adverse overseas trade movements.

Inflation

9. The outturn for earnings growth in this pay round, based on the latest earnings and settlements figures, looks like being close to the 14 per cent experienced in the previous pay round. The forecast of earnings from this autumn onwards takes account of the impact of rising prices, the increases in disposable income arising from the Budget reductions in income tax, tight monetary policy and the ability of employers to pay, as well as the commitment to comparability payments in parts of the public sector. Past relationships are not a strong guide in this area and so the forecast is subject to a very wide margin of uncertainty. Subject to this important proviso the forecast shows earnings in the private sector rising at much the same rate as in the last year or two, with rather larger increases in the public services.

10. Even without the Budget the prospect was for some further increase in the rate of inflation this year, partly because of a number of favourable factors affecting last year: notably roughly stable import prices for food and basic materials, reflecting the strength of sterling and the weakness of commodity prices. This year oil prices are up sharply and there are firmer trends in other commodity prices. Moreover there are some domestic factors (*e.g.* the National Insurance Surcharge, local authority rates) tending to raise prices faster this year; and it is likely that some producers will be keen to improve their margins, though the scope for this will be limited by the tightness of monetary and fiscal policies. The Budget itself is estimated to add about 4 per cent to the RPI in the third quarter of this year, leading to a total increase of about 16 per cent. The late date of the Budget means that the impact of indirect tax increases will come entirely in the third quarter of 1979 rather than in the second quarter. Once this effect has taken place retail price inflation in the following year—despite some price effects of the public expenditure measures—is forecast to fall back to around 13½ per cent.

World economic prospects

11. 1978 saw a growth of about 3¾ per cent in GNP in the OECD area, with some slowdown in the United States being compensated by faster growth in Canada, Germany, Italy and some smaller countries. A further, more substantial, slowdown in the growth of United States activity seems probable in 1979 and the first half of 1980 and as a result GNP growth in the OECD area may be around 3½ per cent in 1979 falling to below 3 per cent in 1980. But because the United States is contributing less to total growth and some smaller countries, with higher import propensities, may be growing faster the prospects for trade may be rather more favourable than the GNP aggregates suggest. Weighted appropriately for United Kingdom exports the volume of trade in manufactures is forecast to recover from a very slow increase of about 3 per cent in 1978 (itself an unusually low figure in relation to activity) to an annual rate of some 5–6 per cent from now on.

Trade volumes

12. In 1978, United Kingdom exports of manufactures (less erratics) fully matched the estimated increase in world trade in manufactures, despite the past tendency for United Kingdom exports to lose share in world markets. The figures for the first four months of 1979 are very difficult to interpret, owing to distortions resulting from industrial action. But the indications are of a less favourable performance. The forecasting judgment is that the trend loss of United Kingdom share is unlikely to have disappeared and during the forecast period it is likely to be reinforced by the growing impact of unfavourable competitiveness. As a result of a strong exchange rate and substantial pay settlements, United Kingdom labour costs rose sharply in the first half of 1979 relative to our main competitors. The implication of the forecasts for costs and the exchange rate is that competitiveness over the next year remains close to its level in the first half of 1979, having worsened by some 8 per cent compared with 1978 and 13 per cent compared with 1977. The evidence strongly suggests that, particularly on exports, trade volumes are adversely affected with a considerable lag and so the consequences of the recent changes in relative costs continue to affect the economy through and beyond the period of this forecast. Thus despite a slightly better prospect for world trade over the next year the prospect is for a fairly flat path of exports of manufactures at a level well above the first half of 1979 but a little below the second half of 1978.

13. The volume of imports of manufactures rose by 13½ per cent in 1978, some of the increase reflecting the strong rise in United Kingdom demand. Total imports of goods and services went up 4½ per cent. Over the next year, with domestic demand tending to fall, the rise in imports, particularly of manufactures, should tail off, though the tendency for domestic producers to lose share in the domestic market for manufactures seems likely to continue, partly because of the poor level of competitiveness. Imports of goods and services are forecast to rise 1 per cent over the coming year from the rather high level in the first half of 1979.

14. Including the effects of increasing oil production the visible balance in volume terms is likely to have deteriorated substantially in the first half of 1979 but is forecast to recover to about its 1978 level by the end of the forecast period.

15. The United Kingdom current account benefited in 1978 from a significant improvement in the terms of trade originating in particular, from weak commodity prices. Although there will probably be some further improvement in the overall terms of trade this year this is more a reflection of changes in relative prices of UK and overseas manufactures. While the increase in oil prices has comparatively little effect on the United Kingdom's terms of trade, world prices of industrial materials may at least keep pace with those of manufactures.

16. The surplus on invisibles declined in 1978, mainly reflecting increasing transfer debits—notably payments to the EEC. Some further decline in the invisible surplus seems likely during the period of the forecast. Although the surplus on the services account may begin to rise again transfer debits will continue to increase and the balance on interest, profits and dividends is also likely to worsen, particularly for oil, where North Sea oil profits accruing to foreign-owned companies are increasing rapidly.

17. The net effect of these various trends is to suggest a fairly stable picture with the current account remaining in approximate balance.

PSBR

18. Last year saw a PSBR of £9¼ billion (5½ per cent of GDP at market prices), after £5½ billion (4 per cent) in the previous year. The forecast for 1979–80 is £8¼ billion (4½ per cent): this is about £2¼ billions less than the figure implied by a continuation of the 5½ per cent reached last year. In 1979–80 the effects of the Budget are partly offset by the cost of comparability wage payments in the public sector.

Margins of error

19. The inevitably large margins of error associated with economic forecasts have been regularly emphasised in Government publications and estimates of average errors in past forecasts have been shown. On this occasion these estimates are presented adjacent to most of the key components of the forecast in Table 3. These estimates are in no sense the maximum errors that are likely to occur. For one thing they are based on the average not the largest size of errors recorded in the past. Secondly, for Part A of the table the errors relate to comparisons of the forecast with a relatively long and firm base; errors relating to changes from a six-month period which is itself a forecast will tend to be higher, because the initial period as well as the final period of the comparison is subject to substantial error. This is particularly important for the first half of 1979 which was substantially affected by industrial disputes. Thirdly, there is no clear presumption that past errors are a good guide to future errors. Both the way forecasts are made and the factors influencing economic fluctuations tend to change over time. On the present occasion the large

changes in the Budget itself may tend to increase margins of error. The forecasts are largely based on economic relationships fitted to the historical data of the last 10 or 15 years. Although the economy is modelled in such a way as to take account insofar as possible of the effects of policy changes, it remains a possibility that large changes in policy will affect the economy in ways which are not foreseen. It is particularly difficult to take account of possible changes in confidence and expectations or, for the slightly longer term, of the effect of incentives on supply side relationships.

Table 3. Economic Prospects to 1980

	Main forecast	Lower savings variant	Margin of error([1]) (plus or minus)
A. *Output and expenditure at constant 1975 prices*			
First half 1979 to first half 1980; per cent change:			
Gross domestic product (at factor cost)	−1	+½	2
Consumers' expenditure	−1	+1	2
General Government expenditure on goods and services ...	−2½	−2½	2([2])
Public corporations' fixed investment	−4½	−4½	8
Private sector investment	−½	+1	5
Exports of goods and services	5½	6½	4
Stockbuilding (as per cent of GDP)	−½	0	1
Imports of goods and services	1	3	3½
Manufacturing production	−2½	−½	5
B. *Balance of Payments on current account*			
£ billion:			
1979 First half	−¾	−¾	..
Second half	0	−½	¾
1980 First half	0	−¾	1½
C. *Public Sector Borrowing Requirement*			
£ billion; in brackets percentage of GDP at market prices:			
Financial year 1978–79	9¼ (5½%)	9¼ (5½%)	..
Financial year 1979–80	8¼ (4½%)	7¼ (4%)	2¼
D. *Retail Price Index*			
Per cent change:			
Third quarter 1978 to third quarter 1979	16	16	1
Third quarter 1979 to third quarter 1980	13½	14	5
E. *Money Supply (Sterling M3)*			
Per cent change:			
Mid-June 1979 to mid-April 1980 (at annual rate) ...	9	9	..

(1) The errors relate to average and not maximum errors (on either side of the central figure) experienced in the past. They have been calculated in much the same way (and in many cases are identically the same figures) as those published in the previous Industry Act forecast (Treasury Economic Progress Report Supplement, November 1978, Table 3). The figures for the current account and PSBR were standardised as percentages of GDP and the figures quoted in £ billion therefore reflect the general increase in current price magnitudes. In Section A, however, the errors are likely to be under-estimates of the true margin of uncertainty in the forecast changes shown. This is because the errors relate to changes between the relevant forecast period and a "base period" spanning the four quarters prior to the completion of the forecast. Errors in forecast changes over a period starting with a relatively short "base" (in this case the first half of 1979) which is itself highly uncertain are liable to be greater.

The errors in Section A (apart from manufacturing output) are based on forecasts between June 1965 and November 1976. Sections B and D plus manufacturing output use forecasts between June 1970 and November 1976. Section C uses PSBR forecasts made at the time of the Budget in the years 1967–76. Apart from manufacturing output the errors have been adjusted for subsequent major changes in fiscal policy.

(2) Margin applies to General Government Consumption.

TABLE 4. FORECASTS OF EXPENDITURE, IMPORTS AND GROSS DOMESTIC PRODUCT

£ million at 1975 prices, seasonally adjusted

	Con-sumers' expendi-ture	General Government expenditure on goods and services			Other fixed invest-ment	Exports of goods and services	Stock-building	Total final expendi-ture	*Less* imports of goods and services	*Less* adjust-ment to factor cost	*Plus* Statistical Adjust-ment(1)	Gross domestic product at factor cost(1)	GDP index 1975 =100
		Final con-sumption	Fixed invest-ment	Total									
1977	62,950	23,300	3,850	27,150	16,100	31,500	1,000	138,700	30,350	10,800	100	97,650	105·0
1978	66,400	23,650	3,350	27,000	17,100	32,250	950	143,700	31,750	11,450	0	100,500	108·1
1979	68,350	24,000	3,300	27,300	17,000	32,100	450	145,200	33,100	11,600	350	100,850	108·5
1978 first half ...	32,800	11,800	1,750	13,550	8,550	15,900	550	71,350	15,800	5,700	0	49,850	107·2
second half ...	33,600	11,850	1,600	13,450	8,550	16,350	400	72,350	15,950	5,750	0	50,650	109·0
1979 first half ...	34,350	12,000	1,700	13,700	8,500	15,700	250	72,500	16,500	5,800	250	50,450	108·5
second half ...	34,000	12,000	1,600	13,600	8,500	16,400	200	72,700	16,600	5,800	100	50,400	108·5
1980 first half ...	34,050	11,900	1,500	13,400	8,400	16,600	−150	72,300	16,650	5,800	100	49,950	107·4
Percentage changes													
First half 1978 to first half 1979 ...	4½	2	−2	1½	−1	−1		1½	4½	1		1	
Second half 1978 to second half 1979	1	1½	−3	1	−½	½		½	4	1		−½	
First half 1979 to first half 1980 ...	−1	−1	−12	−2½	−1½	5½		−½	1	0		−1	
Percentage changes at annual rate													
First half 1978 to second half 1979	2½	1	−6	0	0	2		1½	3½	1		1	
Second half 1978 to first half 1980 ...	1	½	−6	−½	−1½	1		0	3	½		−1	

(1) All figures in Table 4 are based on "compromise" estimates of gross domestic product. The statistical adjustment reflects the different movement of expenditure and compromise series.
Note: Figures in £ million are rounded to £50 million. Percentage changes are calculated from unrounded levels in £ million and then rounded to ½ per cent. The GDP index in the final column is calculated from unrounded numbers.

Policy Assumptions and Forecasting Issues

Policy Assumptions

For the 1979/80 financial year the policy assumptions incorporated in the forecast are those set out in the FSBR and budget speech. The exchange rate has been assumed to be determined by market forces from 1979Q3 with modest net intervention designed to smooth the path of the exchange rate. Also the growth in £M3 is forecast to be at about the mid point of the 7-11% target range for the Banking year to April 1980. This is consistent with a small fall in interest rates from current levels. For the 1980/81 budget it has been assumed that personal tax allowances and bands, and the specific duties are revalorised. The volume of public expenditure is assumed to be at the same level as in 1979/80. This implies additional cuts above those announced for 1979/80. Local authority rates, known for 1979/80, have been assumed to grow broadly in line with earnings with an additional increase in response to the cut in the RSG announced in the Budget. The increase in Nationalised Industry prices this year reflects the best forecast judgment; in 1980/81 their prices are assumed to respond so as to reduce borrowing.

Forecasting issues

Earnings

Pay settlements in the private sector have been averaging 11-12% in the present pay round which with allowance for "wage drift", brings the growth of earnings to around 14%; close to the previous pay round. In the present pay round, and to a far greater extent, in the 1979/80 pay round earnings in the public services will be boosted by the effects of comparability agreements. In cases where we now have no direct evidence on the size of comparability awards they have been assumed to average 10%, though these are taken to come on top of "normal" increases for the 1979/80 pay round; the latter are taken to be about 3% lower (in terms of earnings rather than settlements) than private sector increases in the same period. Between the financial years 1978-79 and 1979-80 average earnings in the public service sector are forecast to rise by about 17½%; on 1980-81 the increase is put at 19%.

One of the crucial judgments is the extent to which these increases in public services pay encourage leap-frogging demands from the private sector. Some small allowance for this and for continued pressure to restore differentials or relativities is built into the forecast. Private sector and nationalised industry earnings increases are forecast to average around 15% in the 1979/80 pay round.

Prices

In constructing the price forecasts a small allowance has been made for the abolition of the Price Commission and the weak financial position of companies. This amounts to an addition of ½% to mainly cost-determined prices by the fourth quarter of 1979.

Trend Productivity

In the post-budget forecast trend productivity in manufacturing has been revised downward by ½% to 1¾% per annum and in non-manufacturing (other than public services) by ¼% to 1¼% per annum. This reflects our judgment about the recent trend in the relationship between output and employment.

Trade volumes

Preliminary assessment of strike effects in 1979Q1 suggests an underlying 8% loss in volume terms of exports of manufactures. It has been assumed that 6% is made good during Q2 and Q3. The experience of recent months has led to a partial discounting of the particularly high level of exports in 1978H2 in setting residuals for the future. The volume of imports in the first four months of this year taken together appears to have been relatively little affected by strikes and there were some indications that the underlying increase in the volume of some categories was a little above expectations. However not much weight has been given to this in residual judgments.

World Trade and Competitiveness

The growth in world trade embodied in this forecast is very subdued with an increase of about 4% in 1979 from 1978. This represents a downward revision from earlier views to take account of higher world oil prices. This factor has also had a material effect on our view on UK cost competitiveness. The exchange rate in the second quarter of this year has been unexpectedly high. The rise in the world price of oil, with the UK moving towards becoming a net exporter of oil, has contributed to an upward revision to the forecast of the exchange rate. Partly as a result of this cost competitiveness improves only slightly from the position estimated for 1979Q2. The forecasts for world oil prices are for increases in the average price of marker crude to $17.50 per barrel by 1979Q4 (ie 38% on 1978Q4) and $18.63 by 1980Q4. This represents a major source of uncertainty and recent developments in the world oil market make these forecasts look too low.

The Economic Effects of the Budget Table B

The overall effect of the Budget is to reduce output and employment in the first year or two below what they would otherwise have been. This is partly because in aggregate it reduces public sector borrowing, but more importantly because its composition is unfavourable to output.

Changes in public expenditure on goods and services have a larger effect on measured output than tax changes because the leakages into saving and imports are smaller. Despite the fact that a sizeable part of the public expenditure package is not expenditure on goods and services (eg sales of assets, deferment of RDG'S), sufficient demand-rich elements remain to have a significant effect on output. The estimated change in unemployment reflects the change in output, with the additional factor that the reduction in expenditure on special employment measures has a relatively large impact on unemployment.

On the tax side the switch from income to indirect tax is estimated to reduce output and employment below what they would have been, although the full year revenue effects roughly cancel out (£4½ billion for income tax and £4¼ billion for indirect tax). This is mainly because changes in indirect tax have a bigger impact on consumption, because of their greater effects on real income and real wealth. A given amount of revenue collected from indirect taxation reduces real income more than the same revenue collected from income tax, partly because the tax base is smaller (consumption instead of income) and partly because, to raise the revenue, the change in prices has to be extra large so as to offset the loss in revenue caused by consumers' substituting away from the goods on which tax is levied. Real wealth falls when indirect taxes and hence prices are increased and this in itself raises savings at the expense of consumption.

The higher level of the RPI resulting from the Budget is mainly a consequence of the rise in indirect taxes, with a very small contribution from higher nationalised industry prices, prescription charges and net mortgage payments (resulting from the reduction in the basic rate). The estimate of 4.6% shown for 1980Q1 for the whole Budget is higher than the "impact" effect of approximately 4%, partly because nationalised industry prices on intermediate goods (eg industrial purchases of gas) take time to feed through. On the other hand the higher exchange rate and lower pressure of demand resulting from the Budget hold prices lower than they would otherwise be.

In the longer run the pressure of demand effect will more than offset the initial price effect, but this may take some years.

The estimates for the RPI are expressed as changes in the level of prices. If they were expressed as changes in the annual rate of inflation the estimate for the year to 1980Q1 would be 5.2% (higher than the change in level, because the same absolute difference in 1980Q1 is expressed as a percentage of the level in 1979Q1 rather than of the higher level of 1980Q1). The estimate for the year to 1981Q1 would be -1.5%. Thus the downward pressure of demand and exchange rate effects on inflation are making themselves felt in the second year.

The reduction in the PSBR caused by the whole package is estimated at £1.6 billion. If this absolute amount is added to the post-Budget forecast of £8.3 billion a pre-Budget forecast of £9.9 billion is obtained (ie about £10 billion as in the Speech). If the Budget were defined differently, for example to exclude rather than include Rooker-Wise indexation, the increase in PRT announced in August 1978 or some or all of the cash limits squeeze announced last month, the pre-Budget forecast of the PSBR would also be different.

The Budget is not expected to have a significant impact on interest rates in the current financial year; it is expected to reduce rates slightly in 1980/81. (The estimates all assume unchanged monetary growth.) This may appear surprising in view of the reduction in public sector borrowing. Again the explanation lies in the composition of the whole Budget. On the public expenditure side, the disposal of assets is expected to reduce interest rates by relatively little. On the tax side, the switch to indirect taxes and the net rise in nominal incomes tends on balance to raise the demand for money, and so higher interest rates are required to keep to the existing rate of monetary growth.

The "other" column in the table includes the effects of the relaxation of exchange controls, minor changes in direct tax (Corporation Tax, PRT, etc), and confidence factors associated with the Budget as a whole but not attributable to any of the components. These factors include small increases in consumers' expenditure and private fixed investment, and a slightly higher exchange rate than would otherwise have occurred.

TABLE B

ECONOMIC EFFECTS OF THE BUDGET[a]

Changes in:	Public expenditure	Indirect taxes	Major income tax	Other changes(b)	Total
Level of GDP (% of base)					
1979 second half	-0.9	-1.5	0.6	0.1	-1.7
1980 first half	-1.9	-2.4	1.2	0.4	-2.7
1980 second half	-1.9	-2.7	1.4	0.6	-2.6
Unemployment (thousands)					
1980 Q1	170	120	-60	-	230
1981 Q1	310	290	-150	-50	400
Current balance (£m)					
1979	310	770	-320	-200	560
1980	1670	1990	-1760	-200	1700
Effective exchange rate (% of base)					
1980 Q1	1.7	3.9	-1.4	-3.2	1.0
1981 Q1	2.7	4.6	-1.8	-2.7	2.8
Level of RPI (% of base)					
1980 Q1	-	4.0	0.3	0.3	4.6
1981 Q1	-1.5	3.1	0.7	1.0	3.3
Average earnings (% of base)					
1980 Q1	-0.5	-	-0.1	-0.1	-0.7
1981 Q1	-1.6	0.2	-1.0	0.6	-1.8
PSBR (£m)					
1979-80	-3290	-1590	3410	-140	-1610
1980-81	-4470	-2730	4480	-230	-2950
Interest rates (% pts)					
1979-80 av.	-0.6	-0.2	0.8	-	-
1980-81 av.	-1.5	-0.7	1.7	-	-0.5

(a) Assumes floating exchange rate
(b) Relaxation of exchange controls, minor direct taxes and overall confidence effects not attributable to any one component

SECRET

TABLE 1 SUMMARY OF EXPENDITURE

AT 1975 PRICES, SEASONALLY ADJUSTED
UNDERLYING AND FORECAST £ MILLION

	1 CONS EXPDT	2 PUBLIC AUTH CONS	3 FIXED INV	4 EXPORTS GOODS + SERVICE	5 INV STOCKS	6 COMPR ADJ	7 TOTAL FINAL EXPDT	8 IMPORTS GOODS + SERVICE	9 FACTOR COST ADJ	10 GDP AT FACTOR COST	11 GDP INDEX 1975=100
1977	62954	23253	19940	31646	974	-612	138807	30403	10827	96965	105.0
1978	66397	23626	20500	32377	981	-718	143887	31863	11444	99862	108.1
1979	68141	24022	20250	32120	389	-327	144922	33036	11537	100022	108.3
1980	68327	23873	19542	33343	-278	-480	144807	33443	11626	99208	107.4
1977 QTR 1	15622	5771	4858	7755	431	-8	34437	7703	2708	24018	104.0
QTR 2	15551	5838	4972	7843	292	-2	34516	7771	2645	24098	104.3
QTR 3	15876	5807	5029	8186	-71	-237	34827	7598	2729	24263	105.1
QTR 4	15905	5845	5087	7802	326	-365	35025	7331	2743	24586	106.5
1978 QTR 1	16296	5923	5169	7943	291	-236	35622	8013	2865	24508	106.1
QTR 2	16407	5807	5133	7992	279	-109	35770	7814	2848	25007	108.3
QTR 3	16850	5873	5124	8246	301	-199	36402	8110	2881	25212	109.2
QTR 4	16755	5942	5080	8196	110	-174	36064	7926	2849	25135	108.8
1979 QTR 1	16944	5903	5044	7437	243	33	35651	8009	2841	24834	107.5
QTR 2	17321	6049	5126	8283	-16	-120	36705	8477	2934	25234	109.3
QTR 3	16853	6024	5072	8230	127	-120	36300	8346	2870	24970	108.1
QTR 4	17023	5906	5006	8168	35	-120	36198	8203	2891	24984	108.2
1980 QTR 1	17007	5913	4900	8271	-38	-120	36113	8326	2893	24774	107.3
QTR 2	17053	5976	4914	8313	-98	-120	36100	8355	2903	24782	107.3
QTR 3	17074	5906	4882	8357	-75	-120	36224	8387	2910	24807	107.4
QTR 4	17133	5974	4840	8400	-67	-120	36306	8423	2918	24845	107.6
1981 QTR 1	17109	6006	4750	8440	-47	-120	36320	8406	2920	24820	107.5

SECRET

SECRET

TABLE 3 FIXED INVESTMENT - PRIVATE AND TOTALS

AT 1975 PRICES, SEASONALLY ADJUSTED
UNDERLYING AND FORECAST £ MILLION

	1	2	3	4	5	6	7	8	9	10
	P R I V A T E									MANUFAC
	DWELL	MANUFAC -TURE(1)	SHIPS +AIR TR	DISTR + SERVICES	NORTH SEA	MISC	TOTAL PRIV(1)	TOTAL PUB(2)	GRAND TOTAL	-TURE TOTAL
1977	1992	3163	390	4016	1593	1402	12556	7390	19946	3572
1978	2296	3580	253	4346	1564	1759	13798	6708	20506	3844
1979	2228	3563	300	4547	1508	1663	13809	6441	20250	3816
1980	2285	3182	300	4657	1257	1749	13430	6112	19542	3438
1977 QTR 1	421	745	124	926	347	344	2907	1951	4858	851
QTR 2	492	766	108	981	481	316	3158	1814	4972	879
QTR 3	535	815	76	1034	372	362	3194	1835	5029	910
QTR 4	544	825	80	1075	393	380	3297	1740	5087	932
1978 QTR 1	614	838	124	1075	406	408	3465	1704	5169	922
QTR 2	566	864	59	1090	401	418	3438	1695	5133	962
QTR 3	551	916	59	1078	372	448	3426	1698	5124	981
QTR 4	545	920	11	1103	405	485	3469	1611	5080	979
1979 QTR 1	538	865	75	1094	412	399	3403	1641	5044	948
QTR 2	550	906	75	1118	407	405	3461	1667	5128	969
QTR 3	563	895	75	1164	337	422	3456	1616	5072	958
QTR 4	577	877	75	1171	352	437	3489	1517	5006	941
1980 QTR 1	564	827	75	1165	345	455	3451	1449	4900	891
QTR 2	579	794	75	1154	334	429	3365	1549	4914	858
QTR 3	566	787	75	1163	304	433	3328	1554	4882	851
QTR 4	556	774	75	1175	274	432	3286	1560	4846	838
1981 QTR 1	545	725	75	1170	248	433	3196	1562	4758	789

(1) EXCLUDING BSC AND OTHER PUBLIC SECTOR MANUFACTURING:
FROM 1977Q3 THE STATE OWNED PART OF THE SHIPBUILDING AND AEROSPACE INDUSTRIES IS EXCLUDED
(2) INCLUDES BRITISH STEEL THROUGHOUT - BRITISH AEROSPACE FROM 1977Q2 AND BRITISH SHIPBUILDERS FROM 1977Q3

SECRET

SECRET

TABLE 5 WAGE AND SALARY BILL (1)

SEASONALLY ADJUSTED
RECORDED AND FORECAST

	1	2	3	4	5	6	7	8	9	10
	PERCENTAGE CHANGES ON THE PREVIOUS YEAR							1975 = 100		£M.
	AVERAGE WAGES AND SALARIES TOTAL	PUBLIC	PRIVATE	CYC.PRIV	REAL DISP AVW+S(3)	W + S EARNERS	W + S BILL	AVERAGE W + S	W + S EARNERS	W + S BILL
1977	9.1	7.1	9.7	9.5	-4.2	0.5	9.7	124.8	99.8	75023
1978	13.0	11.7	13.3	13.6	5.7	0.3	13.3	141.0	100.1	85015
1979	13.9	14.5	13.7	14.1	2.2	0.1	14.0	160.6	100.1	96890
1980	15.4	20.0	14.1	14.5	0.6	-1.9	13.2	185.4	98.2	109646
1977 QTR 1	10.3	10.0	10.4	8.9	-5.8	0.4	10.7	120.5	99.7	18101
QTR 2	9.2	6.7	9.9	9.4	-6.2	0.6	9.8	123.4	99.8	18556
QTR 3	7.8	6.3	8.3	8.4	-6.5	0.6	8.5	125.6	99.8	18889
QTR 4	9.3	5.5	10.4	11.1	1.9	0.4	9.6	129.6	99.8	19477
1978 QTR 1	10.5	9.5	10.0	11.9	3.2	0.1	10.7	133.2	99.8	20033
QTR 2	13.7	11.2	14.4	14.8	7.1	0.2	13.9	140.3	99.9	21128
QTR 3	14.2	11.7	14.9	14.8	8.5	0.3	14.0	143.5	100.1	21638
QTR 4	13.4	14.3	13.1	13.1	4.0	0.0	14.1	146.9	100.4	22216
1979 QTR 1	12.7	9.4	13.7	13.6	4.8	0.6	13.4	150.1	100.5	22723
QTR 2	13.9	14.8	13.0	13.8	4.0	0.6	14.5	159.8	100.5	24190
QTR 3	14.1	16.0	13.5	14.2	-2.1	0.1	14.2	163.7	100.2	24700
QTR 4	14.9	17.5	14.2	14.7	2.2	-1.0	13.8	168.8	99.4	25277
1980 QTR 1	16.0	21.3	15.4	15.7	1.2	-1.7	14.7	175.1	98.8	26061
QTR 2	14.0	21.6	12.5	13.1	0.2	-2.1	12.2	183.0	98.4	27140
QTR 3	15.2	18.5	14.2	14.7	2.4	-2.2	12.0	188.5	97.9	27816
QTR 4	15.3	18.8	14.3	14.5	-1.4	-1.8	13.3	194.7	97.6	28629
1981 QTR 1	15.2	16.8	14.7	14.8	0.6	-1.4	13.0	201.7	97.4	29596

(1) THE WAGE AND SALARY BILL AND AVERAGE WAGE AND SALARY FIGURES IN THIS TABLE INCLUDE FORCES PAY
(2) PUBLIC REFERS TO NON-TRADING PUBLIC AUTH. AND PRIVATE TO THE REST
(3) THIS MEASURE OF REAL TAKE-HOME PAY IS DEFLATED BY THE RETAIL PRICES INDEX

SECRET

SECRET

TABLE 6 CONSUMERS EXPENDITURE

	1 REAL CONSMR EXP. TOTAL	2 DUR-ABLES	3 NONDUR-ABLES	4 REAL PERSNL DISP. INC.	5 SAVINGS RATIO	6 CONSMR PRICE INDEX	7 % CHANGES ON PREVIOUS YEAR OF: CONSUMPTION TOTAL	8 DUR-ABLES	9 NONDUR-ABLES	10 PERSNL DISP. INC.	11 CONSMR PRICES
1977	62954	5114	57840	72955	13.71	132.7	-0.9	-4.6	-0.6	12.8	14.8
1978	66397	6021	60376	77572	14.41	144.2	5.5	17.7	4.4	15.5	8.6
1979	68141	6120	62021	80508	15.36	162.4	2.6	1.7	2.7	16.9	12.7
1980	68327	5965	62361	80264	14.87	187.0	0.3	-2.6	0.5	14.8	15.1
1977/78	63626	5201	58367	73318	13.22	136.0	0.4	-1.7	0.6	12.9	13.6
1978/79	67045	6107	60938	79128	15.27	147.1	5.4	16.1	4.4	16.7	8.2
1979/80	68204	6102	62102	80430	15.13	168.6	1.6	-0.1	2.0	16.5	14.7
1980/81	68429	5931	62498	80441	14.93	192.9	0.2	-2.8	0.5	14.3	14.3
1977 QTR 1	15622	1297	14325	18216	14.24	126.8	-0.9	-0.8	-0.9	12.2	15.2
QTR 2	15551	1225	14320	17966	13.44	131.7	-1.6	-6.6	-1.4	12.9	16.3
QTR 3	15876	1334	14542	18028	11.94	135.4	-0.4	-1.5	-0.3	10.8	15.7
QTR 4	15905	1258	14647	18745	15.15	137.1	-0.6	-9.4	0.2	15.2	12.3
1978 QTR 1	16296	1444	14852	18579	12.29	139.9	4.3	11.3	3.7	12.5	10.3
QTR 2	16487	1501	14986	19441	15.20	142.4	6.0	22.5	4.6	17.0	8.1
QTR 3	16858	1594	15264	19640	14.16	145.9	6.2	19.5	5.0	17.4	7.7
QTR 4	16756	1482	15274	19912	15.85	148.4	5.4	17.8	4.3	15.0	8.3
1979 QTR 1	16944	1530	15414	20135	15.65	151.9	4.0	6.0	3.8	17.6	8.5
QTR 2	17321	1653	15668	20279	14.59	157.1	5.1	10.2	4.5	15.1	10.3
QTR 3	16853	1428	15425	19779	14.79	168.3	-0.0	-10.4	1.1	16.2	15.4
QTR 4	17023	1504	15514	20315	16.20	172.4	1.6	1.8	1.6	18.5	16.2
1980 QTR 1	17067	1512	15555	20057	14.91	177.4	0.7	-1.2	0.9	16.3	16.8
QTR 2	17053	1522	15531	20132	15.30	185.1	-1.5	-8.0	-0.9	17.0	17.8
QTR 3	17074	1453	15620	19918	14.28	190.7	1.3	1.8	1.3	14.1	13.3
QTR 4	17133	1478	15655	20157	15.00	194.8	0.6	-2.1	0.9	12.1	13.0
1981 QTR 1	17169	1478	15692	20234	15.15	201.0	0.6	-2.3	0.9	14.3	13.3

SECRET

SECRET

TABLE 7 RETAIL PRICES INDEX AND CONSUMERS EXPENDITURE DEFLATOR

RECORDED AND FORECAST

	1	2	3	4	5	6	7	8	9	10	11	12
	RETAIL PRICES INDEX JANUARY 1974=100					PERCENTAGE CHANGES OVER LAST YEAR FOR RETAIL PRICE INDEX AND COMPONENTS					CONS.EXPD.DEFLATOR (SEAS. ADJ.)	
	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL						INDEX	P-C CH ON
WEIGHTS(1)	221	131	78	570	1000	FOOD	HOUSING	NAT.IND.	OTHER	TOTAL	1975=100	PREV.YEAR
1977	190.3	161.8	208.1	179.6	182.0	19.0	13.0	12.3	15.6	15.8	132.7	14.8
1978	203.8	173.3	227.2	195.7	197.0	7.1	7.1	9.2	9.0	8.3	144.2	8.6
1979	227.2	209.4	247.6	222.4	223.8	11.5	21.1	9.0	13.6	13.6	162.4	12.7
1980	255.7	243.3	286.3	258.9	258.3	12.5	15.9	15.6	16.4	15.4	187.0	15.1
1977 QTR 1	184.7	154.8	198.9	170.7	174.1	22.6	14.2	14.8	14.9	16.5	126.8	15.2
QTR 2	191.1	165.0	207.5	178.4	181.9	21.8	15.3	13.3	16.7	17.4	131.7	16.3
QTR 3	192.1	164.1	210.9	182.8	184.7	21.0	13.5	11.0	16.2	16.5	135.4	15.7
QTR 4	193.3	163.5	215.3	186.5	187.4	11.9	9.2	10.4	14.7	13.0	137.1	12.3
1978 QTR 1	197.3	162.9	221.1	190.1	190.6	6.8	5.2	11.2	11.4	9.5	139.9	10.3
QTR 2	203.8	171.2	226.0	194.2	195.8	6.7	3.6	8.9	8.9	7.6	142.4	8.1
QTR 3	206.2	176.8	230.2	197.3	199.2	7.3	7.7	9.2	7.9	7.9	145.9	7.7
QTR 4	206.0	182.4	231.7	201.1	202.6	7.6	11.6	7.6	7.8	8.1	148.4	8.3
1979 QTR 1	218.6	191.5	235.3	205.4	208.9	10.9	17.0	6.4	8.0	9.6	151.9	8.5
QTR 2	224.8	206.3	238.6	211.2	215.8	10.3	20.5	5.7	8.8	10.2	157.1	10.3
QTR 3	229.4	218.9	251.8	233.2	231.9	11.3	23.6	9.4	18.2	16.4	168.3	15.4
QTR 4	235.9	222.7	264.6	239.6	238.5	13.4	22.1	14.2	19.2	17.7	172.4	16.2
1980 QTR 1	244.3	220.8	269.1	245.8	244.0	11.7	15.3	14.4	19.7	16.8	177.4	16.8
QTR 2	253.3	244.8	284.6	256.6	256.2	12.7	18.6	19.2	21.2	18.7	185.1	17.8
QTR 3	259.3	251.5	291.0	263.5	263.1	13.0	14.9	15.6	13.0	13.4	190.7	13.3
QTR 4	266.0	255.9	300.4	270.2	269.7	12.8	14.9	13.5	12.7	13.1	194.8	13.0
1981 QTR 1	275.0	261.1	312.1	277.6	277.6	12.5	18.2	16.0	13.0	13.7	201.0	13.3

SECRET

(1) THESE WEIGHTS ARE APPLICABLE TO INDICES BASED ON JANUARY 1974 = 100
THE PUBLISHED WEIGHTS ARE APPLICABLE TO INDICES BASED ON JANUARY 1978 = 100

SECRET

TABLE 8 EMPLOYMENT AND UNEMPLOYMENT IN U.K.

	1	2	3	4	5	6	7	8
	- - E M P L O Y M E N T - -				LABOUR	- - UNEMPLOYMENT - -		
	PUBLIC (1)	PRIVATE(1) MANUF	OTHER(2)	TOTAL	SUPPLY	WIDE(3) UNADJ	NARROW,ADJ(3)	
	000'S	000'S	000'S	000'S		000'S	000'S	P-C
1977	4994	7354	12509	24857	26433	1483	1376	5.7
1978	5024	7311	12590	24925	26524	1475	1375	5.6
1979	5095	7202	12644	24941	26616	1450	1369	5.6
1980	5050	7021	12422	24493	26728	1795	1681	6.4
1977 QTR 1	5013	7339	12490	24842	26367	1418	1330	5.5
QTR 2	4999	7371	12493	24863	26443	1395	1341	5.5
QTR 3	4973	7364	12524	24866	26454	1622	1415	5.8
QTR 4	4992	7338	12529	24859	26469	1499	1420	5.9
1978 QTR 1	5015	7338	12519	24872	26484	1506	1409	5.8
QTR 2	5021	7327	12551	24899	26507	1428	1373	5.6
QTR 3	5015	7309	12610	24934	26536	1571	1361	5.7
QTR 4	5047	7272	12660	24999	26569	1395	1340	5.5
1979 QTR 1	5078	7248	12692	25018	26584	1437	1351	5.5
QTR 2	5114	7229	12684	25027	26597	1355	1312	5.4
QTR 3	5121	7193	12639	24953	26619	1494	1344	5.5
QTR 4	5069	7140	12563	24772	26665	1517	1471	6.0
1980 QTR 1	5035	7092	12505	24632	26685	1674	1567	6.4
QTR 2	5065	7041	12444	24550	26708	1681	1611	6.6
QTR 3	5053	6993	12389	24435	26742	1927	1721	7.1
QTR 4	5049	6901	12354	24304	26780	1899	1827	7.5
1981 QTR 1	5060	6930	12319	24309	26800	2059	1928	7.4

(1) PUBLIC EQUALS NON TRADING PUBLIC SECTOR,PRIVATE EQUALS ~~REST~~
(2) INCLUDES NORTH SEA OIL AND GAS EMPLOYMENT
(3) NARROW EXCLUDES SCHOOL LEAVERS,WIDE INCLUDES THEM

SECRET

SECRET

TABLE 10 SUMMARY OF EXPENDITURE

AT 1975 PRICES.SEASONALLY ADJUSTED
UNDERLYING AND FORECAST

	1 CONS EXPDT	2 PUBLIC CONS	3 PUBLIC EXPENDITURE INV (1)	4 PUBLIC EXPENDITURE TOTAL (1)	5 PRIVATE INV (2)	6 EXPORTS GOODS + SERVICE	7 INV STOCKS (3)	8 TOTAL FINAL EXPDT	9 IMPORTS GOODS + SERVICE	10 FACTOR COST ADJ	11 GDP AT FACTOR COST
£ MILLION 1975	63305	22962	9025	31987	11513	26942	-1627	132201	29028	10453	92377
INDEX NUMBERS 1975 = 100											
1977 I	98.4	101.3	83.4	96.3	105.4	115.8	723	104.3	106.6	102.5	104.2
II	100.3	101.5	80.3	95.5	112.8	119.1	255	105.7	102.9	104.7	105.8
1978 I	103.4	102.9	75.3	95.1	119.9	118.3	570	108.0	109.0	109.3	107.2
II	106.1	102.9	73.3	94.6	119.8	122.1	411	109.7	110.5	109.7	109.0
1979 I	108.1	104.6	73.3	95.9	119.2	116.7	227	109.6	113.6	110.5	108.4
II	106.9	104.4	69.4	94.6	120.6	121.7	162	109.7	114.0	110.3	108.2
1980 I	107.7	103.6	66.4	93.1	118.4	123.1	-130	109.3	114.9	111.0	107.3
II	107.9	104.3	69.0	94.4	114.9	124.4	-142	109.7	115.8	111.5	107.5
PERCENTAGE CHANGES ON A YEAR EARLIER											
1978 I	5.2	1.6	-9.7	-1.2	13.8	2.2		3.5	2.3	6.7	2.9
II	5.8	1.4	-8.7	-1.0	6.2	2.5		3.8	7.4	4.7	3.1
1979 I	4.5	1.9	-2.7	0.9	-0.6	-1.3		1.4	4.2	1.1	1.1
II	0.8	1.5	-5.3	-0.0	0.7	-0.3		0.0	3.2	0.5	-0.8
1980 I	-0.4	-1.2	-9.4	-2.9	-0.7	5.5		-0.2	1.2	0.4	-1.0
II	1.0	-0.1	-0.6	-0.2	-4.8	2.2		0.0	1.6	1.2	-0.6

(1) INCL R.S.C. AND PART OF SHIPBUILDING + AIRCRAFT MAN. FROM 1977QTR1
(2) EXCL R.S.C. AND OTHER PUBLIC SECT MAN. (FROM 1977QTR1 PART OF SHIPBUILDING AND AIRCRAFT IS EXCLUDED)

SECRET

SECRET

TABLE 20 WORLD ECONOMIC VARIABLES

	1	2	3	4	5	6	7	8	9	10	11	12
		- -UK WEIGHTED (DOL)- -				- COMMODITY PRICES (DOL)-						
	WORLD TRADE MANUFS	COMPRS EXPORT PRICES	COMPRS W-SALE PRICES	COMPRS UNIT LABOUR	WORLD INDUST -RIAL PRODN	FOOD (SEE BELOW)	AGRIC. NON-FOOD	METAL ORES	NON-FERROUS METALS	INDEX OF CAP PRICES (UA)	UK WTD COMMO-DITIES	TERMS OF TRADE
1977	117	104	112	116	112	126	124	104	117	133	119.7	109.5
1978	120	126	130	129	116	122	131	105	126	146	124.7	98.9
1979	125	140	143	141	122	129	145	119	149	148	137.6	98.3
1980	132	155	158	156	125	139	160	129	164	150	150.0	97.1
77/76%CH	5.1	8.5	9.8	9.0	3.1	14.6	10.5	2.3	7.6	10.0	11.0	2.3
78/77%CH	3.0	15.4	15.6	17.1	3.6	1.7	5.9	1.4	7.9	10.0	4.2	-9.6
79/78%CH	4.1	11.0	10.4	9.6	4.7	5.9	11.1	12.8	18.1	1.6	10.3	-0.6
80/79%CH	5.7	10.4	10.2	10.6	2.5	7.5	10.1	8.7	9.7	1.0	9.0	-1.2
1977 QTR 1	116	106	100	106	112	120	126	105	120	127	121.2	113.9
QTR 2	116	106	111	108	112	127	133	104	117	132	125.2	117.4
QTR 3	117	110	113	111	112	116	116	102	114	136	115.4	104.8
QTR 4	118	113	116	115	112	117	117	103	117	137	115.9	102.3
1978 QTR 1	118	119	122	121	113	122	122	102	119	145	120.0	101.0
QTR 2	120	123	125	124	115	121	129	102	120	147	122.6	100.0
QTR 3	119	129	133	132	117	120	133	105	129	147	125.3	97.3
QTR 4	123	134	138	138	119	125	139	111	137	147	131.2	97.7
1979 QTR 1	122	136	140	139	121	127	142	114	153	148	135.9	99.8
QTR 2	124	136	140	138	121	125	144	118	151	150	135.8	99.7
QTR 3	126	141	144	142	122	136	145	118	146	148	137.1	97.1
QTR 4	126	146	148	147	122	135	150	126	147	148	141.5	96.7
1980 QTR 1	129	150	152	151	123	138	153	123	152	149	144.7	96.5
QTR 2	131	153	156	155	124	138	156	127	160	151	148.2	96.7
QTR 3	133	156	159	158	125	139	162	131	168	150	151.8	97.6
QTR 4	136	154	163	161	126	141	167	134	175	150	155.4	97.6
1981 QTR 1	138	163	167	166	128	142	169	138	181	151	157.9	96.7

COLUMN 6 IS FOOD WEIGHTED BY UK IMPORTS FROM NON-EEC COUNTRIES

SECRET

SECRET

TABLE 21 BALANCE OF PAYMENTS

AT CURRENT PRICES,SEASONALLY ADJUSTED
UNDERLYING AND FORECAST £ MILLION *

	1 EXPORT GOODS	2 IMPORT GOODS	3 VISIB BAL	4 EXPORT SERV	5 IMPORT SERV	6 BAL SERV	7 BAL TRANSF	8 BAL IPD	9 INVIS BAL	10 CURRENT BALANCE	11 CURRENT BALANCE DOLLARS(1)	12 CONTRIBNS OIL (2)
1977	32147	33891	-1744	11532	8584	2948	-1225	392	2115	371	647	1935
1978	35432	36606	-1174	12263	9310	2953	-2013	670	1618	444	852	2416
1979	38525	40265	-1740	13344	10099	3245	-2366	393	1272	-468	-959	3881
1980	44454	44920	-466	15185	11512	3673	-2848	-179	646	180	362	5074
1977 QTR 1	7520	6466	-946	2814	2132	682	-273	137	546	-400	-685	392
QTR 2	7921	8700	-779	2863	2120	743	-287	62	516	-261	-448	512
QTR 3	8531	8534	-3	2909	2163	746	-334	100	520	517	897	522
QTR 4	8175	8191	-16	2946	2169	777	-331	85	531	515	934	508
1978 QTR 1	8409	9004	-595	2964	2252	712	-574	88	226	-369	-711	493
QTR 2	8752	8925	-173	2967	2368	599	-440	225	382	209	383	610
QTR 3	9051	9418	-367	3154	2355	799	-536	258	521	154	297	615
QTR 4	9220	9259	-39	3178	2335	843	-463	109	489	450	893	696
1979 QTR 1	8390	9571	-1181	3168	2419	749	-563	212	398	-783	-1578	765
QTR 2	9856	10156	-300	3256	2464	792	-556	150	386	86	177	924
QTR 3	10078	10273	-195	3413	2561	852	-640	46	260	65	133	1047
QTR 4	10201	10265	-64	3507	2655	852	-607	-17	228	164	336	1143
1980 QTR 1	10609	10712	-103	3610	2759	851	-647	-10	194	91	185	1212
QTR 2	10975	11128	-155	3759	2876	883	-735	-25	123	-32	-64	1267
QTR 3	11267	11365	-98	3853	2896	957	-745	-42	170	72	146	1277
QTR 4	11605	11715	-110	3963	2981	982	-721	-102	159	49	98	1316
1981 QTR 1	12039	12169	-130	4101	3099	1002	-794	-145	63	-67	-132	1354

(1) N.B.COLUMN 11 IN U.S.DOLLAR MILLIONS

(2) VALUE OF N.S. OIL PRODUCTION LESS IPD DEBITS

SECRET

SECRET

TABLE 22 EXPORTS OF GOODS AT 1975 PRICES

£ MILLION,1975 PRICES

	1 ADJUST VALUE	2 SHIPS + AIRCRAFT	3 PREC STONES	4 ERROR ADJUST	5 RESI-DUAL	6 TOTAL MANUF	7 FUEL	8 NON-MANUF	9 SECTION 4	10 RESI-DUAL	11 TOTAL OTS	12 BOP ADJUST	13 TOTAL BOP
1977	17256	1074	1287	0	0	19624	1367	2293	694	-7	23971	-835	23136
1978	17800	859	1311	0	0	19970	1720	2637	720	4	25057	-1148	23909
1979	17206	806	1369	0	0	19543	2174	2496	724	-1	24936	-1143	23793
1980	17564	947	1440	0	0	19951	2020	2576	754	1	26208	-1192	25016
1977 QTR 1	4225	210	307	0	0	4742	327	573	169	1	5812	-173	5639
QTR 2	4209	242	308	0	0	4899	350	556	183	-8	5980	-253	5727
QTR 3	4455	394	263	0	0	5112	363	591	168	-8	6246	-183	6063
QTR 4	4209	233	349	0	0	4871	307	573	174	8	5933	-226	5707
1978 QTR 1	4376	224	333	0	0	4938	370	651	164	-2	6121	-302	5819
QTR 2	4372	238	317	0	0	4929	420	606	180	-24	6171	-225	5946
QTR 3	4541	188	312	0	0	5041	473	656	173	19	6362	-290	6072
QTR 4	4511	204	347	0	0	5062	463	604	203	11	6403	-331	6072
1979 QTR 1	3800	194	340	0	0	4419	510	503	160	0	5652	-282	5370
QTR 2	4543	229	351	0	0	5123	488	676	194	0	6481	-290	6191
QTR 3	4400	224	349	0	0	5038	575	631	184	0	6428	-284	6144
QTR 4	4305	229	349	0	0	4963	601	626	186	-1	6375	-287	6088
1980 QTR 1	4390	232	354	0	0	4976	685	633	186	1	6481	-291	6190
QTR 2	4395	235	357	0	0	4987	715	640	188	0	6530	-296	6234
QTR 3	4392	238	362	0	0	4992	747	648	189	0	6576	-300	6276
QTR 4	4307	242	367	0	0	4996	779	655	191	0	6621	-305	6316
1981 QTR 1	4301	246	374	0	0	5001	796	604	193	0	6656	-309	6347

SECRET

SECRET

TABLE 25 IMPORTS OF GOODS AT 1975 PRICES (OTS)

£ MILLION,1975 PRICES

SITC	1 FOOD ETC 0 + 1	2 FUEL OIL	3 FUEL COAL +GAS	4 FUEL TOTAL 3	5 BASIC MATER. 2 + 4	6 SEMI-MANUFACTURES PR.ST. +SILV	7 SEMI-MANUFACTURES OTHER	8 SEMI-MANUFACTURES TOTAL 5 + 6	9 FINISHED MANUFACTURES CAPIT. GOODS	10 FINISHED MANUFACTURES CONS. GOODS	11 FINISHED MANUFACTURES OTHER	12 FINISHED MANUFACTURES SHIPS + AIR	13 FINISHED MANUFACTURES RESID -UAL	14 FINISHED MANUFACTURES TOTAL 7 + 8	15 MISC. 9	16 RESID -UAL	17 TOTAL 0 - 9
1977	4415	3420	150	3570	2571	1132	5957	7090	2140	3035	2371	656	0	8196	742	-3	26581
1978	4390	3293	188	3481	2630	1251	6783	8035	2537	3411	2697	658	0	9303	794	-6	28633
1979	4330	2804	322	3126	2559	1295	7201	8493	2760	3910	2925	753	-2	10346	579	9	29442
1980	4270	2888	268	3156	2412	1391	7063	8454	2815	4295	3008	794	0	10912	622	-2	29824
1977 QTR 1	1137	904	23	927	684	215	1501	1718	527	741	591	164	4	2027	96	62	6651
QTR 2	1140	890	43	933	625	368	1457	1825	516	740	588	172	9	2025	366	-32	6890
QTR 3	1120	828	33	861	635	226	1533	1760	566	760	596	168	-5	2085	129	31	6621
QTR 4	1010	798	51	849	627	323	1466	1787	537	788	596	146	-8	2059	151	-64	6419
1978 QTR 1	1099	871	40	911	658	315	1641	1959	594	802	658	199	9	2267	96	83	7073
QTR 2	1094	718	54	772	662	275	1648	1927	637	819	673	166	2	2297	464	-52	7164
QTR 3	1130	865	22	887	644	355	1728	2077	630	901	674	133	-5	2333	139	40	7250
QTR 4	1073	839	72	911	666	306	1766	2072	671	889	692	160	-6	2406	95	-77	7146
1979 QTR 1	1030	718	102	820	608	325	1732	2054	646	904	709	176	0	2435	85	108	7140
QTR 2	1153	682	87	769	695	300	1896	2196	713	1021	742	188	-1	2663	170	-50	7596
QTR 3	1073	704	66	770	635	333	1800	2133	699	983	739	193	-1	2613	176	51	7451
QTR 4	1074	700	67	767	621	337	1773	2110	702	1002	735	196	0	2635	148	-100	7255
1980 QTR 1	1072	734	67	801	610	341	1761	2102	691	1037	739	197	0	2664	146	-1	7394
QTR 2	1066	734	66	800	604	345	1753	2098	694	1066	742	198	0	2700	156	-1	7423
QTR 3	1067	717	67	784	601	350	1765	2115	710	1080	758	199	0	2747	170	0	7484
QTR 4	1065	703	68	771	597	355	1784	2139	720	1112	769	200	0	2801	150	0	7523
1981 QTR 1	1064	700	63	763	592	361	1803	2164	712	1133	780	201	0	2826	150	0	7559

SECRET

SECRET

TABLE 30 EXCHANGE RATES AND COMPETITIVENESS

	1	2	3	4	5	6	7	8	9	10
	. . . EXCHANGE	RATES . . .		- - COMPETITIVENESS OF GOODS - -						
				- EXPORTS OF MANUFAC. -			. WHOLESALE PRICES/IMP. PRICES .			
	EFFECTIVE EXCH.RATE	EX. CORP WTD. RATE	DOLLAR/£ EXCH.RATE	PRICE COMPET	REL.UNIT LAB.COST	REL.WHS. PRICES	OTHER S-MANUF	CONSUM GOODS	CAPIT GOODS	OTH.FIN. MAN(1).
1977	62.12	60.375	1.745	102.76	89.52	96.96	100.66	88.47	99.88	88.99
1978	63.00	59.375	1.920	107.58	93.10	100.77	101.74	87.96	102.95	94.46
1979	65.23	60.762	2.050	112.69	102.14	108.01	103.77	90.48	107.25	99.81
1980	62.33	57.051	2.027	111.03	103.00	109.09	104.66	92.08	108.38	99.97
1977 QTR 1	61.00	60.430	1.714	98.66	88.10	93.80	99.89	86.05	98.16	87.52
QTR 2	61.00	60.060	1.719	102.07	87.50	95.98	98.92	88.31	99.79	88.66
QTR 3	61.00	59.860	1.735	103.36	87.70	97.44	101.47	89.26	100.34	88.59
QTR 4	63.30	61.150	1.814	106.95	90.00	100.47	103.52	90.39	101.28	91.25
1978 QTR 1	65.40	62.230	1.928	110.29	94.70	104.32	104.71	91.31	103.71	94.90
QTR 2	61.50	58.370	1.836	104.06	91.90	98.45	102.35	87.59	102.82	93.52
QTR 3	62.40	58.540	1.932	107.22	92.50	99.90	102.04	87.52	102.92	93.92
QTR 4	62.70	58.360	1.985	108.74	93.63	100.41	98.08	85.60	102.38	95.52
1979 QTR 1	63.90	59.491	2.015	112.00	96.75	103.77	101.97	86.86	103.99	98.19
QTR 2	67.10	62.873	2.070	115.14	105.53	109.71	103.86	91.25	108.40	101.16
QTR 3	65.20	60.770	2.050	112.19	103.09	108.87	104.48	91.77	108.38	99.96
QTR 4	64.70	59.915	2.063	111.42	103.19	109.69	104.82	92.22	108.38	99.97
1980 QTR 1	63.55	58.589	2.047	110.81	102.71	109.17	104.98	92.46	108.13	99.73
QTR 2	61.76	56.697	2.007	104.52	101.62	107.49	104.42	91.70	107.24	98.91
QTR 3	62.46	56.963	2.037	112.21	103.91	109.96	104.62	93.36	109.18	100.70
QTR 4	61.56	55.950	2.018	111.57	103.98	109.72	104.64	93.21	109.01	100.54
1981 QTR 1	60.22	54.499	1.991	110.85	103.71	108.86	104.34	92.86	108.59	100.16

(1) EXCLUDING SHIPS AND AIRCRAFT

SECRET

TABLE 51 EXPENDITURE PRICE DEFLATORS

PRICE INDICES AND THEIR PERCENTAGE CHANGES ON A YEAR EARLIER

	1 CONSUMERS EXPENDITURE INDEX	2 P-C	3 PUBLIC AUTH CONSUMPTION INDEX	4 P-C	5 FIXED INVESTMENT INDEX	6 P-C	7 EXPORTS OF G&S AND SERVICES INDEX	8 P-C	9 TOTAL FINAL EXPENDITURE INDEX	10 P-C	11 IMPORTS OF GOODS AND SERVICES INDEX	12 P-C	13 GDP AT FACTOR COST INDEX	14 P-C	15 GNP AT MARKET PRICES INDEX	16 P-C
1977	132.8	0.0	124.2	0.0	129.4	0.0	134.0	0.0	132.2	0.0	139.7	0.0	126.9	0.0	130.2	0.0
1978	144.2	8.6	138.2	10.3	142.7	10.2	147.3	6.7	143.6	8.6	144.1	3.1	140.0	10.3	143.5	10.3
1979	162.4	12.6	157.8	14.2	160.7	12.6	161.5	9.6	161.2	12.2	152.4	5.8	156.0	11.4	163.7	14.1
1980	187.0	15.2	187.0	18.5	185.6	15.5	178.9	10.8	184.4	14.7	168.5	10.5	178.6	14.5	190.0	16.0
1977/78	136.1	0.0	124.8	0.0	132.8	0.0	140.5	0.0	135.4	0.0	140.4	0.0	130.4	0.0	134.0	16.0
1978/79	147.2	8.2	141.1	9.8	145.8	9.8	150.2	6.9	146.7	8.4	146.4	4.3	142.4	9.2	146.8	9.6
1979/80	168.7	14.7	165.0	17.0	167.0	14.5	165.5	10.1	167.1	13.9	155.4	6.2	162.0	13.8	170.6	16.3
1980/81	192.9	14.3	194.1	17.6	191.5	14.7	183.7	11.0	190.8	14.2	173.1	11.4	184.2	13.7	196.2	15.0
1978 QTR 1	139.9	10.3	133.6	11.0	137.8	11.2	143.2	7.4	138.4	9.9	140.5	2.1	135.9	11.3	138.5	12.4
QTR 2	142.4	8.1	136.1	9.5	140.9	10.0	146.6	6.0	142.0	8.1	144.5	3.8	138.0	10.2	141.3	9.5
QTR 3	145.9	7.7	140.0	9.5	144.5	9.6	148.0	5.9	145.1	7.4	145.2	3.1	141.7	9.3	145.1	8.6
QTR 4	148.4	8.3	143.0	11.3	147.5	10.5	151.3	6.9	148.4	9.1	146.3	3.5	144.5	10.6	149.0	10.7
1979 QTR 1	151.9	8.5	145.1	8.6	150.5	9.2	155.4	8.5	151.3	8.9	149.7	6.6	145.3	6.9	151.8	9.6
QTR 2	157.1	10.3	156.1	14.0	157.1	11.5	158.3	8.0	157.0	10.6	148.9	3.0	153.8	11.5	159.5	12.8
QTR 3	168.3	15.4	163.1	16.4	164.3	13.7	163.9	10.7	165.4	14.3	153.8	5.9	160.2	13.1	169.5	16.8
QTR 4	172.4	16.2	168.1	17.6	170.7	15.8	167.8	10.9	170.4	14.9	157.5	7.7	164.4	13.8	174.3	17.0
1980 QTR 1	177.4	16.8	174.0	19.9	176.5	17.2	171.9	10.6	175.4	15.9	161.8	8.1	169.8	16.9	179.6	18.3
QTR 2	185.1	17.8	186.3	20.2	182.6	16.2	177.2	11.9	183.1	16.6	167.6	12.6	176.2	14.5	187.9	17.8
QTR 3	190.7	13.3	190.4	16.8	188.7	14.8	180.9	10.4	188.1	13.4	170.0	10.6	181.9	13.5	193.7	14.3
QTR 4	194.8	13.0	197.1	17.3	194.6	14.0	185.3	10.4	193.6	13.2	174.5	10.8	186.6	13.5	198.7	14.0
1981 QTR 1	201.0	13.3	202.5	16.3	200.6	13.7	191.2	11.2	198.4	13.4	180.3	11.5	192.2	13.2	204.7	14.0

SECRET

SECRET

TABLE 53 FACTOR INCOMES - SHARES

PERCENTAGE OF TOTAL DOMESTIC INCOME NET OF STOCK APPRECIATION

	1 INCOME FROM EMPLOYMENT	2 INCOME FROM SELF EMPLMT.	3 ..NET COMPANY PROFITS.. NON-OIL	4 OIL	5 PUBLIC CORP.ETC NET SURPLUSES	6 RENT	7 TOTAL DOMST. INCOME (1)
1977	69.8	8.7	8.0	1.4	4.0	8.1	100.0
1978	69.7	8.8	8.1	1.6	3.8	8.0	100.0
1979	71.0	8.8	5.9	2.5	3.5	8.3	100.0
1980	70.8	9.0	5.1	3.0	3.9	8.3	100.0
1977 QTR 1	70.9	8.5	7.2	1.4	3.9	8.2	100.0
QTR 2	69.9	8.6	7.9	1.5	4.1	8.1	100.0
QTR 3	69.4	8.8	8.0	1.4	4.3	8.0	100.0
QTR 4	69.2	9.1	8.7	1.3	3.6	8.0	100.0
1978 QTR 1	69.3	8.9	8.5	1.6	3.7	8.0	100.0
QTR 2	70.0	8.8	7.7	1.6	3.9	7.9	100.0
QTR 3	69.4	8.8	8.5	1.6	3.7	8.0	100.0
QTR 4	69.8	8.7	7.9	1.7	3.8	8.1	100.0
1979 QTR 1	72.2	8.7	4.9	2.1	3.5	8.6	100.0
QTR 2	71.0	8.7	6.3	2.3	3.5	8.2	100.0
QTR 3	70.5	8.9	6.3	2.7	3.6	8.2	100.0
QTR 4	70.3	8.8	6.2	2.8	3.6	8.2	100.0
1980 QTR 1	70.7	8.8	5.7	2.9	3.5	8.2	100.0
QTR 2	71.2	9.1	4.6	3.0	4.0	8.2	100.0
QTR 3	70.4	9.0	5.4	3.0	4.0	8.2	100.0
QTR 4	70.8	8.9	4.8	3.1	4.1	8.3	100.0
1981 QTR 1	71.3	8.8	4.1	3.2	4.3	8.3	100.0

(1) NET OF STOCK APPRECIATION

SECRET

SECRET

TABLE 50 PRIVATE SECTOR - CAPITAL ACCOUNT AND NET ACQUISITION OF FINANCIAL ASSETS

£ MILLION AT CURRENT PRICES, SEASONALLY ADJUSTED

	1	2	3	4	5	6	7	8	9	10
	.....P E R S O N A L		S E C T O R......			......INDUSTRIAL AND COMMERCIAL COMPANIES......				
	SAVING *	CAPITAL TRANS (NET)	LESS FIXED INV	LESS INCR IN VALUE OF STOCKS	NET ACQUIS FINAN ASSETS	SAVING *	CAPITAL TRANS (NET)	LESS FIXED INV	LESS INCR IN VALUE OF STOCKS	NET ACQUIS FINAN ASSETS
1977	13276	127	-4220	-1163	8020	8648	257	-9678	-1027	-1800
1978	16143	296	-5737	-939	9763	9586	365	-11128	-1062	-2236
1979	20090	324	-6177	-1078	13160	7974	197	-12564	-327	-4719
1980	22316	302	-7309	-1144	14160	8950	310	-13330	647	-3413
1977/78	13160	150	-4578	-1024	7728	9315	313	-10238	-903	-1513
1978/79	17794	313	-5869	-1057	11181	8514	301	-11385	-1070	-3639
1979/80	20547	329	-6508	-1062	13308	9005	227	-12887	70	-3585
1980/81	23174	278	-7498	-1198	14754	8587	301	-13378	668	-3820
1977 QTR 1	3290	52	-935	-348	2059	1735	75	-2149	-401	-733
QTR 2	3180	32	-1002	-299	1911	2219	86	-2524	-381	-600
QTR 3	2914	32	-1075	-264	1607	2181	47	-2471	31	-212
QTR 4	3892	11	-1206	-252	2443	2513	49	-2541	-276	-255
1978 QTR 1	3194	75	-1293	-209	1767	2402	131	-2702	-277	-446
QTR 2	4206	67	-1343	-241	2709	2369	88	-2817	-213	-573
QTR 3	4058	66	-1553	-263	2308	2639	68	-2808	-255	-356
QTR 4	4605	68	-1548	-226	2979	2176	76	-2794	-317	-861
1979 QTR 1	4845	92	-1425	-327	3165	1330	67	-2961	-285	-1848
QTR 2	4646	66	-1497	-201	3016	2250	90	-3136	79	-700
QTR 3	4923	76	-1585	-274	3142	2161	50	-3178	-124	-1090
QTR 4	5676	66	-1673	-276	3817	2224	-16	-3284	3	-1079
1980 QTR 1	5302	97	-1750	-311	3333	2360	97	-3284	112	-715
QTR 2	5699	65	-1807	-260	3677	1850	71	-3304	201	-1181
QTR 3	5423	70	-1851	-274	3367	2440	73	-3354	171	-668
QTR 4	5892	78	-1895	-284	3783	2300	77	-3388	163	-847
1981 QTR 1	6100	73	-1945	-360	3927	1997	80	-3332	133	-1122

	11	12	13	14	15
	.....FINANCIAL COMPANIES.....				TOTAL PRIVATE
	SAVING *	CAPITAL TRANS (NET)	LESS FIXED INV + STOCKS	NET ACQUIS FINAN ASSETS	NET ACQUIS FINAN ASSETS
1977	1329	-150	-2377	-1198	5022
1978	2020	-83	-3087	-1150	6377
1979	1963	-200	-3744	-1981	6460
1980	2015	-194	-4711	-2890	7857
1977/78	1237	-66	-2690	-1519	4696
1978/79	2300	-201	-3038	-939	6603
1979/80	1912	-178	-4116	-2382	7341
1980/81	1997	-204	-4818	-3025	7909
1977 QTR 1	373	-33	-513	-173	1153
QTR 2	322	-39	-506	-223	1088
QTR 3	366	-40	-702	-376	1019
QTR 4	268	-38	-656	-426	1762
1978 QTR 1	281	51	-826	-494	827
QTR 2	477	-42	-782	-347	1789
QTR 3	611	-42	-693	-124	1828
QTR 4	651	-50	-786	-185	1933
1979 QTR 1	561	-67	-777	-283	1054
QTR 2	524	-45	-876	-397	1919
QTR 3	433	-44	-1001	-612	1440
QTR 4	445	-44	-1090	-689	2049
1980 QTR 1	510	-45	-1149	-684	1934
QTR 2	508	-49	-1140	-681	1815
QTR 3	507	-53	-1188	-734	1965
QTR 4	490	-47	-1234	-791	2145
1981 QTR 1	492	-55	-1256	-819	1986

* SAVING AND INCREASE IN VALUE OF STOCKS OF THE PERSONAL SECTOR INCLUDES STOCK APPRECIATION;
SAVING AND INCREASE IN VALUE OF STOCKS OF THE COMPANY SECTOR EXCLUDES STOCK APPRECIATION

SECRET

QAJT UKPRIN.OUT

10 DOWNING STREET

19 June 1979

The Rt Hon William Whitelaw CH MC MP
Secretary of State
Home Department
50 Queen Anne's Gate
LONDON SW1

Dear Willie,

At yesterday's meeting on Strategy, it was agreed that colleagues would send in lists, within a week, of all measures - regardless of Department affected - which "accelerated" positive economic activity, whether by giving extra incentives of whatever kind, or removing existing obstructions.

Could you, and other colleagues, add to that list the names of possible outside speakers whom we could get to help put across a concerted message this summer, aimed primarily at union members, about the meaning and purpose of the Budget and the futility of a traditional militant union response to it.

At our meeting, we agreed that it would not be enough for the message to be propagated by Ministers only. Credible outside speakers (eg people like Robens?) would be needed.

I am copying this to other colleagues who attended the meeting.

Yours

John

JOHN HOSKYNS

COVERING CONFIDENTIAL

Econ Pol VP

bc. Mr Wolfson
James
Hoskyns

10 DOWNING STREET

cc FCO
Paymaster General

From the Private Secretary

19 June 1979

I enclose a note of the meeting on Government strategy which took place here at No. 10 yesterday morning. Please could you ensure that its circulation is confined to Ministers and to your Permanent Secretary.

I am sending copies of this letter and enclosure to Tony Battishill (HM Treasury), Andrew Duguid (Department of Industry), Ian Fair (Department of Employment), David Edmonds (Department of the Environment), Bill Burroughs (Department of Energy), Tom Harris (Department of Trade), Jim Buckley (Lord President's Office), Gerry Spence (Central Policy Review Staff) and Martin Vile (Cabinet Office).

TL

John Chilcot, Esq.,
Home Office.

COVERING CONFIDENTIAL

VS.

PM's notes from Strategy Mtg on 18/6/79

Stop the Rot.

Turn Round

Presentation

Supply constraints.

Psychology

~~Defeat~~. Retreat.

Advance

Prime Minister

One answer would be to

put Michael Heseltine on

E Committee?

Wider Basis than now. *

Nothing. Obtaining [?]

Chancellor. ← Zero-inflation

Charted reduction on money supply

Pay freeze out.

Direct or indirectly [?] of bank surpluses [?].

* Continuing prospect of things being much better.

Tax cuts not enough.

Deregs. →

Select one Minister – to explain

to Ind. & local govt.

Part of package – mini 7 accelerators

– cleaning up.

– enterprise

① Task force for

hard work

② Exchange Rate –

Control.

③ Floating Sterling

Output.

Net Disposable Income.

£b

Christopher.

Incomes. — Output

Lisr/ Imp. Indese

Keith.

Alan Howarth.

Two lists.

$+^{ve}$ $-^{ve}$.

<u>Good News Stories</u>

<u>Wheal Jane</u> –

<u>Announcements this</u>
<u>week</u>.

<u>[illegible]</u>'

Is there a chance for a very quick private word with you _after_ the meeting and _before_ your lunch.

Winston

cc KB

NOTE OF A MEETING AT 1100 IN 10 DOWNING STREET ON MONDAY 18 JUNE 1979 TO DISCUSS JOHN HOSKYNS' PAPER ON GOVERNMENT STRATEGY

Present

Prime Minister
Home Secretary
Secretary of State for Industry
Secretary of State for Employment
Secretary of State for the Environment
Secretary of State for Trade
Lord President
Chancellor of the Exchequer
Sir Kenneth Berrill
Mr. John Hoskyns
Mr. Clive Whitmore
Mr. David Wolfson
Mr. Tim Lankester

The meeting had before it John Hoskyns' paper on Government strategy which had been circulated under the Prime Minister's minute of 14 June to the Home Secretary. It was agreed that this paper provided a useful conceptual framework against which to consider the problems facing Britain over the next ten years. The paper suggested the need for a "stabilisation programme" which would last three to four years and which would provide the basis for a real revival of the economy in the middle and late 1980s. It was certainly necessary to re-establish the conditions for growth in the UK - and this meant getting rid of the cancer of inflation, creating the right macro-economic environment and the right attitudes to growth, and changing the power balance so that the trade unions were no longer able to upset the country's growth aspirations. However, "stablisation programme" was a bad phrase which had the connotation of stagnation; and in any case it would not be acceptable to have a period of no growth lasting for as long as three to four years. A return to growth must come sooner than that, and it must be

/clear that the

clear that the Government was aiming at growth: if it was thought that, for example, the Government were more interested in freedom of choice or counter-inflation for its own sake, that would be politically disastrous. It was no doubt inevitable that the economy would have to mark time for a while, while the conditions for growth were being re-established. But measures to establish these conditions and "stabilisation" would have to go hand in hand. Thus, the "stablisation" and rebuilding policies would need to merge together.

In order to make the initial period of little or no growth more palatable, it was essential that the electorate should understand the reasons for it, and also that it should be clear in this period that the necessary measures were being undertaken. This applied in the economic sphere; but, in addition, there were other measures, for example in relation to housing and law and order, where it would be essential to show that advances were being made. Further consideration would have to be given to the terminology of the Government's economic programme: "rebuilding" or "redeveloping" might be more appropriate than "stabilisation".

As to the content of the programme, the first essential was to create the right macro-economic environment. The Budget was a first step in this direction. It was now necessary to follow through, in particular by sticking firmly to the monetary target which the Chancellor had set. Monetary discipline was the essential pre-condition for reducing inflationary expectations and bringing inflation down. Incomes policy, and a fortiori the idea of a pay freeze, should be rejected. The idea that there might be a pay freeze would create precisely the wrong expectations, it would lead to pre-emptive strikes, and it would raise the question of what would follow. It was agreed that this should

/not be

CONFIDENTIAL

- 3 -

not be pursued any further. On the other hand, it was argued that in order to reduce inflationary expectations as fast as possible, it would be worth introducing an explicit monetary contraction programme over, say, a three-year period. Only with such a medium-term programme would inflation be squeezed out of the system. Against this, it was pointed out that, while a medium-term programme was a good idea in principle, it was important to be careful on the question of timing. If the programme were too ambitious, and assuming the Government stuck to it, there was a risk that it would destroy parts of private industry before they had an opportunity to become more competitive. For the moment, we should continue to rely on 12-month targets rolled forward every six months. Whether it would be possible to extend the targets forward would depend partly on how quickly the private sector was able to improve its performance.

In further discussion, it was argued that establishing the right conditions in respect of taxation and monetary policy was not enough. If confined to that, the rebuilding process would come too slowly. It was important that specific measures should be introduced, in addition, to help the supply side to expand. These could be broadly broken down into two types of measure: first, measures designed to free industry from bureaucracy and controls; second, measures designed positively to accelerate redevelopment. Various possibilities under these two heads were mentioned:

(i) Further help to small businesses might be brought forward for inclusion in the Finance Bill;

(ii) Officials were looking at the Sector Working Parties' views on how industry could benefit from decontrols. It would be worth considering having a programme of decontrol as had happened in the early 1950s.

(iii) It would be worth considering designating a Minister with special responsibility to visit the regions and to discuss with industrialists the opportunities for growth. This might be on the pattern of Lord Hailsham's responsibility for the North East in the Macmillan

CONFIDENTIAL /administration

administration. The emphasis would be not just on the financial assistance which the Government could offer, but also on other ways of improving the prospects for investment and industrial change.

(iv) In the context of the Shotton closure, it might be possible to make Shotton a special "decontrol area" - where, for example, all planning applications would be dealt with within six months. This could be a pilot scheme which, if successful, could be copied elsewhere; and in any case, it was more likely to be successful than pumping in money on orthodox lines. On the other hand, it was pointed out that legislation would probably be needed for such an approach and that work was already in hand to speed up planning applications country-wide.

(v) It would be worth considering how the institutions could be brought to take on their proper responsibilities for their massive equity holdings in British industry with a view to ensuring that management in industry improved. Another related possibility, although it would not directly affect industry, would be to encourage the institutions to deploy their funds into redeveloping inner city areas especially into housing, and thereby reduce the role of the public sector there.

(vi) A number of specific proposals would be coming forward shortly from the Department of Industry.

It would be useful if each of the main economic Departments would produce lists of specific proposals, and these need not be confined to their own Departmental responsibilities.

It was pointed out that the present economic background was exceptionally unfavourable. The international environment, about which the paper said very little, was considerably worse than it had been in the early 1970s; although it could not be avoided, the Budget had made things worse for inflation in the short-run; the UK's performance, as indicated in the declining ratio of manufactured exports to manufactured imports, had declined dreadfully; and recent experience with pay bargaining showed that union leaders were primarily interested in the RPI and higher money wages as the basis for negotiation, and hardly at all in output. One of the main priorities must be to "sell" the Budget and undermine the arguments of the trade union critics: otherwise, the Budget strategy would all too easily fail, before the supply effects came through. The forecasts in the Financial Statement and Budget Report had unfortunately given the critics a field-day. It was a pity they had been published since they were unreliable and their basis was in doubt. On pay bargaining too, it was essential to convince negotiators that the traditional approach would only mean more inflation and more stagnation. It was important to get this message over in time to influence the mood of trade union conferences this summer.

In further discussion, it was argued that the trade unions might try to breach the strategy. The Government's attitude to them, and its policies affecting them, were crucial for the strategy's success. The paper did not really confront the question of to what extent, and in which sectors, it would be wise to resist the trade unions. It would be helpful to have a separate paper setting out the timing of major claims over the coming winter, what were the critical ones from the point of view of the unions' possible stranglehold over the economy, and what were the options for Government. On the other hand, it was argued that there was more than an even chance of getting through the winter without a show-down. At the moment, the unions did not appear to be looking for one, and the risks would be less in a situation where we were relying on monetary discipline rather than on pay norms - or even the possibility of a pay freeze. At the same time, however, the risk remained that the unions <u>might</u> unite against the Government; for, despite the disarray which they were currently showing, they were still very powerful. This meant that it would be unwise to legislate too much or too fast. In addition, it was worth remembering that many of our difficulties with the trade unions

/were due to

were due to poor management. This was particularly so in the public sector where - not coincidentally - the unions had caused the greatest difficulties.

The proposals of the Secretary of State for Employment for legislation on the trade union front would be discussed by E Committee the following day. These did not, however, cover the questions of taxing unemployment benefit, paying supplementary benefit to strikers and the PAYE rebate and it would be worth considering these in due course. It would also be worth considering the manner in which individuals were able to collect their unemployment benefit: on the face of it, it seemed all too easy for benefit to be collected.

It was further pointed out that, while attitudes must change, this would be no easy matter. The psychology of much of the working population, but particularly in the North, was unfavourable. Many people preferred to continue with our present, unsuccessful ways, rather than accept the challenge of improvement. A major task must be to change attitudes, and to do so rapidly. This was necessary not only as part of the rebuilding process, but also in order to retain the electorate's support if and when there were industrial trouble. On the other hand, it was argued that there already were signs of a change in attitudes. People understood much more than they had done that manufacturing industry needed priority, and that the country would only revive if industry became competitive once again. However, it was important to consolidate this change of mood - particularly, given the immediate economic prospect, and the need to get through it without disruption.

/In further

In further discussion, it was argued that Ministers must make every effort in the months immediately ahead to put over the Government's strategy. Further work was needed on clarifying what the message should be, but there was already sufficient to be getting on with. It was also important that the press should carry as many "good" stories as possible on the economic front which would show that the strategy was working: the Paymaster General and the No. 10 Press Secretary would have an important role to play here. On the other hand it was argued that Ministers needed more resources for putting together speech material. They did not always have the time to do it themselves, and Information Departments were ill-equipped to help. Against this, it was pointed out that there was a difference between the basic ideas in the strategy and putting them into the right form. No. 10 and the Treasury ought to be able to help with the former, while Information Departments could surely help Ministers with drafting. In addition it was argued that presenting the strategy should come not only from Ministers but also from other quarters. For example, the Government's friends in the press, the IEA and selected businessmen could perhaps be persuaded to do more.

Summing up, the Prime Minister said that the meeting had been a useful, first discussion. Following on the proposal for specific ideas to help with the supply side of the economy, the Secretaries of State for Industry, Employment, the Environment and Trade and the Chancellor should send their own lists of ideas to the Prime Minister by the end of this week. These lists would then be examined by John Hoskyns and Sir Kenneth Berrill and priorities would be established. Secondly, Ministers should do all they could to present the strategy. John Hoskyns would be in touch with them, and would provide assistance in the form of basic ideas. The

/Conservative

CONFIDENTIAL

Conservative Research Department might also be able to help. It would be for Information Departments to assist Ministers in putting speeches together. Thirdly, the Home Secretary should arrange for the Civil Contingencies Unit to prepare a paper setting out the timing of major pay claims over the next year, the problems which these could involve and the Government's options for dealing with them. The Secretary of State for Employment might wish to be associated with this work. Fourthly, Ministers would need to meet fairly regularly to consider the strategy. But it would not be worthwhile unless there was something specific to look at. The examination by John Hoskyns and Sir Kenneth Berrill of the lists of proposals which Ministers would be preparing should therefore provide the basis of discussion for the next meeting of Ministers.

TL.

Copies to:-

PS/Home Secretary
/Secretary of State for Industry
/Secretary of State for Energy
/Secretary of State for Employment
/Secretary of State for the Environment
/Secretary of State for Trade
/Lord President
/Chancellor of the Exchequer
/Sir John Hunt
/Sir Kenneth Berrill

CONFIDENTIAL

JS

10 DOWNING STREET

From the Private Secretary

SIR JOHN HUNT

MONTHLY ECONOMIC REPORT

The Prime Minister has seen/the June Monthly Economic Report (E(79)9) and has confirmed that she would like to see this Report each month. I pointed out to the Prime Minister that this was only a very summary report, but I did not in the event show her the old, longer version. She seems content for the moment.

T. P. LANKESTER

18 June 1979

LIST OF THOSE ATTENDING PRIME MINISTER'S MEETING TO DISCUSS THE JOHN HOSKYN'S PAPER AT 11.00 A.M. ON MONDAY 18 JUNE

Home Secretary

Secretary of State for Industry

Secretary of State for Employment

Secretary of State for the Environment

Secretary of State for Trade

Lord President of the Council

Chancellor of the Exchequer or John Biffen

Tim,
Original to P.M.
copy to John Hoskyns

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

17.6.79

Dear Private Secretary,

The Prime Minister is discussing a paper from the No.10 Policy Unit at 11.00 am tomorrow (18th June).

I would be grateful if she could have this note from me before then, since I am unable to attend the meeting, and also if you could supply a copy to John Hoskyns for him to see <u>before</u> the meeting.

As I am drafting this from home and have no copying facilities perhaps you would be kind enough also to make a third copy and return it to me under personal cover.

Yours sincerely

David Howell

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

S.of S.Energy
Personal Minute

17.June 1979

PRIME MINISTER

As you know, I have to be at the Energy Ministers' meeting in Luxembourg this morning when you are discussing the Hoskyns Strategy Paper. I shall be putting in some personal comments to John Hoskyns later in the week, but in the meantime may I make the following brief points:

1. In my view the key to the whole Stepping Stones approach, and to the achievement of a calmer and more stable economic climate, has been all along to establish much more clearly in workers' minds the nature of their real interests, in terms of living standards, purchasing power, ownership of possessions and general status - as opposed to their 'interests' as depicted and advanced by political (and muddled) union leaders.

2. The contrast over the next fifteen months is going to be particularly vivid - with the reality being an actual improvement through our tax and other policies in the position of many workers (especially skilled groups such as miners and electricity workers who have been the greatest threat in the past), but with union propagandists focussing on the RPI figure and talking of 20% and 25% wage increases to 'catch up'.

3. This is a battle of argument, understanding and presentation which we have got to win in Round One (eg before August 1980) otherwise we will continue to find ourselves (in Hoskyns' graphic

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ

phrase) trying to pitch our tent in the middle of a landslide.

4. This will require vast efforts of selling and persuasion to establish three things in particular (amongst others):

a) that our tax changes will bring real benefits to millions of trade union members, and others, in the next fifteen months, if allowed to;

b) that the ~~standard~~/standard of living in the average household is what matters, that people should keep hold of this 'reality' and not be too mesmerised by once and for all shifts in the RPI (The introduction soonest of a new index to reflect this is crucial);

c) that our plans for wider ownership for all are serious and tangible and will bring workers an early increase in status and economic security for their families which socialist economics could never offer.

5. I suppose the mark of real success would be if we could show in the next few months that ~~even~~ if there were no wage movements at all in the Pay Year 1979-80 (i.e. a freeze) people would be substantially better off by mid-80 in terms of their real and true interests, pay less tax and have more jobs.

6. The weeks between now and the start of the new Pay Round offer an opportunity which may never re-occur to drive home where real interests lie and set the course for stability from 1980 onwards. A ~~vast~~/huge effort of Ministerial persuasion and argument will be required.

David Howell

PART 2 begins:-

S/S Energy to PM 17/6/79

PART 1 ends:-

PM to H. Sec M5/79T 14/6/79

END

Filmed at the National Archives (TNA) in London

February 2010