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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	Lord Allen
Chancellor of the Exchequer	Mr. David Basnett
Secretary of State for Employment	Mr. Frank Chapple
Mr. Ian Gow	Mr. Tony Christopher
Mr. David Wolfson	Mr. Geoffrey Drain
Mr. Clive Whitmore	Mr. Moss Evans
Mr. Henry James	Mr. Alan Fisher
Mr. Tim Lankester	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

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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

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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

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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

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take 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.

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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 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

Lord Allen 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 Prime Minister interjected that 50 per cent of goods were not VATable, and that the Government had no intention whatever of imposing VAT on them. Lord Allen 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 Prime Minister 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. Lord Allen interjected that the trade unions were interested not only in wealth creation but wealth distribution as well.

Mr. Evans 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

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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

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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

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Distribution:

Private Secretary to the Chancellor of the Exchequer
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