Mr Wolfson
cc Mr Duguid
Mr Walters

Prime Minister 2

This discussion with the TUC Economic Committee was on predictable lines. But Mr Murray admitted that the TUC £6 bn package would lead to higher interest rates.

TL 26/2

MB.

NOTE OF A MEETING HELD AT 11, DOWNING STREET ON TUESDAY, 24 FEBRUARY, 1981 AT 5.30 P.M.

Present:

Chancellor of the Exchequer
Secretary of State for Employment
Chief Secretary
Mr. Unwin
Mr. Dixon
Mr. Burgner
Mrs. Gilmore
Mr. Mortimer
Mr. Ian Stewart, MP

Mr. Basnett)
Rt. Hon. Lionel Murray)
Mr. Cave)
Mr. Christopher)
Mr. Daly)
Mr. Drain)
Mr. Duffy)
Mr. Evans)
Mr. Fisher)
Mr. Gill)
Mr. Jackson)
Mr. Jenkins)
Mr. Parry)
Mrs. Patterson)
Mr. Sirs)
Mr. Whatley)
Mr. Willis)
Mr. Lea)
Mr. Callaghan)

BUDGET REPRESENTATION BY TUC ECONOMIC COMMITTEE

Mr. Basnett said that the TUC Economic Committee had sought a meeting with the Chancellor on reading the report of the February meeting of the NEDC. This had suggested that neither the Government nor the CBI appreciated the true scale and speed of the erosion of British industry, and that the Government had not seriously addressed itself to the proposed steps to recovery set out in the TUC's Economic Review. The TUC wished to take the opportunity also to indicate the immediate steps which in their view were needed in the Budget. There had been a catastrophic 14 per cent fall in manufacturing output, unprecedented even in the 1930s, and a reversal of all growth achieved since 1967. GDP had fallen 3 per cent last year, and 440,000 redundancies had been notified to the MSC in the first 11 months of 1980. All the forecasts, which the Government had not challenged, pointed to a continuation of these disastrous trends. At the meeting with the Prime Minister in October, the General Council had requested an urgent change in course of economic policy on the grounds that unemployment had reached the level of 2 million. It had increased by 23,000 per week since then, and of course these figures understated the real problem because of the large amount of unregistered unemployment. The total shortage of jobs was now around 3½ million. The forecast that employment would reach 5 million by the end of the 1980s, mentioned at the last NEDC meeting, had not been challenged by the Government. The TUC welcomed the belated signs of flexibility by the Government over the serious problems of the mining industry. There was joy in heaven after a sinner's repentance, but there were doubts whether the repentance went far enough or was for the right motives. If a change in course was not possible through mutual discussion and debate, without the threat of industrial force being used, there was bound to be a tendency for that threat to be brought into play. The TUC did not want this development, but had to consider whether there were other means of deflecting the Government from its present disastrous policies. As a careful reading of the Economic Review showed, the TUC did recognise the importance of competitiveness and the challenge that was presented by new technology. It was ready to react positively to proposals for the introduction of new technology when their implementation was by agreement; it should be remembered that it had been the CBI General Council, not the TUC, which had turned down the joint statement on technological change. The TUC did not believe that the problems of Britain could be easily solved. Instead they were calling for a long term policy for restructuring and modernising industry; specifically they suggested large investments in improving the transport and telecommunications systems. More

Hardly !

generally their aim was to reverse the appalling waste of resources involved in unemployment. They calculated that each unemployed worker cost £7600 in lost output, so that the total bill was over £18 billion per year. The direct cost to the Exchequer of unemployment would outstrip the receipts of North Sea oil and gas in 1981-82. In short you could not lay waste an economy and claim to be solving its problems; this was what the Government appeared to be doing.

2. Mr. Murray said it was quite clear that the downward spiral was continuing. As he travelled round the country, and in particular to places such as the West Midlands, he found that the disastrous consequences of present policies were increasingly recognised by both trade unionists and employers. So far as the Budget was concerned, the first urgent need was for a reversal of the decision to increase employees' National Insurance contributions. A reduction of ½ per cent in the employers National Insurance Surcharge (costing £½ billion) would also be very desirable. The TUC was most concerned at the rumours circulating about the Government's intention not to allow full indexation of tax allowances; this would have damaging effects on purchasing power and would be inequitable. It was worth pointing out in passing that it favoured a far more open discussion of the possible content of the Budget in its preparatory stages so that it was not necessary to rely on leaks in newspapers.

3. The TUC Economic Review recommended a net stimulus of £6 billion to the economy. This sounded a lot of money, but it was really a very modest proposal which would do no more than prevent unemployment from rising further. It was intended as a stabilising package and should not be seen as large scale reflation. It had been criticised because it had amounted to a proposal to revert to old style demand management. The TUC firmly believed that it was essential to manage the economy in a positive way. They wanted a counter-cyclical stimulus for private sector investment as well as more investment in the nationalised industries. In many

parts of industry there were no signs of genuine adaptation to the problems of the 1980s and in areas such as training and technology the Government had a crucial part to play. There were bound to be arguments and differences about the means which should be used, but the important point to realise was that the situation we were in was not automatically self-correcting. It was no answer to the very real problems to play about with the minor variants of monetary policy. The TUC accepted that its measures would lead to an increase in the PSBR; but they argued that a net stimulus of the order proposed would in time lead to higher revenue, save much of the enormous expenditure currently going on unemployment, and generate new savings. The PSBR was only one half of the problem; there was also the financial deficit of the company sector, which was presently greatly inflated by companies borrowing to survive. The TUC also argued strongly the case for a rise in pensions, long term unemployment benefit and child benefit at least in line with inflation. It was wrong to say the TUC was not concerned about inflation - they had been extremely concerned at the effect of last year's VAT measures on inflation, and hoped that the Chancellor had nothing similar in mind. This was not the time for an increase in indirect taxes. Far too high a price was being paid for getting inflation down, in terms of the erosion of industrial production and the rise in unemployment. The question which the TUC wished to put was what level of unemployment needed to be reached before there would be a modification of present policy. He hoped that, as present signs seemed to indicate, the answer was that level had been reached. The TUC was offering the Government a viable alternative to its present policies. It accepted that there were some risks, but when compared to the risks which were already being taken it was clearly the better way.

4. The Chancellor said that the Government had not accepted and did not accept the unemployment figure of 5 million by the end of the 1980s mentioned at last meeting of NEDC. Nor did it accept the implication that recent events showed it had changed

its basic economic strategies; the MTFS had explicitly allowed for variations in response to changed circumstances. It had always been recognised that cyclical factors would operate to raise the PSBR, depending on the extent and depth of the recession. The Government was desperately concerned about rising unemployment, because of its social and economic consequences, and about the failure of the economy to grow; but it had to cope with the world as it was, not with how it would like it to be. Colleagues in Europe were facing very similar problems and recession and rising unemployment were worldwide phenomena. The impact of the succession of oil price increases had affected all countries and the present difficulties were not a consequence of Government policies. The TUC were asking for a stimulus to the economy of £6 billion, which would require additional borrowing on that scale. Did the TUC believe this could be achieved in present circumstances without severe upward pressure on interest rates? It was hard to see how a large increase in rates could be avoided if the PSBR rose to £17½ billion.

5. In reply, Mr. Murray said the UK was in a strong position internationally to give a lead in reducing interest rates and increasing demand. He recognised that there would be some upward pressure on interest rates from action to increase demand, but this would be counter-acted to some extent by the strong tendancy at present for rates to come down. There was also the argument that more growth in the economy would generate additional savings, which again would tend to counter-act any tendancy for interest rates to rise.

6. The Secretary of State for Employment said that he did not accept the view that unemployment was on an inexorable upward trend. The number of young people coming onto the labour market had now peaked, and there was a retirement bulge as those born in the population boom after the First World War reached retirement. Developments in technology inevitably meant some rundown in the number of people in manufacturing industry - the present level in the UK (32 per cent) compared with 25 per cent in the US.

On the other side there were opportunities for greater employment in service industries, in high technology industries. Further moves towards early retirement might also help. Of course there was room for debate about the rate of decline in the number of people in manufacturing industry, and for saying that it was too fast at present. There was evidence to show that when the upturn came increased demand would be met mainly by increased productivity, and that there would only be a relatively small increase in manufacturing employment. Mr. Prior hoped for a revival of investment intentions by the end of 1981; but the key to a better industrial performance was a reduction in unit labour costs relative to those of our international competitors - UK unit labour costs were still much too high.

7. The TUC commented that rising unemployment was an inescapable fact and that there was no real sign of present strong upward trend being halted let alone reversed. Public sector employment, office employment and employment in new technology were no longer expanding. Unless more money was injected into the economy to get industry off its back and for investment in the future, not only would there be no end to the recession, but we would be in serious trouble in years to come. They recognised the need to improve marketing, to increase competitiveness, to improve the quality of management and industrial relations, but substantial action was needed on aggregate demand. The idea that if you squeezed industry hard, this would squeeze inflation out, and achieve increased competitiveness was wholly wrong. Industrial investment was needed to improve competitiveness, and they sought a boost to demand to facilitate this.

8. The Chancellor pointed out that, even if the interest rate objection could be overcome, there was no guarantee that an injection of demand on the scale the TUC were requesting would produce the desired effects. The lesson of past attempts to reflate out of recession was that only a small proportion went to higher output, a larger proportion to imports, and by far the

largest proportion to renewed inflation. Nor was vast investment necessarily the answer - as the example of the steel industry indicated. Here large scale investment had produced a large unneeded capacity, and we were now having to face the cost of disinvestment. It was crucially important to improve competitiveness so that we could begin to create real wealth. This depended on getting inflation down and keeping it down, because only then would investment in industry increase, and by getting our unit labour costs down to the levels of our competitors. In short he had studied the TUC's Economic Review very carefully, and he understood the intellectual case it argued for a large injection of demand. In his view this was not the right way out of our difficulties and would be fraught with danger. The inevitable increase in interest rates, which the TUC had not sought to deny, would worsen the problems of industry because of the increase to the cost of borrowing and the further stimulus that would be given particularly if there were a substantial fall in the exchange rate. Finally, it was worth pointing out that the present picture was not one of unmitigated gloom. There was evidence that British firms were still getting orders and hanging onto markets that on the arithmetic they should be losing. This suggested that UK industry was more often able to compete on price and quality than was often realised.

PSJ

(P.S. JENKINS)

25 February 1981