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PRIME MINISTER

Worth going through the meeting note.

MJS 30/vii

NOTE OF A MEETING WITH THE TUC ECONOMIC COMMITTEE HELD IN ROOM 29/2, HM TREASURY ON THURSDAY, 26TH JULY, 1979

The Chancellor accompanied by the Secretary of State for Industry and the Chief Secretary received members of the TUC Economic Committee at the Treasury yesterday at their request. Annex 1 lists those present at the meeting. Annex 2 contains a TUC press release issued by Mr. Murray at the end of the meeting.

The Chancellor welcomed the Economic Committee. He hoped they would feel free to ask for a meeting whenever they had views to offer the Government. Lord Allen thanked the Chancellor for seeing them. He had to say that the trade union movement felt deep concern at the direction of Government policies. Mr. Murray would elaborate.

In an opening statement Mr. Murray recalled that the General Council had met the previous day in an atmosphere of genuine concern and depression. Their unanimous conclusion was that the direction of Government policies endangered public expenditure, living standards and jobs. Concern had been expressed also about the inadequacy of consultation with the trade union movement. After the Budget the Chancellor had indicated his readiness to consult the TUC about economic policy. Yet major decisions had been announced without consultation of any kind.

Mr. Murray went on to express the TUC's concern at the savage attack on the public sector and public services. The Government were rumoured to be cutting public expenditure by another £4 billion. The Chancellor had spoken of selling assets worth £1 billion. Cuts on this scale were certain to reduce demand on the private sector as well as gravely damaging the public sector. Against this the income tax reductions in the Budget benefited only a small minority of people. The TUC were unconvinced of the improvements to incentives. The Government's actions would reduce output and consumer spending by 1 per cent; cut private sector investment by 1½ per cent; and further depress the economy. Ministers were digging a hole in the public sector which it was impossible for the private sector to fill. What were the Chancellor's estimates of the likely loss of public sector jobs? How soon would the figure of 2 million unemployed be reached? Would the figure go even higher? Public services were an important component of living standards. Cuts in direct taxes accompanied by cuts in public services did not represent an improvement in living standards. The TUC were opposed to suggestions of a new cost of living index if this did not reflect changes in the standard of public services.

The Government could not blame falling living standards on OPEC. As an oil producer rising energy costs would not harm our terms of trade. Any diminution of living standards in the next twelve months would be due entirely to the deflationary effect of the Budget. The only direct effect would come from inflated profits for the multinational oil companies; these should be dealt with by introducing a windfall profits tax. The Government were mistaken in their economic analysis. The people would come to recognise this as living standards fell. It was time for frank speaking.

The Chancellor replied that the Government shared with the TUC a common objective in securing better economic performance and better prospects for the British people. They were not in office to try strange new experimental theories on the economy. Government policy was the product of close analysis of the economy in Opposition. But, as he had plainly said the previous day in a speech at Alnwick, the outlook for output was "frighteningly bad".

In reply to Mr. Murray's detailed points, the Chancellor denied that the UK could be insulated from the effects of the general oil price increase. As a trading nation we suffered externally from the reduced prospect for world growth and international trade, because of the burden on the oil consuming countries. Internally, living standards suffered because the higher relative price of oil meant less to spend on other things.

The Government shared the TUC's wish to see rising standards of public services. By international standards, the quality of our public services was falling. Ministers were not theologically opposed to public expenditure. The first priority was to get the economy back on course. It was wrong to talk of savage cuts in expenditure. As the Chief Secretary had explained in the House of Commons the previous day the Government's aim was to stabilise the level of public expenditure. The country could not afford the increases planned by the last Government. Public expenditure this year had to be contained to the level in 1978/79.

As for sales of public assets, a sensible disposals policy had two advantages. First, it enabled the reduction in other public expenditure to be smaller. Second, it enabled our public corporations to benefit from access to private capital. The Chancellor went on to reject talk of "digging a hole" in public expenditure. His own PSBR target for 1979/80 was only £1¼ billion less than his predecessor's target. Before the Budget measures, this year's PSBR was running at around £11 billion. That was unsustainable and everyone agreed it had to be reduced. This could have been achieved by reducing public expenditure or raising taxes. The Government, like the

TUC, wanted to get taxes down. Sensible cuts in public expenditure were the only alternative. That was the first half of the equation: the other half involved measures to improve the supply side of the economy. This would take time to come through. Meanwhile, the poor outlook for growth was undeniable whilst public spending and inflation were brought under control. Improvement in living standards would have to be deferred. Nor would he deny the possibility of higher unemployment, though the prospects here turned decisively on the outlook for pay settlements in the public and private sectors. But the fact remained that there was no alternative if the Government were to make room for manoeuvre in the economy.

Mr. Murray made four points in reply. First, the TUC could not accept a small improvement in living standards than other countries at a time when North Sea oil equipped the UK better than its competitors to sustain higher investment and growth. We had an obligation not to add to the prospect for world recession, to increase the likelihood of "slumpflation". Second, the TUC were convinced that improved productivity and performance depended critically on high capital utilisation; this was true e.g. in chemicals, in steel and in glass. We should be increasing economic activity, not reducing it. Third, the Treasury computer must be providing Ministers with unemployment forecasts. What were they? Fourth, the Chancellor had spoken of reducing the PSBR, but lower growth, reduced incomes and higher unemployment would surely increase the need for public borrowing.

The Chancellor did not deny that the short term prospects for growth were gloomy. But with money supply tightly controlled, he repeated that the level of pay settlements would critically influence the outlook for jobs. He remained puzzled by the TUC's insistence on higher growth at all costs. To the extent this came from improved efficiency and productivity they were on common ground. But the TUC seemed to be looking for higher growth from higher demand. How did Mr. Murray suggest the Government could sustain a higher level of public sector borrowing without forcing up interest rates, an excessive growth in money supply and accelerated inflation? Is that what the TUC were advocating? As for the world economy an underlying trade deficit of £2 billion for the first half of the year was hardly indicative of a country not playing its part in maintaining world trade.

Mr. Murray thought Ministers were approaching the matter in too static and mechanistic a way. The PSBR had to be looked at dynamically. By generating extra resources higher growth would not inflate the PSBR by as much as low growth and high unemployment. The Government should be ready to take risks to maintain jobs. The Chancellor said that with interest rates already standing at 14 per cent such risks were not acceptable. The Secretary of State for Industry emphasised that jobs would be threatened just as much by a combination of high interest rates, crowding out of the private sector and accelerating inflation.

Lord Allen said he was confused by the Government's apparent belief that cuts in public expenditure could improve growth. The Chancellor said that the belief that one could generate growth and employment by expanding the money supply was no longer valid. We now knew that the result would be faster inflation, higher interest rates, fewer jobs and less growth. By controlling public spending, interest rates could be reduced, the economy put into better balance and the foundations laid for resuming growth again. Mr. Murray replied that the Government's policies seemed to him to be a recipe for bankruptcies and unemployment.

THIS PAGE WAS OMITTED FROM THE NOTE OF A MEETING WITH THE TUC ECONOMIC COMMITTEE HELD IN ROOM 29/2 H M TREASURY ON THURSDAY, 26 - JULY - 1979.

It all sounded very odd. The Chancellor strongly contested this; the experience of 1974/1976 demonstrated that bankruptcies and unemployment would be more likely to follow from an unsustainable level of public sector borrowing. Mr. Murray thought that preoccupation with the money supply was leading the Government to undervalue other equally important factors.

Mr. Murray then made some remarks about the nationalised industries and public corporations. Alone of major industrialised countries, we were diminishing our ability to control energy sources. Current US experience was particularly relevant. To strip BNOC of its powers of initiative and management was totally backward looking. The TUC were also concerned to learn of major changes planned in the structure and financing of some key nationalised industries. Decisions had been announced which threatened to weaken British Airways and British Aerospace. This was also true of the Post Office. And there were doubts about the long-term prospects for steel and shipbuilding, with damaging consequences for job prospects at Shotton and Corby. The Government had embarked upon a policy of creaming off to private enterprise all the profitable parts of the nationalised industries without giving any opportunity for the other side of the case to be argued by the TUC or the workers involved. The Government should know of the bitter resentment felt by workers in those industries. This was nowhere more true than in the steel industry where workers and management had co-operated over a long period to tackle major structural problems and reduce capacity. The TUC could not understand the argument for selling the seed corn to pay medium term debts. Workers were bound to defend their jobs against decisions which they did not understand. The TUC were particularly alarmed at the threats to BNOC and the loss of control over our national oil supply.

The Chief Secretary questioned Mr. Murray's use of the United States as an example of a more enlightened approach to these problems.

On the contrary, recent US experience illustrated the difficulty of adopting realistic oil-pricing after too long a period of over-regulation. Adjustment to market conditions in those circumstances was bound to be more painful. Mr. Murray's fears about losing control of North Sea oil were misplaced. The guarantee of security of oil supplies lay in BNOC's 51 per cent participation agreements. The Government had no proposals in mind to amend those. Control of UK oil was therefore secure. The Chancellor added, in reply to a question from Mr. Murray, that there was no intention of future changes in control.

The Secretary of State for Industry said the Government wished to see less political decision-making in the nationalised industries. He distinguished between the public utilities and public corporations which were really international trading concerns. Prosperity and job prospects in the latter depended on both vigorous management and continued access to additional capital. The Government believed that private shareholders injecting private capital would help to secure better prospects for the workers in those industries than continued management by public boards. Where monopoly public utilities were providing an inadequate service the choice was either between asking the corporation to pull itself together or to expose it to greater competition. The steel industry demonstrated all too clearly how continued delay in tackling fundamental problems made more painful the ultimate adjustment required. Security of jobs depended on how quickly major public corporations could be made internationally competitive. As for the changes in regional policy, he had been careful to keep the same level of support for the worst hit areas, whilst making long-needed adjustments in the boundaries of the relatively more prosperous parts of the country. He had also recognised the need to phase changes over a sufficiently long period - despite criticism from some of his own supporters.

Mr. Chapple, speaking for the TUC nationalised industries committee, echoed TUC fears about the effects on jobs at Shotton. The Chancellor had said that tax cuts would lead to more jobs, but he feared that these would be jobs in Japan, not at home. The Secretary of State for Industry said the TUC should remember that money saved on public spending would increase consumer expenditure, so creating and supporting extra jobs. Mr. Chapple was right to think that some of the extra demand would go on imports until British industry became more competitive. It was not given to politicians or to the TUC to say where the extra jobs would be found. Mr. Chapple replied that this seemed a simple-minded approach to running an economy. He feared the Government's policy could put civilised behaviour at risk. He did not accept that the Government had a mandate to dispose of national assets. He wanted to know the Government's intentions regarding disposal of BP shares. Were the employees of BP to participate? And what assurances could the Government offer if employees did not take up their shares?

Replying, the Chancellor said that in his Budget statement he had made clear the Government's intention to raise £1 billion this year by disposing of public sector assets, including a tranche of BP shares. The aim was to spread the burden of financing the public and private sectors, both to reduce demands for Government finance, and to enable our public coporations to compete more successfully in the market place. He deprecated as much as the TUC the shadow which overlay Shotton: this was something which the workforce might well have been spared if Shotton had stayed in the hands of John Summers rather than become part of British Steel. Mr. Chapple said he could not see the logic of taking this kind of action at a time when the world was facing growing recession. It did not seem consistent with the aim of reducing the PSBR to sell of the most profitable parts of our nationalised industries. The Chancellor replied that, to stay successful, these needed more development capital which could be best provided by the private sector. But, as had been explained, there was no question of threatening control of our oil supply.

Mr. Gill then spoke about British Aerospace and British Shipbuilders. British Aerospace was a profitable enterprise, which had been conspicuously successful under public ownership. It had a world-wide reputation as a highly efficient organisation, As a high technology enterprise it provided a valuable fall-out for the rest of industry. He very much deprecated proposals to sell off shares to private enterprise. He was particularly unhappy about any option to sell of Dynamics, in the event of difficulty in disposing of a block of shares in the main company: this would make the industry unbalanced. As for British Shipbuilders, there was no immediate prospect of finding a purchaser, but it did the Government no credit to contemplate disposal when they did become profitable. Replying, the Secretary of State for Industry said that the Government would far prefer to sell a balanced part of the British Aerospace operation. He could not accept Mr. Gill's criticism of the Government's attitude to British Shipbuilders. He believed that the injection of private capital and management could only benefit the workers involved.

At this point, Lord Allen intervened to say that he hoped the Government recognised that consultation did not mean that the Government talked to the TUC only about fait accompli. Mr. Murray said this was illustrated by developments on the National Health Service. The Government had earlier indicated that there was no intention to cut back the NHS. The TUC had since heard that Ministers were not planning to raise the Health Service cash limits for inflation or the increase in VAT. They had the impression of a real cut-back in Health Service expenditure of £100 million next year, despite an ageing population. The Health Service needed more not less money. There had been no opportunity for consultation with the Government in advance of decisions. The TUC had no answers to the fears expressed by those working in the Health Service. And cuts were threatened in the Civil Service, in local authorities and in quangos. <u>Mr. Murray</u> thought the Government were also mistaken to throw away the Energy Commission. Ministers should come clean with the TUC. Either there must be proper consultation or not. Ministers could not take unilateral decisions and then expect the TUC to help minimise the damage. With proper consultation the TUC would expect to share the responsibility for the consequences of decisions.

<u>The Chancellor</u> commented that the Government were involved in a continuous process of decision-making; not all decisions could be the subject of consultation. Some issues were more properly discussed with Departmental Ministers than centrally with the TUC's main committees. Civil Service staff questions probably came into this category. So did consultations about expenditure about the Health Service. <u>The Chancellor</u> assured Mr. Murray that Ministers were ready at all times to hear representations from the TUC either at departmental level or through meetings with the Economic Committee.

<u>Mr. Murray</u> said that the TUC had reached a broad agreement with the Labour Government on arrangements for discussing public expenditure priorities. They would like the same sort of involvement with the present Government. With the Chancellor's agreement, they would like to offer some procedural suggestions. <u>The Chancellor</u> said he would be glad to receive any TUC views.

The meeting ended with brief exchanges on the handling of the press.

AB

(A.M.W. BATTISHILL)
27th July, 1979

ANNEX 1

Those present at the meeting:

Chancellor of the Exchequer	TUC Economic Committee
Secretary of State for Industry	Lord Allen
Chief Secretary	Mr. Basnett
Mr. Ian Stewart, MP	Mr. Chapple
Sir Lawrence Airey	Mr. Christopher
Sir Anthony Rawlinson	Mr. Drain
Mr. J.B. Unwin	Mr. Duffy
Mr. Mower	Mr. Evans
	Mr. Fisher
Mr. Lippitt (Dept. of Industry)	Mr. Gill
	Mr. Parry
	Mr. Murray
	Mr. Willis
	Mr. Lea
	Mr. Callaghan
	Mr. Pursey
	Mr. Barber
	Miss Hughes

Circulation:

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Sir Lawrence Airey	
Sir Anthony Rawlinson	Mr. Lankester, No. 10
Mr. Bailey	
Mr. Littler	
Mr. F. Jones	
Mr. P. Dixon	
Mr. Unwin	
Mr. F.E.R. Butler	
Mr. Ridley	