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J B Unwin  
Under Secretary

Mr T Lankester  
10 Downing Street

26 October 1979

PERSONAL & CONFIDENTIAL

*Dear Jim,*

I enclose the papers I mentioned to you which relate to the whole series of decisions required between now and the end of the year and in particular (in Douglas Wass' minute) to the presentation of the Industry Act Forecast. I should be grateful if, for obvious reasons, you would keep these to yourself for the time-being.

*Yours Ever,*  
*J B Unwin*  
J B UNWIN

CHANCELLOR OF THE EXCHEQUER

MR. J. B. UNWIN,

cc Chief Secretary  
Financial Secretary  
Minister of State (C)  
Minister of State (L)  
PCC —  
MEG  
Mr Ridley  
Mr Cropper  
Mr Cardona

## DECISIONS ON TARGETS, FORECASTS AND ASSUMPTIONS: AUTUMN 1979

I mentioned to you the other day that I was concerned that you and your Ministerial colleagues should be fully seized of the nature of the decisions, and their timing, that would be required of you if we were to carry out the plans you have provisionally made to publish in the next few months the economic forecast, the financial plan and the Public Expenditure White Papers (Marks I and II). Besides these publications we have a time-table to meet in publishing the cash limits for the RSG and for the nationalised industries and in providing the Government Actuary with the economic assumptions he needs to cost the social security programmes for the Contributions Review.

2. These exercises are to a greater or lesser extent all inter-related and it would be unbusinesslike to proceed in piecemeal fashion. Indeed if we do we could find awkward inconsistencies arising. The attached note describes the relationships and puts forward a sequence according to which decisions might be taken.
3. The first and most urgent decision required is what we should publish in the way of a short-term forecast under the terms of the Industry Act towards the end of November. Mr Shepherd has just put forward the full report of the forecasters, which deals with the variant cases you wished to have explored, and this will form the basis for your consideration.
4. As I see it, there is a range of choices as to what the published forecast might contain. These include:-

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(i) The main forecast as submitted. Subject to all the uncertainties and margins of error, this reflects the forecasting team's best judgment about the likely outcome. But there are obvious difficulties in presenting this as the Government's central view, not least in the risk that the inflation forecast would affect expectations and become to some degree self fulfilling. I imagine that even if you thought it right to publish this as one case, you would wish to display others also.

(ii) Three or four separate cases. These could embrace, but need not be the same as, those reported on in Mr Shepherd's submission. Unless you wished to identify one as the most likely case, they would not strictly be variants but possible views of equal status. There would be no technical objection to this, but I suspect it would lead to a good deal of confusion, and both Ministers and officials (eg in the House and in the Treasury Committee) would be pressed very hard to reveal which of the alternatives - to the extent that they were credible - was the 'central' one. It would in any case be difficult to repeat this device in the Budget forecast next Spring when it will be published alongside the public sector accounts and the Government will be obliged to commit itself to a specific inflation forecast (eg for the November 1980 social security uprating).

(iii) A single case - not necessarily one of the four explored but perhaps containing a blend of some of the elements in them - reflecting the most favourable prospect that it seemed realistic to publish. If, as I imagine you would wish, this embodied a better outlook on inflation, it would be necessary to make it explicitly clear that the reduction in inflation through 1980 postulated, in accordance with Government policies and expectations, a deceleration in earnings during the current pay round. It would also be made clear that to the extent that earnings did not so respond, the outlook for inflation and output would be correspondingly poorer.

5. The choice between these is not easy. The advantage of course (i) is that, on our reckoning, the main case is more likely to be validated than any other. This is the one therefore that should be used as the basis for fixing cash limits (subject to any volume squeeze which as an act of policy it is desired to secure). It is the one which the forecasters would like to publish, not least because their professional reputation is at stake. I recognise the difficulties however and would not press you to adopt this course if your judgment was that it would undermine Government policy. If you regard the effective choice as being between (ii) and (iii), you may see attractions in the former in that it does not give a simple figure to be shot at. As a course it depends critically on our being able somehow to be neutral with respect to the four cases. Course (iii) is attractive in the short run, but the credibility of the case might not survive for long.

6. Whatever course you choose, there would, I think, be great advantage in switching the emphasis in the presentation of the forecast from the figures to the prose. I do not think we can omit a table similar to those produced in the past, but it should be possible to bring out more emphatically than hitherto the uncertainties, judgments and margins of error to which the bare figures are subject.

7. Since, as the attached note shows, a number of other decisions hang on the forecast, it would be most helpful if a decision on the scope of the publication could be reached very soon. You may think that a meeting would be helpful in achieving this. You will also, I expect, want to secure the Prime Minister's agreement to the course of action you favour.

8. Finally, we have been giving further thought to your suggestion for a discussion with outside forecasters. I think this would be helpful, but frankly I doubt whether it would be feasible in relation to the immediate forecast. What I should like to do is to think in terms of arranging a seminar towards the end of the year after this forecast has been published and before we start the next forecasting round, and, if you agree, I will bring further proposals forward on this.

DW.

DOUGLAS WASS  
25 October 1979

## DECISIONS ON TARGETS, FORECASTS AND ASSUMPTIONS: AUTUMN 1979

Note by the Central Unit

Introduction

The purpose of this note and Annex is to distinguish and discuss the principal occasions up to January 1980 on which the Government will be obliged to release or publish specific forecasts, targets or assumptions about the future course of key variables such as unemployment, the RPI and average earnings, the PSBR and £M3. (It covers also occasions - such as publication of the RSG cash limits - on which figures for key variables are not given directly but underlie published figures for other quantities.) The note comments briefly on the problems of securing consistency and is intended as a background to the separate submissions that will be coming forward on the substance of individual issues.

2. The main issues of substance (eg the possible need for fiscal adjustments to secure PSBR figures compatible, at unacceptable interest rates, with declining target £M3 growth) are likely to arise in connection with the putative medium-term financial plan (MTFP). It is assumed that such a plan would be published with, though not necessarily in the same document as, the second Public Expenditure White Paper (PEWP II). Preparation of such a plan supported by consistent medium-term revenue and expenditure projections would involve a great deal of detailed work for which adequate preparatory time would be vital. If publication were next January, decisions about the form of the plan would need to be taken by mid-November at the latest. Final decisions on public expenditure programmes for 1981-82 to 1983-84 would need to be taken by then and the economic assumptions for the programme figures in PEWP II and the MTFP would need to be decided by the end of the first week in November.

The events

3. The various events that need to be considered are set out in rough chronological order in the Annex. For each entry this shows the decision deadline, release or publication date, and a brief

summary of the kind of information to be provided. Omitted are:

(i) Various EEC and OECD occasions on which UK officials will have to discuss the outlook and provide forecasts. We cannot exclude the possibility of leaks but there have been none recently.

(ii) The possibility of a Government paper for the 4 December meeting of NEDC. For immediate purposes it can be assumed that such a paper would be written round whatever figures had already been released in other contexts.

#### Inter-relationships

4. There are some complex interactions between the 9 events listed at Annex A. However there are two fixed points conditioning the approach to the rest:

item 1 1980-81 RSG cash limit: Treasury Ministers have put proposals to colleagues (Chief Secretary's paper to MISC 21) for a cash limit providing for local authority cost increases of around 13%. This represents a shading-down of pay and price assumptions (equivalent to an annual rate of 14.6%) consistent with the short-term forecast submitted on 8 October.

item 2 PEWP I: The 1980-81 programme figures will be based on the same economic assumptions (for 1980-81 unemployment, price and earnings increases) as were used in the 1979 Survey. It is also planned to give the unemployment assumption of 1.65m for 1980-81 in the text of the White Paper.

5. Examination of the commitments set out in the Annex suggests there are two main groups of items within which it is essential to maintain broad consistency.

#### November Announcements

6. The first is the late November clutch of announcements. This

comprises the RSG cash limit and Scottish housing subsidies (for both of which local authorities are the main audience), the assumptions for the Government Actuary (GAD) (on which final decisions should be taken by end October), the Industry Act forecast and the nationalised industry cash limits.

7. The nationalised industry cash limits will be set after discussion with each industry of its own assessment of the cost increases it will be facing, and the price increases it can make. The figures agreed for the nationalised industries and the provision for local authorities' cost increases will need to be broadly consistent with the picture of the economy in the Industry Act forecast; but some variation can be defended on the basis that the provision in cash limits take account of the particular circumstances of each case. At the same time the cash limits will need to make sufficiently realistic allowances for cost and price increases to avoid a situation in which they are exceeded. Similarly reasonable consistency between the short term forecast and the assumptions for the GAD and Scottish housing subsidies is needed to avoid problems of substance. And they should also be consistent with the published Industry Act forecast, although the incorporation of variants in the forecast might ease (though not eliminate) this problem to some degree.

8. The above suggests that early decisions on the Industry Act forecast are necessary so that sets of assumptions for the GAD, housing subsidies and the nationalised industry cash limits can be fixed to be consistent with it. (The GAD needs final figures by the end of October if the normal timetable for the Ministerial review of National Insurance contributions is to be met.) Otherwise as time passes what can be published as the Industry Act forecast will have become progressively more prejudiced by the need for consistency with earlier ad-hoc decisions on assumptions to be provided (and in most cases published) in these other cases.

9. However, the possibility of inconsistency between the (post Budget) economic assumptions underlying the figures in the first public expenditure White Paper (PEWP I) and the figures to be given in various contexts at the end of November, seems unavoidable. There is thus a case for making clear in briefing when PEWP I is published

the  
 that the economic assumptions date from/early summer; that the autumn forecasting round is not yet complete and that the assumptions (and certain of the programme figures) may need revision later; but that whatever happens, the PSBR will be restrained as necessary to ensure that the Government's £M3 targets are met.

Later Announcements (including January 1980)

10. The second group of announcements within which consistency would seem essential comprises PEWP II and a MTFP and the November roll-forward statement about the ceiling on monetary growth for the 6 months beyond April 1980. The need for consistency between the first two is obvious and referred to in paragraph 2 above; if, however, the Industry Act forecast published in November incorporated a range of variants, then this might to some extent ease the difficulty of publishing in a MTFP/PEWP II, if it appeared necessary, a projection for 1980-81 differing from any central case in the Industry Act forecast.

11. The overriding importance of a clear and consistent message on monetary targets based on realistic underlying assumptions, means that the target rate of monetary growth to be announced in November for the period to October 1980 should be consistent with what might be envisaged for a MTFP without prejudicing subsequent decisions on such a plan. Advice on the November roll forward will come forward separately in due course.

Conclusions

12. The discussion in this note suggests the following main conclusions:

- (a) a very early decision is now required on the numbers to be published in the Industry Act forecast;
- (b) decisions on the economic assumptions to be supplied to the Government Actuary, and to be used for calculation of Scottish housing subsidies, should be taken only after figures for the Industry Act forecast have themselves been settled (assumptions for the Actuary are needed urgently, which reinforces conclusion (a));



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(c) If a medium term financial plan is to be published next January, decisions will be needed by mid-November on the form of any such plan, so that there is adequate time in which to prepare consistent sets of revenue and expenditure projections and to deal with any problems of substance which might arise. This in turn requires decisions on public expenditure programmes for 1981-82 to 1982-83 by the same time, and decisions on the economic assumptions underlying the programme figures by the end of the first week in November.

Central Unit  
H M Treasury  
22 October 1979

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<u>decisions needed by</u>	<u>publication date</u>	<u>event</u>	<u>details</u>	<u>comments</u>
25 Oct (Cabinet)	16/20 Nov	Cabinet decision on 1980-81 RSG cash limit. (Meeting with local authorities' Consultative Council on 26 October. Public announcements on <u>16 Nov</u> (Scotland) and <u>20 Nov</u> (England & Wales)).	Decisions needed on assumptions for earnings increases for local authority employees (as a result of Clegg and other comparability awards, 1979-80 pay round and part of 1980-81 pay round) and RPI Nov 1979 to average 1980-81. Individual assumptions are <u>not</u> published and public presentation will only give allowance made for overall costs. Local authorities may be able to guess at underlying assumptions.	Treasury Ministers are recommending 13% on local authority costs. This is a rounding down, allowing for hoped-for productivity increases, of the 14.6% figure resulting from assumptions of: 14% for settlements in the 1979-80 pay round, 12½% for the 1980-81 round and 14½% for the RPI increase from November 1979 to average 1980-81. In addition 6% has been allowed for the effect of Clegg awards. The assumptions are consistent with the autumn forecast.
end Oct	20 Nov	Economic assumptions for the Government Actuary's Report to permit Ministers to review of National Insurance contribution rates for 1980-81.	Assumptions on: i. RPI % increase Nov 79 to Nov 80 ii. % increases average earnings 1979-80 on 1978-79 and 1980-81 on 1979-80 iii. average level of unemployment in 1979-80 and 1980-81.	a. Buoyancy of the fund if assumption for increase in average earnings proves to be on the low side means there is some leeway in choosing assumptions which in the event will probably not affect the PSBR. b. Legislative and administrative procedures to be completed before Christmas would make it difficult to delay a decision on assumptions much beyond the end of October.

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<u>decisions needed by</u>	<u>publication date</u>	<u>event</u>	<u>details</u>	<u>comments</u>
-	1 November	Publication of PEWPI on 1980-81	Public expenditure figures by programmes but only a minimum of economic cladding. No specific forecasts or targets for economic variables but it is intended to give the unemployment assumption of 1.65m for 1980-81.	Chancellor has agreed (meeting on 9 October 1979) that the unemployment and other assumptions should be left unchanged from those used in the Survey. The 1980-81 unemployment assumption (1.65m) underlying the social security figure is included in the draft White Paper going to Cabinet and has already appeared in the press following a leak. PEWPII assumptions for 1980-81 (and programme figures as necessary) may differ from PEWPI in the light of the Industry Act forecasts to be published in late November.
early Nov* Nov*		Nationalised industry cash limits for 1980-81	Limits are set after discussion of cost increases likely to face each industry. The industries have a view on how these cost increases relate to general inflation. The pay and price assumptions underlying the cash limits are not published.	<p>a. The cash limits need to be consistent with the picture of the economy presented in the Industry Act forecast. They also need to make realistic allowance for cost and price increases.</p> <p>b. Whenever the limits are published there could well be strong pressure (eg from SCT) for the pay and price assumptions to be released.</p>

\*the NCR cash limit may need to be decided and published rather sooner

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<u>decisions needed by</u>	<u>publication date</u>	<u>event</u>	<u>details</u>	<u>comments</u>
mid Nov	mid Nov	Roll-forward of £M3 target	Budget undertaking to roll forward 6 months beyond April 1980 "in the autumn", implying publication of a target range for £M3 growth October 1979 to October 1980	<p>a. Strong arguments for an announcement of some kind on (but not before) 15 November when October £M3 figures are published.</p> <p>b. Strong arguments also for announcing a decision in principle on a medium term financial plan. Markets would expect something to be said.</p> <p>c. The figure for the roll-forward target should be consistent with what might be envisaged for a medium term financial plan, without prejudicing decisions on it. Desirable to declare policy on SSD simultaneously, with figures for £M3 foll-forward.</p>
		Future of SSD "corset" scheme	If SSD were to continue then ceiling in IBELs growth beyond December 1979 would need to be announced. If SSD were to be scrapped then mid-November announcement required to give the banks adequate notice for operational purposes.	
As soon as possible given the other decisions (GAD, n.i. cash limits etc) which hinge on it.	late Nov	Publication of Industry Act forecast	<p>Publication of forecasts "as to such matters as appear [to the Treasury] to be appropriate" Precedent suggests, for each of several variants:</p> <p>i. % growth in GDP and components to second half 1980</p> <p>ii. RPI increase to Q4 1980</p> <p>iii. current account of b.o.p. for 1979 and 1980</p> <p>iv. PSBR, nominal and as a % of GDP, for 1980-81</p>	<p>a. Legislative commitment is normally interpreted to require publication of forecast on or before 20 November. Some slip-page probably tolerable but could cause Parliamentary embarrassment.</p> <p>b. Unemployment and £M3 projections are not published as part of the Industry Act forecast. But the former can be guessed from the GDP growth rates.</p>

NOTE ALSO

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decision needed by	publication date	event	details	comments
				<p>c. Problems would arise if economic projections in PEWP II and/or a MTFP were inconsistent with the Industry Act forecast. Difficulty is not only with 1980 itself but also with medium term projections for later years: PEWP II/MTFP cannot show a totally implausible discontinuity between 1980 and 1981</p>
mid Nov	end Nov	Statutory Instrument on Scottish Housing subsidies for 1980-81 to be laid	<p>Figures given to local authorities for increases in average earnings and cpi, 1980-81 on 1979-80. Also for projected "pool" interest rate for all l.a. outstanding debt). Figures for projected expenditure on these assumptions are published in an Order.</p>	<p>a. Did not attract great attention in 1978, the first year of a new system.</p> <p>b. In 1978 the assumptions used and published were those contained in the Survey. LD would propose to do the same this year but the Scottish Office may press for up to date figures.</p> <p>c. Assumption on course of interest rates in 1980-81 is neatly obscured by use of "pool" rate.</p>
early Nov	Jan	PEWP II, 1980-81 to 1983-84	<p>publication of</p> <ol style="list-style-type: none"> <li>i. public expenditure figures by programme</li> <li>ii. possibly, economic projections over the period on at least two cases</li> <li>iii. "broad working assumptions" on numbers of unemployed</li> <li>iv. PSBR and revenue projections</li> </ol>	<p>Item iv could possibly be published in the MTFP if that were to be published separately.</p>

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decisions needed by	publication date	event	details	comments
as soon as possible for <u>form</u> of any plan.	Jan	medium term financial plan	<u>No</u> final decisions yet taken on whether to have a "plan" and if so what it should contain. But it seems likely that it would give for the 5 years 1979-80 to 1983-84, £M3 targets year by year and sufficient supporting detail to demonstrate their credibility, especially in relation to planned public expenditure.	<p>a. Plan, if agreed, will be centrepiece of government's medium term strategy and fiscal policies.</p> <p>b. MTFP could be incorporated in PEWP11 or published separately (in which case some of the revenue projections etc given in CMND 7439 could be omitted from PEWP11)</p>