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RECORD OF A MEETING BETWEEN THE PRIME MINISTER AND THE CBI AT 1545 HOURS ON MONDAY 9 JULY 1979

Present:

Prime Minister	Sir John Greenborough
Chancellor of the Exchequer	Sir Adrian Cadbury
Secretary of State for Industry	Mr. Fiennes Cornwallis
Secretary of State for Employment	Sir Francis Tombs
Secretary of State for Trade	Mr. H.A. Whittall
Mr. Ian Gow	Sir John Methven
Mr. David Wolfson	Sir Donald MacDougall
Mr. John Hoskyns	Mr. Richard Dixon
Mr. Henry James	
Mr. Clive Whitmore	
Mr. Tim Lankester	

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Welcoming the CBI delegation, the Prime Minister thanked them for their warm welcome to the Budget and to the Government's overall economic strategy. The strategy consisted of two key elements: improving incentives and returning power and responsibility to the private sector. The Government depended upon the private sector to make the strategy succeed.

Sir John Greenborough said that the CBI were pleased to have the opportunity to express their views to the Prime Minister directly. The CBI were indeed very pleased with the Government's strategy, and this was reflected in the letters which they had sent out to their members. He and Sir John Methven had found that the response of many employers was encouraging. Industry was committed to accept the challenge which the Government had provided. It would be important to monitor progress.

Against this generally encouraging background, the CBI wished to discuss with the Prime Minister two main policy areas: first,

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the exchange rate, exchange controls and interest rates; second, the coming pay round. On the latter, Sir John Greenborough said that the Prime Minister's speech in Cambridge the previous Friday had struck just the right note.

Sir Adrian Cadbury said that the CBI's view on the short-term economic prospect was similar to the Government's. The main problems facing industry were high interest rates, declining competitiveness and low profitability - for the first quarter of 1979, profitability in real terms had been only 2.9 per cent, and the CBI were forecasting only 3 per cent for the rest of the year. The CBI fully supported the Government's efforts to economise on public expenditure, but they felt it important - for the sake of the construction industry and for the country's infrastructure - that the cuts should not be concentrated on the capital side. As for interest rates, they accepted the overriding need to reduce the rate of inflation, but they were concerned about the effect of high interest rates, especially on small businesses. High interest rates were also putting upward pressure on the exchange rate. They therefore hoped that the MLR would be reduced as early as possible, consistent with keeping the money supply under control.

The CBI's latest survey showed that 67 per cent of respondents regarded prices as the major factor constraining exports; and even where export performance was being maintained, the high exchange rate meant that profitability was being reduced. A study carried out by Mr. Oppenheimer for the CBI in 1978 showed that many firms were worried about becoming uncompetitive because of the rising pound; the recent appreciation only underlined this concern. The CBI appreciated that there were certain advantages of a high exchange rate - in particular, the discipline which this imposed and its effect on inflation. But the speed and magnitude of the recent appreciation, and uncertainty over sterling's future course, were causing difficulties. The CBI hoped that the Government would abolish the remaining exchange controls as soon as possible: this would remove any artificial

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boost to the rate and would encourage the building up of assets abroad against the eventual decline of North Sea oil.

The Chancellor replied that the Government and the CBI appeared to be in close agreement on objectives. The Government disliked high interest rates, but against the background of accelerating inflation and excessive monetary growth, it had had no alternative but to increase MLR. Unfortunately, there was no evidence as yet that monetary growth was slowing, even though the authorities had achieved heavy sales of gilts since the Budget. The main problem was the very high level of bank lending to the private sector. Sir Adrian Cadbury agreed that it would be a mistake to reduce MLR prematurely before the money supply was firmly under control again, but asked that in reaching a decision on timing the Government should take into account the heavy cost which industry was having to pay as a result of high interest rates.

The Chancellor went on to say that he had made clear in his Budget speech that he intended to move to the progressive dismantling of exchange controls. The trade union response to this had been muted because they seemed to understand that an excessively high exchange rate was likely to threaten jobs. But after forty years of controls, it was only sensible to move step by step. Although he could not say what was a desirable level for sterling, it was clearly right on merits to relax exchange controls. The CBI's point that there should be early relaxation was well taken. But the extent to which the Government could influence the exchange rate was limited: industry might have to live with a relatively high rate and improve its trade performance through better non-price competitiveness.

Mr. Whittall commented that many companies had been forced to take on fixed-price export contracts because of tough competition, and this - particularly in the capital goods field -

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was causing problems. Mr. Cornwallis said that small companies were especially vulnerable to the high level of interest rates. Their priority at present was to reduce their overdrafts, rather than expand their businesses. They were also badly affected by the uncompetitive pound, and were more likely to give up exporting than were larger companies. Sir Adrian Cadbury said that, more generally, industry was likely to be facing a liquidity squeeze by the end of the year: although it was vital that the Government should maintain its policy of monetary discipline, industry's requirements could not be altogether neglected.

Turning to pay, Sir John Methven said that the next round was not going to be easy. However, the pay climate was already rather different from what it had been the previous year. The CBI were doing all they could to strengthen employer solidarity: they were planning two major conferences on pay and they would be circulating to all their members "pay talking points" which were intended to provide employers with advice on how they should set about negotiating in the coming round; for example, they would spell out the tax cuts in the Budget and the prospect that inflation - after peaking at 16 to 17 per cent - would thereafter be falling.

The CBI were thus doing their best to create the right climate for pay negotiations. It would be helpful if the Government could do more itself. It was especially important to influence trade unionists over the next two months when they would be at their annual conferences. The Prime Minister had projected the message very well in her weekend speech, but it needed to be spelt out again and again - and not just by the key economic Ministers. The message would only get home if it was repeated frequently. Sir John Greenborough added that he hoped that Ministers would consider carefully this whole communication aspect.

/ Sir John Methven

Sir John Methven went on to say that the CBI were keen to pursue the idea of a public discussion on the economic prospects. Neither the CBI, nor the Government, nor the trade unions, wanted a pay norm, but there appeared to be increasing support for the idea of a wider discussion of the choices ahead. In their view, it was important that such discussion should get under way if the economic realities were to be brought home to people. In particular, every effort must be made to disconnect the likely peaking of the rate of inflation from next year's pay claims.

The Chancellor said that the Government would do all they could to communicate the strategy, and create the right climate, as Sir John Methven had suggested. The Secretary of State for Employment pointed out that it was not always easy for Ministers to put the message across: in some ways it was easier for industry itself. The Government had an important role to play in influencing claims in the public sector, but its influence on private sector bargaining was likely to be fairly limited. The private sector would have to bear the brunt of claims early in the round. The Prime Minister said that Ministers would find it helpful, in communicating the strategy, to have a list of "success stories" in industry. Sir John Methven said that the CBI did keep such a list, and they would be glad to provide Ministers with examples: it was much easier to get publicity for them if Ministers, and preferably the Prime Minister, mentioned them.

As for the CBI's proposals for a wider economic discussion, the Prime Minister said that the Government were considering the proposal to set up a Forum. If such a Forum were established, it would be important that small businesses should be represented on it.

Sir John Methven then referred to the latest exposure draft on inflation accounting. The sooner progress could be made on inflation accounting, the sooner there would be a clearer understanding of the real level of profit in companies. He hoped

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that the Inland Revenue would clarify their approach to the fiscal aspects. The Chancellor replied that this work was in hand.

Thanking the Prime Minister for the meeting, Sir John Greenborough said that he hoped that she would be willing to meet the CBI regularly; he suggested a further meeting in the latter half of September. The Prime Minister said that she would be willing to meet regularly.

Finally, Sir John Methven said that in speaking to the press after the meeting he would only tell them what the delegation had told the Prime Minister; they would not indicate what Ministers' response had been.

The meeting closed at 1645.

10 July 1979

Distribution:

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