

C 68

CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Minister of State (C)
- Minister of State (L)
- Sir Douglas Wass
- Sir Lawrence Airey
- Sir Fred Atkinson
- Sir Kenneth Couzens
- Sir Anthony Rawlinson
- Mr Bailey
- Mr Byatt
- Mr Cassell
- Mr Kemp
- Mr Middleton
- Mr Shepherd
- Mr Davies
- Mr Folger
- Mr Ridley

**
 0.6.2
 1 share
 certainly
 want to see
 before
 finishing*

*P.M.'s speech
 main base*

MEETING WITH THE PRIME MINISTER ON MONDAY 5 NOVEMBER

You are meeting the Prime Minister for a discussion at 5.30 pm on 5 November. This brief covers topics that are likely to come up.

Industry Act Forecast

2. One of the main purposes of the meeting is to discuss your minute of 2 November to the Prime Minister on the Industry Act forecast and related questions. You are familiar with the background and underlying issues. I assume that your discussion will start from the premise that a forecast will have to be published later this month. It may be possible to repeal the Bray amendment in due course (Mr Folger's note of 1 November discusses this); but this could not be in time for this month's statutory obligation.

*1
 frag D.*

3. Your minute focuses on the inflation issue, which seems likely to be of most concern to the Prime Minister. In crude terms, the question is how far the Government could plausibly push down the main case forecast of 17% in Q4 1980. At our meeting the other day you decided on the figure of 14%. This assumes both a constant exchange rate and constant interest rates and an even more optimistic view of the outcome on earnings in the present pay round than the (optimistic) 14% the forecasters have already assumed. Your minute deliberately presents the Prime Minister with the option of 15% or 14%. This was in order to give her a choice and, frankly, to reduce the chances of being pressed to go below 14%.

2

4. As you know, many of us feel that 14% is itself straining credibility and that 15% (which would still show substantial deceleration from the peak earlier next year) would be more prudent. (You may have seen that the latest Phillips and Drew forecast - to be published on Monday - now forecasts inflation at 15% for the end of next year.) A fortiori we think there would be serious risks in going below 14%. It would strain credibility further; and it could pose practical problems in relation to cash limits.

5. We hope it will be possible for you to reach agreement with the Prime Minister on Monday on the inflation point. I imagine that she will not want to see the other numbers (for GDP etc) in detail. As you know, the forecasters are working on a further variant case in the light of the discussion with you on Tuesday. Your minute to the Prime Minister (last paragraph) is also designed to discourage her from asking for the full forecast report. But a copy could obviously be provided if she wants it.

③ 6. Related to this latter point is the question of circulating the forecast in Whitehall. You decided in July that your normal practice would be to circulate it to the Prime Minister and to 5 of your Cabinet colleagues; and a number of officials in other Departments (who in some cases have helped in the preparation of the forecast) would also expect to receive copies on a personal basis.

7. There seem to be two main options. The first is to circulate the present full report as it stands as a purely internal document with suitable caveats on its sensitivity. The second is to delay circulation for the time being and then circulate on the above basis the "Bray version" on which the forecasters are now working. If the latter option is chosen some officials in other Departments who have been concerned in the preparation of the main forecast will be aware of what has happened. But this would not be disastrous and the important thing seems to be to clear your intentions with the Prime Minister.

Government Actuary's Report

8. I assume that the Prime Minister will not now query whether the Actuary has to publish assumptions on unemployment and inflation. It

is highly inconvenient to have to do so; but it is inescapable and the Chief Secretary's minute to the Prime Minister of 30 October explained why.

9. The important point now, as your own minute points out, is to reach an early decision on the assumptions. The reason for this is that, if new contribution tables are to be prepared and distributed to industry in good time in the new year (and many firms, particularly those who are computerised, need lengthy advance notice), the Contributions Order must be ^{added} ~~laid~~ by about ²⁰ ~~28~~ November and debated before Christmas. Working backwards, and taking into account the work necessary by the Actuary and by the DHSS before Mr Jenkin can put proposals to you, this means that a decision (by normal Actuary/DHSS standards) is already overdue and any further significant delay could jeopardise the changes of processing the Order before Christmas. We very much hope, therefore, that you will be able to secure the Prime Minister's agreement to the assumptions set out in paragraph 8 of your minute.

10. So far as the assumptions themselves go, while they must be consistent with those to be used and published elsewhere, they must also be such as not to jeopardise policy in respect of the National Insurance Fund itself. Your policy objective, agreed at Tuesday's meeting, is to ensure that contribution rates can be raised a $\frac{1}{4}\%$ a side so as to secure income of about £400 million in 1980-81 which would benefit the PSBR and which, if contribution rates are not put up would be lost, thus further restricting your room for manoeuvre in the Budget.

11. We estimate that the assumptions set out in paragraph 8 of your minute (14% or 15% prices Q4 1980, 14% earnings average 1980-81 on average 1979-80, and 1.6m unemployed average for 1980-81) would provide a forecast position on the Fund which would enable Mr Jenkin to justify to Parliament (and more specifically to individuals and to industry) a $\frac{1}{4}\%$ a side increase. They should show a small surplus on the Fund after allowing for some £400m increase. To alter the assumptions so that a larger surplus was shown could make it difficult to secure this, given that the Fund's balance stands at around £4 billion and there are those who say it should not be allowed to increase further. (You may like to know that the Prime Minister her-

self has become acquainted, through a constituency case, with the large balance and has asked why in this situation a small improvement in certain benefit conditions could not be given.)

12. The arithmetic is such that an increase in prices or unemployment reduces the forecast balance while an increase of earnings increases it. In terms of the policy objective on the Fund and PSBR, therefore, you will want to resist any proposals that the prices or unemployment assumptions should be decreased. The Prime Minister may in particular jib at the unemployment assumption of 1.6 million but you should oppose any reduction in it. As you know, the Chief Secretary revealed the White Paper assumption of 1.65m (based on an earlier forecast) in the House yesterday.

Economic Prospects

13. You have discussed with Sir Douglas Wass the possibility of stimulating a discussion with some or all of your senior Ministerial colleagues on economic prospects and strategy generally. I understand also that at your talk with her yesterday the Prime Minister volunteered the idea that there might be a session at Chequers after Christmas to discuss both economic and manpower strategy.

14. You may want to raise with the Prime Minister the possible advantage of arranging an economic discussion before Christmas. The main object of this would be to secure greater understanding and support among your Cabinet colleagues (particularly the uncommitted and influential) for your present strategy, particularly given the many important decisions that still remain to be taken (and the unattractive nature of some of the indicators and figures that seem bound to emerge over the coming months). Such support would not only help you and the Prime Minister at Cabinet and other Ministerial discussions in carrying forward your present economic strategy; it might even induce some of your more reticent colleagues to give you greater support in the public campaign of getting the economic message over.

15. There are many possible ways of doing this if you thought the idea worth floating on this occasion. One would be to have a "trial

run" by holding a discussion first with a smaller "inner group" of Ministers. You will best judge whom this might contain; but obviously you would want to involve some influential non economic Ministers like Mr Whitelaw. Such a meeting could be the prelude to a wider discussion in the full Cabinet and would probably better be regarded as an ad hoc arrangement rather than as a regular 'standing' discussion group. An other option would be to go straight to the full Cabinet, with or without a Treasury paper in the first instance. Clearly the Prime Minister's views on how best to handle this would be critical. She has not so far been disposed to open out the economic discussion and there can be advantages to you in this; but on the other hand the road ahead may prove increasingly difficult to travel- particularly in so far as public expenditure is concerned - unless more collective Ministerial support is forthcoming.

16. A further question is whether any discussion should be linked to specific operational issues. The obvious one would be any proposals for a medium term financial plan which would in any case be linked with the second Public Expenditure White Paper. I imagine that you would not want to have to seek specific collective approval for the details of a financial plan. But since the compilation of a credible plan raises fundamental questions of the consistency of the Government's fiscal and monetary policies there might be advantage in exhibiting the general problems and seeking to secure the support of your colleagues in principle in advance. This would be particularly so if you judged that it might be necessary at any stage to reopen major policy questions with the colleagues eg on public expenditure.

17. Finally, the logistics of any such discussion or discussions would also be for consideration. Chequers always comes to mind; but past experience suggests that there could be disadvantages in this unless the time allowed were pretty severely disciplined.

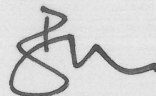
Summary

18. In sum, you will want to use this meeting to:-

- (i) Secure agreement on Monday to your proposals for the presentation (and Whitehall circulation) of the Industry Act forecast, and in particular the prices figure for Q4 1980;

(ii) Secure agreement on Monday to the inflation and unemployment assumptions you have proposed for the Government Actuary, and in particular to avoid lower assumptions that would make it difficult to justify a $\frac{1}{4}$ % increase in contributions;

(iii) float with the Prime Minister the possibility of a discussion on general economic strategy before Christmas.



J B UNWIN

2 November 1979