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Prime Minister

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MR SCHOLAR

cc Mr. Walters
Mr. Ingham
Mr. Hoskyns

Economic Assumptions

You will have seen the exchange of notes between Alan Walters and me about the Chancellor's note of 27 October to the Prime Minister which contains proposals for the economic assumptions which have to be published towards the end of November. I have also discussed the presentation of these figures with Bernard Ingham.

We see no reason to disagree on economic grounds with the Chancellor's proposals for assumptions of 2.9 million (narrow definition) for the average level of unemployment in 1982-83, for 10 per cent as the increase in RPI between November 1981 and November 1982, and for 7½ per cent as the similar figure for earnings.

But these figures, and notably the earnings figure, will give rise to adverse public comment. On the unemployment and RPI figures, it will look as though we are now admitting both that unemployment is going to go on increasing and that inflation will not get into single figures in 1982: we shall have to work hard to persuade people of the possibility that unemployment will peak during 1982 and fall significantly below 2.9 million by the end of the year, and that 10 per cent is only the mid-point of a range of possibilities for inflation, which could of course be lower, particularly if pay rises are moderate. The earnings figure is particularly awkward, because it is bound to be set against the 4 per cent planning factor for public service pay, and union negotiators speaking on behalf of public service groups will lose no time in pointing out that it looks as though the Government are intending to discriminate against them to the tune of 3½ per cent. There is not much of an answer to this: wage drift ought not to come into it, since the 4 per cent is a pay bill figure, and we shall have to rest on the argument that, as the economy peaks up, we expect both increased overtime work-
ing and genuine increases in productivity.

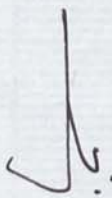
/The Chancellor

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The Chancellor says that in arriving at these figures he has balanced the need to influence expectations against the need for credibility. He is thus implying that the average earnings figure is already on the low side of what the Treasury actually expect. Given that he has therefore already accepted the principle that the public assumption does not have to be the centre of the Treasury's range of estimates, I think there is a strong case for suggesting that the paramount need to influence the pay round in the right direction points to a lower figure, perhaps of the order of $6\frac{1}{2}$ per cent. Otherwise, the Treasury is going to be hard put to come up with arguments to justify adherence to the 4 per cent pay factor.


29 October 1981

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