

CCSU



Prime Minister ①

Alan Walters thinks

Treasury Chambers, Parliament Street, SW1P 3AG the earnings
01-233 3000

assumptions too

pessimistic (too high)

- see his note, attached.

PRIME MINISTER

ECONOMIC ASSUMPTIONS

Agree these assumptions or

We need early decisions on certain assumptions to be used for
three related purposes:-

will you discuss

with the Chancellor?

- (a) In the Chief Secretary's Cabinet paper about public expenditure for discussion on 28 October, and in subsequent announcements; MCS 19/10
- (b) for the Industry Act Forecast, to be published, along with our decisions on public expenditure next year, early in November;
- (c) by the Government Actuary for his half-yearly revaluation of the National Insurance Fund. His report too will be published in November.

2. The assumptions I intend to authorise are set out in the following table:

	1982-83	1983-84	1984-85	1985-86
Unemployment (GB, narrow basis, millions)	2.9	3.2	3.2	3.2
Average earnings (% increase)	9	6½	-	-
RPI (annual % increase to November)	6 to 6½	5	-	-

3. My reasons are as follows:-

(a) Unemployment

The latest short-term economic forecast suggests unemployment (on the present basis) of about 3.1



million next March. For 1983-84, the forecasts point to some further increase - perhaps by another 0.2 million throughout the year, giving an annual average of about 3.2 million. This profile is broadly in line with most outside economic forecasts.

For the year ahead the recent practice has been to use the forecast average figure. For later years the practice has varied, but we last year used a conventional assumption of no further increase. I believe that we should stick to this, and use the 3.2 million figure for the three years in question: the 1983-84 figure would be published this autumn; the two later years' figures would appear in the White Paper in January or February. To go for a lower figure would be implausible. Although it is proposed to change the basis of count, which is expected - but not certain - to lead to a lower recorded figure, this will not affect the Government Actuary's calculations, and the uncertainty about the new series means that we cannot use it for the assumptions we give him now. We can consider later the form of presentation in the PEWP publication and the GA's report.

This will again
lead to accusations
that you are
planning on high
unemployment for
years; but there is
no way round the
problem.

(b) Average earnings

The forecasts indicate a rate of increase of about $7\frac{1}{2}$ per cent next year, which would be consistent with settlements in the new pay round of about $5\frac{1}{2}$ per cent or less. But to publish a figure as high as $7\frac{1}{2}$ per cent would weaken the message on pay which we have to get across, and could become a self-fulfilling prophecy. I therefore propose to use a figure of $6\frac{1}{2}$ per cent.

(c) Prices

The forecasters believe that at the end of 1983 the RPI will be increasing at an annual rate of just below $5\frac{1}{2}$ per cent. I propose to shade this down to 5 per

/cent.

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cent. This will be helpful in conditioning expectations, and it will have very little effect on public expenditure programmes, though it will of course lead the Government Actuary to propose a smaller benefit uprating in November 1983, and this may in turn increase the difficulty of clawing back this year's overshoot, as described in the Chief Secretary's minute of 5 October. But I believe this is a risk we must take, given the importance of giving the right signals on prices and so having the right impact on pay negotiations.

- 4. I attach a note explaining which of these assumptions are published, how they are presented, and when and where they appear. If you would be unhappy about any of the figures I plan to use, perhaps we might have a word tomorrow.

G.H.

19 October 1982

HOW THE ECONOMIC ASSUMPTIONS APPEAR IN PUBLICATIONS

	AUTUMN STATEMENT (inc Industry Act Forecast)	GOVERNMENT ACTUARY'S ANNUAL REPORT	PUBLIC EXPENDITURE WHITE PAPER
DATE DUE	Early November	Early November	Jan/Feb
UNEMPLOYMENT	Not shown in IAF, but in AS figures for 1982-83 and 1983-84 used as basis for estimates of expenditure for social security. May be stated in AS as they will be in GA report <u> </u> <u> </u>	Financial year averages for 1982-83 and 1983-84 shown <u> </u> <u> </u> <u> </u>	Financial year averages up to <u>1985-86</u> shown.
AVERAGE EARNINGS	Not shown. Internal forecast used to derive published estimates of government revenue	Average growth rates to 1982-83 and 1983-84 shown	Not shown
RPI	Annual percentage changes to 1982 Q4 and to 1983 Q4 shown. /	Annual percentage increases to November 1982 and November 1983 shown	Annual percentage increases to November 1983 shown, then price uprating in line with cash factors. <u> </u>

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cc Mr. Mount
Mr. Vereker

MR. SCHOLAR

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ECONOMIC ASSUMPTIONS: CHANCELLOR'S MEMORANDUM OF 19 OCTOBER

Although the Chancellor's figures, reported in his paragraph 2, seem superficially to be eminently "reasonable", the Prime Minister should be aware that they also suggest that little or nothing is being done about the need to reduce wages costs per unit of output in order to promote employment.

Real wages, in RPI terms, increase about 2½% or 3% in 1982/83 and by 1½% in 1983/84. Thus we shall have no assistance at all from real wages, in terms of retail prices, for reducing the level of unemployment. The whole weight of reducing wage costs per unit of output is thrown on to the increase in productivity, or possibly the depreciation of the exchange rate. Assuming the exchange rate does not change over these years, and assuming that productivity relaxes back to its inherent 1% or so which we experienced during the 1970s, this implies that real wages per unit of output are expected to increase over this period. This indeed provides a rationalisation for not merely the same level of unemployment, but an increasing number. Of course, we may be rescued by continuation of the dramatic increase in productivity which we have recently observed in the manufacturing sector. Perhaps so, but we ought to know that we are leaning very heavily on this particular hope.

These results may well be what the Chancellor's advisers expect to occur. But if it does, it's a confession of failure. Our dramatic success in achieving a 5% inflation rate in 1983 will be nullified by the lack of adjustment of wages. And this will be reflected in the high unemployment figures.

I suspect that the forecasters may have got it wrong. I believe wages came down last year faster than anyone thought. I suspect that this issue might be taken up with the Chancellor.

19 October 1982

Dictated but not signed by ALAN WALTERS

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