

SUBJECT

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cc Martin

10 DOWNING STREET

From the Private Secretary

2 November 1981

Sir Ray Pennock called in to see the Prime Minister during the afternoon of 30 October, to outline the main points of the address he will be making to the CBI Annual Conference; and for a general discussion.

He said that the main thrust of his speech would be concerned with pay. He continued to believe that moderation in pay increases in the forthcoming round was the key to the defeat of inflation. He was considering floating the idea that employers and employees should by agreement decide to forego any pay increases for the next 12 or 24 months. He intended to reiterate his earlier calls for a reduction in the totality of public expenditure and, within the global figure, for a shift from current revenue expenditure to capital expenditure. He would also urge cuts in public sector manpower, and a cut in the National Insurance Surcharge. He intended to argue that 1½-2 million jobs would be at stake if we withdrew from the EEC. He also felt strongly that this was a particularly good moment for the Government to push ahead with trade union reforms - on the abolition of the closed shop and on the removal of immunities where unions are involved in strike action in breach of contract.

In the discussion on trade, which was to take place on Monday afternoon, he expected that there would be a good deal of pressure to take action against Japanese imports. He himself had a good deal of sympathy with this.

Sir Ray asked the Prime Minister's advice on how he should deal with the pressure he expected to face for an addition to the borrowing requirement of £1-1½ billion - the effect of abolishing the National Insurance Surcharge, and also of mounting increased capital projects of various kinds (like the Channel Tunnel and rail electrification). The Prime Minister answered by reference to the upward pressure which this would bring to bear on domestic interest rates.

I am sending copies of this letter to Ian Ellison (Department of Industry) and John Rhodes (Department of Trade).

J. O. Kerr, Esq.,
H.M. Treasury.

M. C. SCHOLAN

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PRIME MINISTER

SIR RAY PENNOCK

Sir Ray Pennock saw me earlier this week to outline the main points of the address he will be making to the CBI's annual conference which begins on Sunday 1 November.

He will, as before, say that the first priority must be the defeat of inflation. As a key part of that battle pay increases in the forthcoming round will have to be very low. He will stress that many companies in the private sector will not be able to increase the pay of their employees at all in the next twelve months, and he will therefore go on to emphasise the need for ^{no more than} small increases in the public sector and to welcome the Government's pay factor of 4 per cent.

He will also reiterate his earlier calls for a reduction in the totality of public expenditure and, within the global figure, for a shift from current revenue expenditure to capital expenditure. Again, repeating a familiar theme of his, he will urge cuts in public sector manpower, drawing comparisons with the much steeper run down in the private sector.

He will also return to the charge about a cut in the national insurance surcharge.

There was one particular point about his speech over which he was hesitating. The economists at the CBI are arguing that the PSBR should be put up by one to one and a half billion pounds. These extra resources should go into capital projects (like the Channel tunnel and rail electrification). They claim that because some 15 per cent of the capacity of manufacturing industry is at present unused, a sum of this size could be absorbed without any inflationary effect: since existing capacity would be used, there would be no question of

paying higher wages or raising prices. Sir Ray said that his people were urging him strongly to develop this proposal in his speech. He had discussed it with the Chancellor who had told him that the Treasury economists took a different view from their CBI colleagues and thought that such a step would be inflationary.

/the I said to Sir Ray that it seemed to me that/most obvious risk of this proposal was that if the extra money was not to be found by additional taxation - and plainly that would not be something the CBI would recommend - , it would have to come from increased borrowing and this would be very likely to push up interest rates higher than they would otherwise have been - and that presumably was the last thing the CBI would want.

Sir Ray acknowledged my objection and said that in the light of our conversation he would mention the idea in neutral, non-committal terms as an idea with advantages and disadvantages, if he touched upon it at all in his speech.

Finally, he said that he would include a passage arguing strongly against the Labour Party's line on withdrawal from the Community, particularly because of the employment effects of withdrawal and what would be ~~the~~ very great difficulty of trying to find alternative markets; and a warning that if the Japanese did not very soon begin to match their words about restraint in their exports with deeds, Community governments would have to impose import controls.

At the end of all this Sir Ray said that he would find it very helpful if he could see you for half an hour before he goes to his conference (there is no doubt in my mind that it helps him enormously with his membership if he can tell them that he sees you regularly). I have therefore provisionally arranged for him to come in at 1615 on Friday 30 October. May I confirm this time please ?

Yes
me

23 October 1981

JRW

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From
Sir Raymond Pennock
President

22/10/81

CBI
CONFEDERATION OF
BRITISH INDUSTRY

22nd October 1981

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Dear *Cline*,

In view of the date which you have kindly arranged on Friday 30th October at 4.15 p.m., I thought it worth while to send you a copy of the background papers to the nine debate sessions we are having at Eastbourne. It is early days but they have, so far, had a very good reception.

You will see from them that Conference discussion splits itself into People (issues 1-3) on the Monday morning; Trade (issues 4-6) on the Monday afternoon; and the Economy (issues 7-9) on the final Tuesday morning. I would propose to give the Prime Minister the highlights of each of these sessions at our meeting.

Best wishes,

Yours sincerely,

Ray.

C.A. Whitmore Esq.,
Principal Private Secretary to the Prime Minister,
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London, SW 1.