FINANCE

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FROM: ROBIN HARRIS
14 July 1982

FINANCIAL SECRETARY TO THE TREASURY

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cc Sir L Airey - IR
Sir D Lovelock - C&E

Ian - this is a Conservative meeting. How come the note is so widely distributed? and doubtless copied as many times again? MS.

NOTE OF A MEETING OF THE CONSERVATIVE PARLIAMENTARY FINANCE COMMITTEE: 13 JULY 1982

The meeting was addressed by Sir Terence Beckett, Director General of the CBI.

Sir Terence said that the CBI's proposals for the last budget were moderate, in spite of pressure internally from a powerful minority which wanted more reflation. The CBI had got about half of what it asked for. However, it had in practice turned out to be quite a "restrictionary" budget. The Treasury now accepted the CBI's forecast of 1% growth over the year rather than it own optimistic forecast at the time of the budget.

CBI trend reports over the last four months covering more than half manufacturing industry suggested that output and demand were going to be very flat. The June survey covered the 4 months through to October and this showed that activity would be flat for the first three quarters of this year. This was not conjecture but rather information obtained from companies' purchasing schedules.

If predicted growth of 1% did not in fact materialise unemployment would rise to $1\frac{1}{4}$ million at the turn of the year. There was evidence from his members that firms were backing off planned investment. Companies such as Tube Investments and GKN were again looking for further manpower cuts. ICI's problems over Wilton were well known. They were under extreme pressure and were not competitive. British Airways would have to take out more jobs. BSC faced well known problems in its US market. Leaders of the motor industry were telling him that there might not a British motor industry at all in five years time.

Inspite of those gloomy indications, he was disinclined to change his view that activity would be flat or would rise by 1% this year. However, it was clear that there were big downside risks and few corresponding opportunities. The world scene was bleak.

He was about to go back to the CBI council to see whether the CBI's main budget proposals should be put again to the government. He stressed that his wish was not to increase demand but rather to help businesses to get there costs down. They needed more help in doing this. Also current expenditure needed to be reduced and investment expenditure increased. They were continuing to look at ways in which this could be done. [He also referred to his published letter to the Chief Secretary on pay, public spending and use of the contingency fund: the letter was distributed in the form of a press release at the meeting].

In answer to Mr Dorrell, who drew attention to signs of increasing import penetration, Sir Terence said that he had always believed this would happen. That was why he resisted pressure to increase demand. A small amount of extra demand was acceptable, but not much more. We must not go the way of France. A lower exchange rate would help a little. The risks of a lower exchange to inflation were exaggerated. The Treasury however would not quite agree. Low commodity prices and the green pound mechanism reduced in practice some of the disadvantages of a lower exchange rate. We were still 35% less competitive than we were in 1975. There should also be another cut in NIS.

In answer to Mr Foreman, Sir Terence said that it was not just manufacturing but retailing which was flat. He agreed that higher public spending on capital projects in practice had revenue spending implications: but these were not too significant. Within public expenditure, it was important to cut pay, pensions and manpower.

Mr Budgen agreed with the CBI that interest rates needed to fall substantially. The CBI should argue this for money supply reasons. The Treasury appeared instead to be more interested in the exchange rate. The CBI also, he felt, needed a more distinctive view about energy prices. High energy prices were damaging industry and would do so over the long term.

In answer, Sir Terence said that the government had done a great deal on energy prices in the recent budget and something in the previous one. Our energy prices now were broadly competitive with those of Europe. However, it was not reasonable to expect successive Chancellors to introduce measures of this sort year in year out. Therefore, further action in the "middle distance" would be necessary. His feeling was that the use of an implicit exchange rate policy by the government was only a step in the procedure of keeping inflation down. Both the Prime Minister and the Chancellor had emphasised that there was no exchange rate target.

Mr M Stevens thought that the picture painted by Sir Terence, while applying to large firms, under-rated the progress made by small firms. Hammersmith and Fulham Chamber of Commerce were, for example, a few months ago, optimistic.

Sir Terence, however, said that the CBI had a Small Firms Council and listened to them. Moreover the manufacturing trends survey did reflect a fair balance of industry. He emphasised that he took no delight in recording "flatness".

In answer to Mr John Osborn , Sir Terence said that he strongly agreed with a recent Economist article showing how the government had been playing into Scargill's hand by subsidising conversion to coal. It was also dangerous that the wage negotiations dates in the coal industry had been brought forward from the Spring to November.

In answer to Mr John Page, Sir Terence said that the Japanese constituted a valid exception to the desirability of free trade, because of their"lazer beam"approach and the fact that they were not prepared to import our goods.

Mr Peyton said that the small firms in his constituency confirmed Sir Terence's view that activity was flat and were very gloomy. Interest rates would need to come down and stay down to give them confidence. There was also no proper industrial strategy and one was needed.

Sir Terence agreed. Ministers did not understand that when he called for an industrial strategy he did not want detailed intervention. If we had had such a strategy we would, for example, like France have sufficiently invested in nuclear energy and so avoided many present problems.

Mr John Browne said that one area in which the government had to give a lead through industrial strategy was in videotext.

Sir Terence said that the government must redouble its efforts to gain the understanding by the United States of what was at stake if its present policies continued. It could be ruin for the world. We should try and separate ourselves from the US more. We could sacrifice a little on the exchange rate to do so. We now have the money supply and PSBR under control. But the real rate of interest was going up as inflation fell.

Mr Wolfson agreed that an industrial strategy was needed.

Sir Terence said that one was generally being attempted, most notably in the Information Technology field.

Mr R Howell thought that the CBI should do more to condemn overmanning in the public sector in general and the Health Service in particular. Sir Terence agreed and said that the burden of the public sector had infact greatly increased while the strength of industry supporting it had decreased.

RH

ROBIN HARRIS
14 July 1982