



Prime Minister

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Treasury Chambers, Parliament Street, SW1P 3AG
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12 January 1982

Michael Scholar, Esq.,
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New Michael,

Clive Whitmore mentioned that the Prime Minister would like to see a note on the discussions at Chevening last week-end. The attached note, while not purporting to be a full record of meetings which lasted for more than 9 hours, does, I think cover all the main points discussed.

Yours ever,

John Kerr

J.O. KERR

A handwritten signature in dark ink, appearing to be 'John Kerr'.

CHEVENING DISCUSSIONS - 9/10 JANUARY 1982
BRIEF SUMMARY OF MAIN POINTS EMERGING

Economic strategy

The objective of reducing inflation was crucial but not so far as to exclude consideration of its effects on output and unemployment.

2. A monetary framework should continue; this was desirable in itself as well as important for consistency of presentation. It should comprise elements which the Government could directly influence; target paths for inflation or money GDP were unconvincing. Primacy was likely to be given to £M3, but not exclusively to this. A mock-up should be produced of the MTFFS showing how it might be presented at the time of the next Budget including in the first place quantifications of £M3, M1 and PSL2. Such a mock-up should extend over the period currently covered by public expenditure plans - that is, up to and including 1984-85 - though possibly with less precision in later years. The quantities assigned to the aggregates should be consistent with a steady downward pressure, starting from a recognition of the likely 1981-82 outturn for £M3. The mock-up should describe the evolutionary nature of the MTFFS and monetary policy, and should put this in the context of wider budgetary objectives. Work might also be done on a composite indicator, but if adopted this would be for internal purposes only.

3. There should be no published target or band in respect of the exchange rate. However internal limits might be adopted which would become "triggers to thought" as the level, or rate of change, moved outside them. As between level and rate of change, it was thought that the absolute levels the more important, though precipitate change should be avoided. It was thought that the current level was about right, with a difference of view as to whether some small movement up or down was the more risky. There should be a leaning towards the present rate, and also a leaning towards stability.

4. So far as operational decisions on interest rates were concerned, substantive discussion of this paper was postponed.

5. On the level of the 1982-83 PSBR, different views were expressed as to whether something around the £7½ billion emerging from the updated interim forecast should be looked for, or something higher was acceptable. Discussion ranged over the desirability of looking for interest rates lower than they would otherwise be, meaning a low PSBR, and something giving more "tangible" benefits by way of actual tax reductions, which would require a higher figure. Come Budget time, the outlook for private bank lending then seen would have to be taken into account.

6. It was agreed that discussions of the level of 1982-83 PSBR should be conducted in terms of actual cash - that is, any 1981-82 tax backlog which as the result of the strike falls into 1982-83 should be regarded as revenue for that year for this purpose.

7. As between giving any tax relief available to companies or persons, it was argued on the one hand that prospects for the company sector favoured any assistance going largely to companies, whether by way of help with interest rates (cf low PSBR) or eg NIS reduction. On the other hand it was also argued that on the personal side it remained desirable to do something about the poverty/unemployment traps and that action here was important from a political point of view, having regard to how the personal tax burden had increased. There was also the question of helping with pay bargaining.

8. On indirect taxes, full revalorisation had to be seen as the maximum that could be looked for at the time of the next Budget. Indeed this might be optimistic.

9. In a tour de table seeking ideas about small douceurs in the next Budget, a number of suggestions, including the following, were made; reduction in corporation tax rates, help on interest rates for tax exhausted companies, limited measures in the social security field to help those on low incomes, development of help for small businesses, some reduction in NIS (if not a major cut), some reliefs on capital gains tax, and something, even if not very much, over and above full revalorisation on income tax thresholds.

10. The Chancellor asked in particular for further work to be done on :-
- a. Limited and targeted help for the construction industry (DOE to be consulted) and
 - b. An inexpensive package which might help the disabled and similar, and
 - c. A further trawl for measures to assist enterprise eg small businesses.

Public expenditure

11. The analysis in Sir Anthony Rawlinson's paper as to the necessary timing of public expenditure decisions was accepted.
12. Different views were expressed as to the desirability of bringing tax/fiscal stance decisions into line with public expenditure decisions. It was argued that the Treasury had the worst of all worlds at the moment; tax/fiscal stance decisions were coming increasingly into commission, while they were still not bringing effective leverage onto public expenditure decisions. This pointed in the direction of more detailed and quantified decisions being put in front of Cabinet colleagues on the tax/fiscal stance at the time public expenditure decisions were looked for, and, following this, some kind of early announcement; thus in effect a Budget, albeit with "Greenish edges" and capable of being modified later, before Christmas. The serious practical difficulties for Ministers and the Treasury about trying to frame a Budget in October-November, at the same time as the main public expenditure discussions, were recognised. It was also argued that there was a risk of the Treasury losing control of tax decisions, so that the PSBR - where the right level was in any case an elusive concept - became the residual with all the difficulty that implied for economic management.
13. The impending TCSC enquiry into the Armstrong Report was mentioned. The difficulties involved in presenting to the Committee some of the arguments which pointed away from the Armstrong concept was noted. The Chancellor said that it was most important that this enquiry did not give rise to a new "role of the C & AG" situation. A submission would go to the Chancellor within the next week.

14. It was agreed that the move to cash planning might have had the effect in practice of shortening the public expenditure planning period. But it was also agreed that neither the present period, nor of course cash planning itself, should be abandoned now. It was not thought there was much of a case for a full-blown cost terms 10 year planning apparatus alongside the shorter term cash planning apparatus, but more might be done by way of studying the possible evolution over the longer-term of the cost of major individual programmes.

15. The paper showing the evolution of public spending totals in the long-term was frightening. It illustrated the logical consequences of giving way to the inevitable pressures and appetites for more and better public services without having regard to the where-withal to pay for them. One factor this pointed towards was greater privatisation and/or greater payment by individuals for the public services which they consumed. But the difficulties were immense. As a first step it was necessary to persuade Cabinet, and then possibly the public, that the problem existed. It was agreed that a paper should be prepared, after discussion with Departments, with a view to bringing the matter before Cabinet after the Budget, possibly in May; meanwhile the Chancellor would say something at Cabinet at the end of January, or possibly circulate a short paper, giving notice of this. Thereafter there might be a case for making public the picture, if only to try to avoid, or at least point out the dangers of, re-establishing the various pledges which currently plagued public expenditure constraint.

Some other points which were mentioned

16. There was no substantive discussion of the paper on the role of the Treasury in the field of Departmental financial management. But it was suggested that the question about merit rewards for individual managers should be kept under active review; and there was also agreement that it was necessary to seek to line up the management bookkeeping of departments with the Parliamentary needs and requirements for accounting etc. A political push might be needed in this whole area eventually.

17. Nor was there any discussion of the paper on local authority expenditure, though it was remarked that this was one of the most important, if not the most important, current problems in the public expenditure field, with its

interaction of constitutional and financial considerations. It was noted that a submission would be going forward to Treasury Ministers shortly.

18. The Chancellor asked that sight be not lost of the TASS and NICIT exercises. He noted with approval that the various "unconventional" ways of improving the labour market which had been developed in the Treasury in the summer were being pursued.

19. The overwhelming importance of better control and efficiency in the public sector as a whole was noted. It was observed that there was a limit to which the private sector alone could carry forward economic recovery, particularly if dragged down by an economically unhelpful public sector.

20. There was brief discussion of the first draft of a paper which the Chancellor might put to Cabinet for 28 January.

Central Unit

12 January 1982

12 JAN 1988

