

# TREASURY

# SECRET

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SIGNATURE

*R. Kiley*

DISPOSAL DIRECTIONS

DESTROY AFTER 25 YEARS

PRESERVE



PO -CH /GH/0001



PART A

MISCELLANEOUS PAPERS

PO -CH /GH/0001

PART A

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REFER TO

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PAR (19/12/79) PAR 4/10/93

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The Presidency/Hugh Sidey

## Trying to Show His Toughness

There is a deep sadness in Washington this week. Concern about Jimmy Carter and his Administration has gone beyond anger. The immediate shock of the graceless Cabinet changes will wear off, but doubts about the President will grow even larger and seep out across the world. Ultimately, they are doubts about America.

The presidency is a very personal office. Despite the best efforts of scholars to stuff it into pigeonholes and hang it up on graphs, the presidency takes on the moods of the man in the office. His purposes become policy by osmosis. His sense of urgency regulates the administrative speed. The food he likes shows up on menus at state dinners, and the Marine Band magically plays his favorite tunes. The very words he uses shape the language of his time in power.

The Jimmy Carter now at work behind the closed White House doors is not the Jimmy Carter we grew to know in the first 30 months of his presidency. It is true that he was from the beginning a somewhat elusive figure. But at the center there was a man of regular habits, kindly ways and comfortable personal characteristics. He did warn us last week that he was going to change "my life-style and my way of working." But the events of this week represent more than that.

This is a disorganized and sometimes insensitive Jimmy Carter, overreacting to demands for leadership in an effort to save himself, seemingly unable to look ahead and see how his actions will affect the country. This is an un-

ILLUSTRATION FOR TIME BY DAVID LEVINE



certain Jimmy Carter trying to show how tough he is. It is true that many influential voices pleaded with Carter to be more decisive. Given his dismal political prospects and his genuine personal distress over the national attitude, an environment for extreme action was created, to which Carter responded.

But his new Cabinet is less distinguished than his old one. It cannot possibly change the substance or the image of the Government in the time left to Carter. The new White House staff arrangements that invest the Georgians with more power than ever will do nothing so much as reinforce the President's own failings, which have come from his inexperience and his narrow background.

Every time in the past couple of decades that a President has felt compelled to demonstrate to the world how tough he was we have been dragged deeper into trouble. A major cause of the Viet Nam involvement was Jack Kennedy's concern about machismo, and then Lyndon Johnson's determination to show that Texans did not back away from fights.

The most devastating echo of all heard in the somber streets of the capital after the paper executions was the voice of Richard Nixon. The image of a closeted Jimmy Carter mercilessly cutting down his Cabinet officers was a little like the picture of Richard Nixon swearing into the hidden microphones.

The question arose whether Carter had yielded authority to Hamilton Jordan, Charles Kirbo and Jody Powell. Or had he harbored for months dark impulses to clean out his Cabinet, even while posing in an aura of human kindness? While the purge was going on, the President went out into the Rose Garden to meet with the Future Farmers of America. "Some things don't change," he said softly. "The fundamentals don't change—love within a family, honesty, friendship among people, the desire for peace, respect for one another, the beauty of nature and genuine patriotism based on confidence in our country." In that appeal there seemed almost a public apology for what he had done.

There is a great mythology about how men change in the presidency. Harry Truman scoffed at any such notion. "After a certain age," Truman said, "it's hopeless to think people are going to change much." Jimmy Carter may be the one to prove Harry wrong, but the evidence at this moment is that Presidents who try to be what they are not create more chaos than they cure.





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PWP.  
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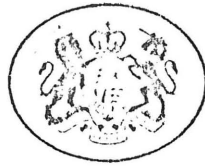
Chancellor

Sir Wm Pitt.

The Admirals  
You were also, I believe,  
going to mention the "Admirals"  
as a successful opportunity

AB  
9/8





3

MR CROPPER  
EXPERT TAX ADVISERS

cc Minister of State (Lords)

I have seen your draft paper of 29 May embodying proposals for keeping in contact with those who were so helpful to us in tax matters in Opposition. I have little to add to the draft which seems to me to cover the ground excellently. I am sure it is right that we should not cut ourselves off from the advice of these people and that the best results would be achieved by ensuring that we are available for informal discussions from time to time. My own feeling is that a suitable time for the first of these discussions would be after the Budget but before the Committee Stage of the Finance Bill.

In addition, some early form of hospitality seems to be indicated - possibly at No 11?

A handwritten signature in dark ink, appearing to be 'PR' or 'Peter Rees', written in a cursive style.

PETER REES  
30 May, 1979





MR CROPPER

cc Mr Peter Rees

Expert Tax Advisers

1. I agree we should - and ought - to keep in touch.
2. I agree that a formalized arrangement will lead to difficulties.
3. The proposal for informal but fairly regular meetings seems to me to be a good one.

*Arthur Cockfield*

LORD COCKFIELD  
30 May 1979



CONFIDENTIAL



*John to W.P.*

cc Chief Secretary  
Financial Secretary  
Mr Battishill  
Mr Ridley

for information:

Minister of State (C)  
Minister of State (L)

CHANCELLOR

EXPERT ADVISERS

At your request I prepared a draft on this subject for the Ministers of State (C) and (L). They have each agreed my analysis in principle. Therefore at this stage I am circulating to you, to the Chief Secretary and the Financial Secretary, copies of my paper and their comments on it.

2. For consideration, whether you would wish to invite the advisers for a drink at No 11 one evening before Budget Day. ✓

A stylized handwritten signature in black ink, appearing to be 'P. Cropper'.

PETER CROPPER

31st May 1979





UNITED KINGDOM TREASURY AND SUPPLY DELEGATION

BRITISH EMBASSY

WASHINGTON, D. C. 20008

5 June 1979

Sir Geoffrey Howe QC MP  
Chancellor of the Exchequer  
HM Treasury  
Parliament Street  
LONDON SW1P 3AG

*Dear Chancellor,*

At your meeting with Mr Secretary Blumenthal next week, I expect you will want to talk mainly in rather general terms about the economic situation in our two countries and the world. Mr Blumenthal will want to hear from you about the budget and the policies the British Government will be following; to tell you what he thinks about the situation in the United States; and to discuss some world economic questions - especially the oil situation, no doubt - which are likely to be the focus of attention at the summit meeting when you will no doubt meet him again. We have also heard that he may raise some questions about steel and export credit. The Treasury will be supplying briefing on these questions. I thought I would supplement this with a letter about Mr Blumenthal himself and his position in the political and economic scene here.

/ I attach a short biographical note about Mike Blumenthal. His is an American success story - rising to the top in a land he first saw at the age of 21 - and he has had an interesting mixture of experience in government and business. But somehow he is not entirely accepted by the American business community as one of them. He is an intelligent and sensitive man, not a very dominant personality, not the typical American tycoon. He had a rather difficult time during his first months as Secretary of the Treasury and this was partly because he does not have the kind of rotary club style which American business likes. But it was also because the President never gave him his full confidence. Blumenthal has always adopted a more conservative stand than some of the President's advisers. Right at the start, Schultze persuaded the President to propose a tax rebate. A few months later Blumenthal recommended that it should be withdrawn. The day before the President announced its withdrawal, Blumenthal, not knowing what the President was going to decide, made a speech defending it. Later that year, when the President was considering proposals for tax reform, Blumenthal, testifying before a Congressional Committee, said that tax reduction might have to take priority over tax reform. The same afternoon, Jody Powell, the President's press man, told reporters that the Secretary of the Treasury was "only expressing his personal opinions".

/ Blumenthal



Blumenthal apparently took a lot of this kind of thing lying down. The position of the Secretary of the Treasury is not, of course, exactly similar to your own. The Chairman of the Council of Economic Advisers (Schultze) and the Director of the Office of Management and Budget (McIntyre) are independent of him and members of the Cabinet, and he has no responsibility for domestic monetary policy. Who plays the dominant part in economic policy in any Administration is partly a matter of personalities, but Blumenthal has gradually emerged as the most effective of the group of economic advisers around the President, a not very impressive bunch. This last week, the President has announced that he has designated the Secretary of the Treasury as Chairman of the Economic Policy Group within the Administration and indicated that he regards him as the Administration's "chief economic spokesman".

One thing which has improved Blumenthal's position is the recovery of the dollar. Back in 1977, he got a good deal of stick for comments about the dollar which were damaging on the exchange markets and which were regarded as inept. (Some of this comment was rather unfair - in practice it seems to be almost impossible, in the situation of a weak and falling currency, to make comments which are not damaging, and the Secretary of the Treasury can hardly keep his mouth shut altogether.) The main initiator of the policies introduced last November (higher interest rates, much more active intervention) was Tony Solomon, Under Secretary at the Treasury, but Blumenthal supported them fully and sold them to the President. Another change which improved things for Blumenthal was the replacement of Arthur Burns by Bill Miller as Chairman of the Federal Reserve at the beginning of 1978. Miller is a personal friend of Blumenthal's: lately, however, they have been in disagreement and we have had the unusual position of the Secretary of the Treasury urging that monetary policy should be tightened and the Fed resisting.

Mike Blumenthal has travelled a lot in his time at the Treasury - trips to Japan and China, and to Saudi Arabia as well as Europe. He is much interested in trade questions. This was his previous responsibility in Government and as Secretary of the Treasury he still has important responsibilities in this field.

*W S Ryrie*  
W S Ryrie

*Bill Ryrie*

Enc: 1





MR W MICHAEL BLUMENTHAL - SECRETARY TO THE TREASURY

Born in Germany in 1926 he escaped with his family to Shanghai in 1938 where he suffered great hardship. Blumenthal went to the USA in 1947, worked his way through the University of California and took a PhD in economics at Princeton. After teaching economics at Princeton from 1954 to 1957 he went into business with Crown Cork International. Under the Kennedy Administration he served briefly as a Deputy Assistant Secretary in the Economic Bureau of the State Department (1961-63) and then as Chief US negotiator during the Kennedy round of Tariff Negotiations (1963-67). In 1967 he joined the Bendix Corporation where he moved up rapidly to become President and Chief Executive Officer in 1972. He has been Secretary of the Treasury since the beginning of 1977.

He was separated from his wife at the time of his appointment to the Treasury. They were later reconciled for a time but have recently been divorced. They have three children.



✓ MS 9

In ch  
P.C. § 9: ✓

Chancellor

If I may be permitted a  
Comment: Some of these problems  
may be capable of resolution  
if e.g. Inland Revenue officials  
were permitted to 'talk with'  
the advisers from time to time  
— as they do already with other  
representative groups.

Officials have long practice  
of exchanging views with outsiders  
in ways which do not commit  
ministers or (we hope) reveal  
their detailed intentions!

Now that the Budget is out  
of the way you might like to  
dismiss with Sir W. P. ✓  
A.B.

DRAFT



MINISTERS OF STATE (COMMONS AND LORDS)

## EXPERT TAX ADVISERS

1. During the five years of Opposition, the Conservative Party finance team received invaluable assistance from a team of outside tax experts - principally from Keith Carmichael, John Avery Jones, Bruce Sutherland, John Chown and Milo Kerr. Others helped from time to time.
2. The view has been expressed that:
  - i. we owe it to that group to involve them in some way in the activities of the Party now that it is in office, and
  - ii. more positively, we would be foolish to cut ourselves off from their advice, even though we do now have the Civil Service at our disposal.
3. The present Chancellor has already committed himself to open government in the field of taxation (see the Addington Society lecture of February 1977). The first motto of any Chancellor should be, he said, "consult now and draft later".
4. Sir Geoffrey Howe has ruled out the idea of a Royal Commission on tax reform because of the time lag involved; furthermore it is only certain parts of the tax system that are felt to be in need of major overhaul, eg capital taxation, company taxation and family taxation.
5. The main consultative device is seen as the Green or White Paper, or draft Bill - with sometimes a reference to a Select Committee of the House of Commons. This process provides ample scope for the government of the day to set out its own approach





on a major tax problem, to hear the views of the public, the experts and the parliamentarians, and then to legislate accordingly. The advice of our Finance Bill team could well be useful at the stage when a Green Paper is being planned and drafted, as well as at the consultative stage.

6. The Addington Society lecture raised the possibility of a regular separation of the present Finance Bill into two parts - a Finance Bill containing major general tax changes (rates and thresholds in particular) and a Tax Management Bill dealing with technicalities, anti-avoidance measures, and administrative rules. Items proposed for the Tax Management Bill would not, by their nature, need to be subject to strict rules of Budget secrecy; hence it would be possible to subject them to careful consideration not only by the House of Commons but also by experts and interested parties over a period of time.

7. The lecture also explored the possibility of a regularly appointed Select Committee, with special and continuous responsibility for the tax system. This body might conceivably include some non-parliamentary members or assessors; our expert advisers would make good candidates.

8. Thirdly, where ongoing administrative problems are concerned, involving the tone and style of the Inland Revenue and Customs & Excise, the practical experience of our Finance Bill team (gained in their every-day professional work) could be invaluable.

9. It is tempting to suggest that our existing team of five advisers should simply be converted into a formal advisory committee, to whom Green Paper drafts might be referred in course of preparation, and who would be integrally involved in the preparation of Tax Management legislation. However this might raise constitutional problems; it could be argued that any such formal body should be representative of various interests. Indeed



it might even end up with its statutory trade unions. This would be to destroy the instrument that we actually find in our hands - a compact group of practitioners who have worked together over a lengthy period, who know each other's minds and who know the minds of the ministerial team.

10. The preferable answer is almost certainly to retain an informal structure for the group. My suggestion would be that, if ministerial time could be found for a regular commitment, the advisers should be brought together, say, three times a year - either at the Treasury or over dinner - to discuss with Ministers the progress and development of the ideas which were set going during Opposition. The timing of these meetings might be:

i. September/October, when the new year's policy work is being launched in the Departments.

ii. February, when legislation is beginning to take formal shape.

iii. June, when the Finance Bill has just been published.

It could be one of my responsibilities, to organise and minute the business of these meetings, and I could provide the channel through which the advisers might be consulted on an ad hoc basis in between meetings.

11. I am not certain whether the group ought to be recompensed financially, or whether the members would find their relationship with Whitehall would bring its own reward in professional kudos. (Our thanks might find occasional expression at New Year.)

Neither am I sure whether the group would need an official title or status. At an earlier stage I was arguing for establishment of a "Conservative Tax Committee" which I might have run as secretary

*x and perhaps  
one of the key  
figures?  
gib*

*Dependent  
I was guess.  
gib*



from a base in the Research Department. The same title could be adopted now, but even that might leave us open to pressure from the Party organisation to include other experts who might not fit in personal terms.

12. In short, best results would probably be achieved by simply leaving things as they are - a group of enthusiasts who are invited to come together regularly for a good dinner and who can be informally consulted from time to time. This would need the minimum of planning and a start could be made with a dinner meeting some time before the summer recess.

A handwritten signature in dark ink, appearing to be "P. J. Cropper".

P J CROPPER

29th May 1979





CHANCELLOR OF THE EXCHEQUER —

cc Financial Secretary  
Mr Battishill  
Mr Ridley  
Mr Cropper  
Minister of State (C)  
Minister of State (L)

EXPERT ADVISERS

The Chief Secretary has seen Mr Cropper's note to you of 31 May, with his draft dated 29 May and the comments by the two Ministers of State. He has noted and agreed the draft.



A C PIRIE  
5th June 1979

PERSONAL AND  
CONFIDENTIAL

15



UNITED KINGDOM TREASURY AND SUPPLY DELEGATION  
BRITISH EMBASSY  
WASHINGTON, D. C. 20008

The Rt. Hon. Sir Geoffrey Howe, QC, MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
London

25 July 1979

*Dear Chancellor,*

Last week was a long one in Washington politics.

2. It is impossible to avoid an overwhelming impression of political incompetence in the White House. No doubt the effect on the President's political standing in the country as a whole is not to be measured by the reactions of the Washington establishment and the east coast press; but one cannot escape the conclusion that the whole sequence of events has weakened the President, increased doubts over his ability to govern effectively for the next eighteen months, and made it still more doubtful that he can be re-elected.

3. The incompetence began with the cancellation of the broadcast planned for 5 July. There followed the long consultations at Camp David, a ritual which, while building up vast expectations, did again create a situation in which the President could re-establish himself. Whether or not he had done so seemed a bit of a moot point the morning after the broadcast of Sunday, 15 July. The moral appeal in the first twenty minutes of his long television address was strange to European ears; but one assumed that there was a large American constituency to which it was very appealing. The extraordinary thing was that the President did not build anything on this foundation - he made no demand for any sacrifice by the American people, and offered only proposals for action by the Government in Washington (which he went out of his way to denigrate, in the style of his election campaign, as if he still did not belong to it).

4. The country reacted uneasily. Democratic leaders paid ritual tributes. The press in a subdued way commended the President for his effort. The appeal to patriotism had some impact - I was told that even on the foreign exchange market, American dealers hesitated to sell the dollar for a few hours. One odd impression left by the broadcast was that of a newly-packaged President, talking louder and with a desperate, rather contrived, sincerity. Could Jimmy Carter again be born again? Very soon the press shifted to snide comments and then to ridicule and the foreign exchange dealers reverted to normal.



5. However, if matters had been left there the overall effect might well have been a net improvement for the President. The speech made some impact and there was an energy programme (although all of it had been suggested by other people, and some of it was already in draft legislation before the Congress and although it failed to grasp the nettle of faster decontrol of gasoline prices). But there followed the reorganisation of the Cabinet, and this has left Washington gasping with astonishment. Astonishment first at the mishandling of the affair. This was partly the fault of Jody Powell, the President's press man. Apparently the President told the Cabinet that he intended to make some changes and Vance said that it might help the President if he knew that all members of the Cabinet regarded themselves at his disposal. It was Powell who converted this into a mass "resignation" story. There is astonishment also at the apparent pointlessness of the changes. There are no policy differences to explain any of them. And at the same time there is a distinct feeling of distaste because it seems clear that the changes have been made mainly because the President's personal staff, the young Georgians, did not like certain members of the Cabinet. I have heard no one say a good word over the appointment of Hamilton Jordan as Chief of Staff who is generally regarded as a rather sinister figure, inexperienced, cynical and unpredictable.

6. It is very likely, of course, that people in Washington misjudge the significance of all this for the President's future. In most of America, even Califano and Blumenthal are only shadowy names and their departure may have no great significance. Many people will have forgotten all about this within a few months. Even so, one must conclude that the events of last week can only weaken the President. There is nothing to offset the general impression of mismanagement of the whole affair. If it could be said that the Cabinet changes were clearly necessary in order to promote some recognisable new policy, they would be understood, but they seem to have no particular significance, and no one can claim that the Administration looks in better shape after them. Califano was probably the ablest person in the Cabinet. Schlesinger, although able, had been failing recently; but few expect that Charles Duncan, who succeeds him, will be a great improvement.

7. Brock Adams, the Transportation Secretary, walked out with his two chief assistants because they would not work under Hamilton Jordan and there is no replacement yet. Blumenthal is certainly succeeded by someone of equal ability, William Miller, but at the cost of leaving a gaping hole at the Federal Reserve at a critical time, and again the move seems pointless. The chairmanship of the Federal Reserve is an independent and prestigious position, and Miller, who was appointed to it only at the beginning of last year, could probably have kept it for two four-year terms. That he has been prepared to give up this position and serve as Secretary of the Treasury for a President who may have no more than eighteen months in office to run, and to do so because it is suggested that the existing Secretary of





the Treasury has not been sufficiently "loyal", is strange indeed. If the most loyal person the President can find is the Chairman of the Federal Reserve, some people wonder what sort of person he will choose as the next Chairman of the Fed. Certainly there is no one on the existing Federal Reserve Board who is of sufficient stature.

8. And even if much of America may forget and forgive rather quickly, the events of the last week have shown us something more about President Jimmy Carter and what we have seen is not reassuring. There is an impression of a caged animal thrashing around in desperation; and an impression of being much too much under the influence of one young man whom hardly anyone trusts.

9. Within the next nine months or so the question whether Mr Carter is to be President again will, in effect, be settled. Some people think Carter still has a serious chance of re-election; but even making all due allowances for the unexpected, I find it hard to believe now that he can make it. There is no important body of support on which the President can now rely - even the blacks seem to have turned against him.

10. If he does not make it, what will happen? Prediction is very difficult at this stage, but the following propositions seem reasonable.

a. For the Democratic nomination there are only four names to be considered seriously: Carter, Kennedy, Brown and Mondale. Brown can probably be discounted. Carter and Mondale will not be rivals, but if President Carter comes to the conclusion that he is not likely to win and withdraws, like Truman in 1952 and Johnson in 1958, he may well throw his support to Mondale who would then become a strong candidate.

b. Kennedy will probably not be able to resist getting into the race unless Carter stages a wholly unexpected recovery. His mind is probably split on the subject. In many ways he would love to be President and has been flirting almost ostentatiously with the idea in recent months. But he must be deterred by Chappaquiddick and the thought of the assassin's bullet. These thoughts, I fancy, produce a reluctance which is genuine but also tactically useful in helping him to wait until there is a large demand from the Democratic party for him to come forward.

c. Kennedy would probably take the Democratic nomination even if Carter withdrew in favour of Mondale. But it is much less certain that he would sweep into the White House. In the main election campaign, the Republicans would probably use Chappaquiddick to try to destroy him (although their candidate might never utter the word) and they might well succeed.





d. On the Republican side, at this moment Connally looks the most likely man, but he too is flawed as a candidate. Although he was acquitted of the charges brought in connection with the Milk Fund affair, a shady impression lingers; and although there is a great demand for leadership, not everybody wants the Connally style. Reagan is by no means to be written off yet although none of the other candidates looks formidable.

11. To return to the more immediate future, it is true that the recent changes are not connected with any change in the direction of economic policy. The immediate effect - including the effect in financial markets which we are seeing already - will be thought of as a weakening of confidence in the Administration. The economy is pretty clearly moving into recession, although the sharp fall reported in GNP in the second quarter (3.3% provisionally) is partly due to some odd factors, particularly the shortage of petrol in the last few months. It is possible that the second half of 1979 will see the economy pretty flat, with no growth but equally no significant further contraction and I personally suspect that it will be well into 1980 before we see any signs of recovery. This would of course produce rising unemployment before long. But there is still no general demand for stimulative measures and the President has recently rejected the idea of a quick tax cut. We hear that most of the Congressional leaders who were invited to Camp David argued against such a move. However, discussion is growing about the form which a tax cut might take if in due course it becomes desirable. There has even been some talk amongst Republicans of imitating your own budget - or at any rate the income tax cuts in it.

12. Monetary policy is in a state of paralysis. The Federal Reserve has held short term rates steady for most of this year, believing that the economy has been slowing down, despite rising inflation and despite the evidence that credit conditions are by no means tight. Until recently it was reinforced in this view by the strength of the dollar, but that has changed. The rise in the discount rate at the end of last week was probably the first time in history when external factors moved US interest rates in the opposite direction to what a majority of the Federal Reserve would probably think right for domestic reasons. They will probably have to go up further, especially since the domestic signals by no means all point to relaxation. The inflation outlook gets worse steadily and both long and short term interest rates are now well below the current annual rate of inflation.

13. The situation is already producing some signs of frustration and a tendency to blame other countries for the troubles of the dollar. We shall probably see more of this - criticism of high interest rates in other countries, including the UK. The answer has probably got to be a further jacking up of American rates, and before very long.



PERSONAL AND  
CONFIDENTIAL

14. It is not, I am afraid, a very happy picture. America is displaying all too clearly the malaise which the President described so forcefully in his Sunday-night broadcast - lack of confidence - and his own actions since that broadcast seem to have made matters worse. Americans again seem ashamed of their President. But they are stuck with him for 18 months at least. An example of the way people are talking is Hugh Sidey's column in the latest issue of "Time" - a copy is enclosed. A falling currency is bad for national self-respect and there too recovery does not seem to be at hand. The best hope is that Bill Miller, who will certainly be an active and vigorous Treasury Secretary, will form an effective team with the new Chairman of the Fed, who should be nominated this week, and change the atmosphere.

*Yours sincerely,*

W S Ryrie

*Bill Ryrie*

*is a good chance*

PS The news has just come through of the nomination of Paul Volcker to the Fed. This is excellent. It should mean *that there* that things will go as I hoped in my last sentence. He is well respected in the banking community and well known and liked abroad. He is known to have been in favour of a rather tighter policy on money recently. It will do something, on the economic side, to counter the ill-effects of last week's events.

SECRET.

PPP

20



Chancellor

I do think it would be helpful if I could copy this to those concerned w/ it on Monday. It is a very delicate issue.

MB

A handwritten signature in pink ink.

CHANCELLOR

EXCHANGE RATE ETC

We were talking briefly about the position and you asked me to jot down any immediate thoughts I might have before the weekend. If it were felt that something had to be done, I would make the following untutored points:

i. Should the initiative be a modest one, conceived as being followed steadily by others if the first fails? Or is it possibly wiser to do what one can to ensure that, if anything at all is to be done, it is designed to be as convincing as possible, and brings into play simultaneously most of the different steps one might take? One's instinct is that dribs and drabs waste credit in some sense, while the dangers of overkill are limited.

ii. There seems to be four classes of initiatives one might take.

a. Talking whether solo, or in concert with others, to the effect that the rate is grotesque. This would be important in our present predicament, as both you and the PM have made strong and well publicised assertions in public which make it appear to the less well-informed observer that we would not mind the rate going higher.

b. Tactics: modifications in day-to-day smoothing operations, in which changes might be made which might increase the likelihood of a down-turn.





c. Intervention of a more major kind. This could involve a "once and for all swipe" at the rate designed to knock it off its perch; a more sustained intervention to achieve the same; or a more permanent policy still of attempting to "cap" the rate or hold it at some target level. Of these three possibilities, only the first seems tolerable in principle at present. Any of the three could, in principle, be combined with complementary actions in other countries.

d. Controls, in principle at any rate, could be introduced, as partial mirror images of what we have recently dismantled on outward flows. <sup>This</sup> could, perhaps, be focussed quite selectively on certain areas. But could only be operated, one imagines, for a fairly short time and with diminishing effectiveness.

e. Information could be provided about the horrors of the real economy now and in the future. For example one could try methods of

- a more depressing, presentation of the monthly trade statistics. This could be a permanent charge, which focusses very carefully on non-oil trade, declining invisibles, etc;
- a special, one-off, horror story about the trade balance to date in 1979;
- a more permanent horror story about the further decline in the non-oil trade balance one might anticipate in the future (eg the LBS project a £2 bn balance of payments deficit in 1982.





Allowing for some further oil improvements, one shudders to think what this must mean for further non-oil trade deterioration).

2. One assumes any further progress on dismantling exchange controls is taken as read. But if there is a particular area which looks a natural candidate, it is freedom to purchase dollar securities. UK investors know about them and want them, and would increasingly feel it wise to start buying them when the £/\$ rate is so favourable.

3. I hope to have some more considered thoughts soon.

AR

ADAM RIDLEY  
27 July 1979



- cc Chief Secretary
- Financial Secretary
- MST (C)
- MST (L)
- Sir D Wass
- Sir L Airey
- Sir A Rawlinson
- Sir K Couzens
- Mr Atkinson
- Mr Littler
- Mr F Jones
- Mr Bailey
- Mr Anson
- Mr Byatt
- Mr Shepherd
- Mr Middleton
- Mr Hancock
- Mr Unwin
- Mr Bridgeman
- Mr Lovell
- Mr Dixon
- Mr F E R Butler
- Mr Davies
- Mr Ridley
- Mr Cropper
- Mr Cardona

MR BOTTRILL

ECONOMIC DEBATE

..... I enclose the text of the Chancellor's opening speech for the debate this afternoon. We have discussed most of the remaining blanks and square-bracketed passages.

2. If others have any suggestions to make perhaps they could let you have them urgently.
3. I should be grateful if Mr. Bridgeman could look particularly at pages 3, and 14-15 which the Chancellor wishes to redraft.

A handwritten signature in dark ink, appearing to be 'A.M.W. Battishill'.

(A.M.W. BATTISHILL)

1.

- Beg to move motion in name of R.H.Fs.
- First economic debate since Budget.
- Welcome opportunity to set in perspective measures announced on November 15th.

Immediate reason for action: had become clear in the most recent period that underlying growth of sterling M3 was above target of 7 - 11 per cent, announced at Budget time. Two principal causes: higher than expected public sector borrowing requirement in first half of the financial year; and a persistently high level of bank lending.

PSBR always been expected to be high in the first part of the year because of the timing of the Budget measures. But the delays in collecting

/telephone bills

telephone bills and value added tax - both caused by industrial disputes - helped to increase the PSBR in this period by up to £1 billion.

The monthly growth of bank advances in the three months to October averaged about £700 million.

In these circumstances, clearly essential to take action which I did to re-establish and maintain firm control over monetary and fiscal policy. Increase in MLR was no more welcome to Government than to anybody else. But so soon as it became clear that measures of that kind were needed, we did not hesitate to act.

/The market



Markets

3.

There has been  
 been useful sales  
 of 10% and short-  
 lap, and, today,  
 of 10% weekly lap.  
 There, and 10%  
 useful initial  
 applications  
 to the new  
 lap stocks &  
 part-payments  
 from the stocks  
 solid loan notes  
 will ensure a  
~~and~~ considerable  
 contribute to fully  
 10% having equid-  
 in Banking December.

[The market judgment of the package has  
 been clear. [ Two existing tap stocks were rapidly  
 exhausted, and a new tranche of <sup>an</sup> the existing stock  
 was rapidly sold out. <sup>Today</sup> ~~Comment on today's market~~  
 news.] ~~As a result, we have already secured a~~  
~~future flow of receipts from part payments due in~~  
 banking December.]

The measures were designed to maintain the  
 Budget strategy. They were a necessary but  
 manageable response. I am confident that the House  
 will agree that there was no alternative. Certainly,  
 the Opposition has not suggested one. For as  
 the R.H.G. the Member for Leeds East, said on  
 9th November, 1978, col. 1233

[quote extract]

4.

The immediate reasons for our action, however, were only a symptom of the more serious, underlying weaknesses of the economy. I said in my Budget Statement in June that the Government had inherited an economy where the rise in prices and wages was accelerating, output was flat, the balance of payments was in deficit, public spending was rising faster than the country could afford, and monetary growth was excessive. The economic indicators that have become available since the Budget confirm that this diagnosis did less than justice to the seriousness of the shambles that we inherited.

The deterioration in the current balance of payments in the first half of this year is now

/seen to have

5.

seen to have been much greater than seemed likely even at the time of the Budget. Certainly it was far worse than the R.H.G. the Member for Leeds East anticipated when he published his last Industry Act forecast in the Autumn of last year. He predicted that the current account would balance in the first half of this year. In the result the deficit was almost £2 billion.

This deficit reflects for the most part the very rapid rise in imports - a symptom of the economy's poor supply response to the pre-election consumer boom engineered by the R.H. Gentleman. At the same time, however, the surplus on invisibles was also sharply reduced, reflecting our increased

/net contributions

6.

net contributions to the EEC, a smaller surplus on services and increased payments abroad of interest, profits and dividends from North Sea operations. The growing benefit from North Sea oil - worth approximately £7 billion to the current balance of payments this year - has been more than swallowed up by the deficit on other transactions.

The Public Sector Borrowing Requirement was £ billion larger than the R.H. Gentleman had planned - and almost [twice] as large as in the preceding year.

It has also become clear since June that the final outturn for last year's wage round was every bit as bad as we feared. The last disastrous /winter of



7.

winter of the Party opposite left us with an increase in average earnings of 16½ per cent, far in excess of the growth in productivity. At the same time, world oil prices have risen more rapidly than then seemed likely. Both these factors combined with monetary growth that was already too high so that probably the most difficult feature of our inheritance was an inflation rate that was already into double figures, and rising fast.

In face of the depressing conditions which we inherited, the essential tasks then of the Government were clear. They remain the same today. We must defeat inflation. We must restore a balance in the economy - between the resources we /produce and

8.

produce and the resources we consume. In particular we must secure a balance between public and private spending. And we must increase the ability of the economy to supply more goods and services.

There can, I should expect, be no quarrel with those objectives.

Nor, I venture to suggest, should there be room for argument about the policies which are necessary to achieve them.

For in each case no sensible alternative is available.

In the first place, there is no alternative,  
/in the fight

in the fight against inflation, to strict control of the money supply, supported by firm fiscal policy. The principle of this is now widely accepted both in this country and abroad. The R.H. Gentleman, the Member for Leeds East, himself adopted monetary targets when he was Chancellor of the Exchequer. He also committed himself to limiting the size of the PSBR. There is no alternative.

/I should expect the

I should expect the rt. hon. Gentleman to have no difficulty in agreeing to that. I was accordingly very surprised to hear him, in a radio interview on November 12th, expressing the opposite view, when he said that I should "be prepared to make good the shortfall in demand by more government spending or more tax cuts".

/The measures



The measures that I announced on 15th November were necessary to implement our own monetary and fiscal targets. The rolling forward of our present target range for the growth of sterling M3 to cover the 16 months from mid-June 1979 to mid-October 1980 will avoid building into the target for the new period the excess growth in the recent past, while allowing a reasonable period to offset that excess.

The advance payment of Petroleum Revenue Tax will reduce the PSBR by £700 million this year, offsetting the effects of the Post Office dispute and delays to VAT receipts. It will bring the estimated PSBR back to the Budget target of £8.3 billion.

/There have been

There have been a number of suggestions of alternative techniques of monetary control. We have, of course, been looking at these. I have been pressed to make an early decision. But consultation is essential; these are highly technical and complicated matters and could have wide ranging institutional implications. It would not be sensible to introduce a new system, of any sort, before we were sure it would achieve what it was intended to do. The Bank and the Treasury will, however, be issuing quite shortly, a consultation paper discussing schemes of monetary base control.

/I should emphasise

13.

I should emphasise that none of the alternative monetary control techniques that have been suggested will avoid the need to get the fundamentals right, in other words to keep down the level of public sector borrowing and thus to ensure that interest rates are at the right level. Indeed, one possible benefit of a monetary base control is that it would help to bring about a quicker response of interest rates to changes in monetary conditions. In this respect it has a rather different role to play than the SSD scheme, and a monetary base system should not therefore be seen as a replacement to that scheme.

/Many people

Many people have expressed surprise that I did not take direct action to control specifically consumer credit lending. There were a number of reasons for this, as I explained to the hon. Member for Bromley, Ravensbourne following my statement on 15th November. In the first place consumer credit lending is a relatively small part of the total and has been growing <sup>at virtually the same rate</sup> ~~no faster than~~ <sub>as lending ~~some~~ as a whole</sub> lending to other sectors. [Quote percentage figures: "personal" lending? Credit cards?]

Secondly, direct intervention in the workings of any market will inevitably mean distortions as ways are found around the controls. Thus if I acted to tighten HP controls or restrict credit card lending there might be some temporary impact. But /there are many

This figure includes lending on bank credit cards.

Example,  
 In the last year <sup>substantially</sup> ~~substantially~~ lending by the clearing banks to persons, other than for bank purchases increased by 28%.  
 This total lending grew by 23%, or by 26% if acceptances are included.



there are many other channels for credit to consumers and after a while there would be little continuing effect.]

[The way to reduce the demand for credit is to increase interest rates. They bite equally on all forms of credit, including of course consumer credit. I should add that my decision to take no direct action<sup>last month</sup> on the growth of consumer credit <sup>did</sup> ~~does~~ not mean I <sup>was</sup> ~~am~~ unconcerned by it. It is particularly important at a time of stringency within the total of bank lending, <sup>(to)</sup> the needs of more important sectors are met first.]

/Success in

Success in restraining monetary growth, however, without relying on unacceptably high interest rates depends on continued efforts to limit Government borrowing. This means that public spending must be firmly checked if the private sector is not to face an excessively high tax burden. If we are to avoid putting excessive weight on monetary policy - as we must - then we must follow fiscal policies that are consistent with our other objectives.

That no doubt is why my predecessor undertook in his Letter of Intent to the IMF in 1976 to reduce the public sector borrowing requirement and to that end to reduce the share of resources taken by public expenditure. Unfortunately, no sooner was the IMF's back turned than the previous

/administration

17.

administration laid plans for further excessive public spending. Between 1974/5 and 1977/8 the R.H.G. planned to reduce public expenditure by no less than            per cent. But between that year (1977/78) and the present (1979/80) he planned to reverse that process by increasing public expenditure by            per cent. These plans could certainly not have been sustained without higher taxes or even higher interest rates.

In view of the outlook for the level of total resources likely to be available in the economy, the previous administration's planned growth in public spending was totally unrealistic. So it is high time for the Party opposite to make clear where they stand on this issue.

/Does the Party

Does the Party opposite stand by the spending plans it made in Government? The R.H.G. the Member for Heywood and Royton, formerly Chief Secretary to the Treasury, now admits that these plans were too high and must be reduced. The R.H.G. the Member for Leeds East has done so too, since the Election. On the other hand, the R.H.G. the Member for Sparkbrook, speaking for the Shadow Cabinet from Front Bench in this House on October 24th said clearly that Labour's plans should not be cut. Yet on Monday of this week the RHG was leading the attack on the present level of interest rates. So where does he stand? What then, is official Labour Party policy?

/If it is agreed



19.

If it is agreed that economies are needed where would Labour make them? How would they prevent State spending from taking a rising share of output?

If on the other hand the Party opposite oppose all economies, then where is the extra money to come from? If they want to stand by their plans, how would they find the extra money to pay for them - at least £3½ billion extra next year in today's prices?

- 8p on income tax?
- VAT at well over 20 per cent?
- Higher local authority rates?
- Or all three?

Will they condemn irresponsible behaviour by

/local authorities

20.

local authorities or unions, as they so notably failed to do in the case of Clay Cross in 1973?

And will they both complain Government is spending too little, and criticise every step we take to increase the Government's revenue?

/Once again there

Once again there is no doubt about the position of the Government. For once again there is no sensible alternative.

The White Paper, introduced by my r.h.f. the Chief Secretary last month demonstrates our determination to curb public spending in the interests of a firm fiscal policy. It is, of course, too early yet for anyone to start predicting the PSBR for 1980-81. For that depends - apart from anything else - on decisions that have yet to be taken. There should be no doubt, however, that our fiscal policy will be consistent with our monetary stance. With this objective we shall continue to keep all our policies under review, including our public expenditure plans.

/I readily agree,

I readily agree, of course, Mr. Speaker, with those who say that monetarism by itself is not enough.

It is equally important, as R.H. Members opposite will know, that there should be realism in pay bargaining. Excessive wage settlements in the context of a firm control of the money supply can only jeopardise output and employment. Once again there is no alternative to this proposition.

For this Government does not intend to interfere in individual pay bargains. But companies and workers that conclude excessive pay deals now must understand that we shall not print money to finance /them next year.

them next year. Employers who raise prices to cover the cost of excessive wage settlements will risk lost orders and pricing themselves out of the market, together with those whom they employ, they will be faced with the prospect of reducing their activities - with all that that implies for output, investment and employment.

This is why the immediate outlook for commerce, for industry - private and public - and for the public services, and for the people employed in them and their families, depends very much on the response and behaviour of managements, unions and employees, in their approach to pay increases.

/For the Government



For the Government will hold cash limits on Government and local authority public expenditure. They will be fixed in such a way as to accommodate reasonable - indeed by any rational standards substantial - pay increases. But they will certainly not be sufficient to finance fresh increases on the scale of those obtained during the lamentable last year of the previous Government's incomes policy. If increases of that order are again demanded and obtained, public service employment will have to fall, and the standards of public service will fall. We cannot afford to maintain public services at a cost which simply feeds inflation.

Once again there is no sensible or realistic alternative.

/In the same

In the same way, we shall hold the external financing limits of nationalised industries. Each industry will need to examine its costs with care and judge, in the light of possibilities of improving performance, what pay increases can be afforded. Both sides must play a responsible part in this judgement.

Our coal industry faces this responsibility now. Others in their turn will have to face the same problem and recognise the limits of what can be afforded within prices which their customers, and the public at large, will tolerate.

/In the same way

In the same way we shall hold the money supply which is available to finance the private sector. Because once again there is no alternative.

There are signs of growing understanding of the pressures which are developing on output and prices as costs rise - as they have been doing - faster than the prospective growth of money supply. Again it is for each firm and industry, with its unions and employees, to take a responsible judgment of prospects. It is inevitable - and right in a changing economy - that we should see different increases in different industries and firms, reflecting differences in their situations and performances.

/There is of course

There is of course a real danger that too many will see the problem as one which only affects others, not themselves. They will try to steal a brief advantage of an extra few percentage points. Some may indeed be lucky - for a time.

But let no-one doubt that, with the severity of the pressures which will grow if that happens, difficulties will be widespread, and few indeed will be unaffected.

Of course there is room for argument about the pace at which we should be trying to reduce the pace of inflation. Some might argue that we have pitched our aims unrealistically high. Some would /say we should

say we should have aimed for a sharper and perhaps more painful pace of reduction.

But once again there is no practicable or realistic alternative to the course on which we are set. Given responsible behaviour, it should enable us to achieve the objective of reducing the rate of inflation with the minimum of disruption and unemployment.

For there are few people - in the light of the dismal experience of the last Administration - who are now prepared to argue the case for an administered or institutionalised incomes policy.

This makes it more vital for everyone involved

/in pay bargaining



in pay bargaining to have a clear understanding of the economic setting in which they have to conduct their bargaining.

The Government have made it clear that we want by all available means to foster understanding of economic realities and a wider discussion of economic objectives and remedies. Parliament and Parliamentary Select Committees have a crucial role to play. And we attach importance too to the work of the National Economic Development Council and its industry committees on which representatives of management, trade unions and Government can work closely together.

/I have now taken

I have now taken the chair at [five] increasingly useful meetings of the NEDC. At the suggestion of the TUC and CBI, we are to devote the whole of next Wednesday's Council meeting to a discussion of economic prospects and policies. [I believe that this is an important development in the regular work of the Council and hope very much that we shall be able to build upon it.]

The constructive nature of some of our discussions in the NEDC should do something to discourage those who like to believe that there are deep and unbridgeable divisions between the government and trade union movement. Of course we have our differences. But this Government is not

/very different

very different from its predecessor in that respect.

There is, of course, no point in trying to pretend that such differences do not exist. But nor is there any point either in attempting to conceal the wide areas of common ground which also exist .

On the one hand we are grateful to the CBI, for example, for helping to bring home to industry the message of the Government's fiscal and monetary policies. I warmly endorse, for example, the remark made by Sir Ray Pennock at the recent CBI Conference: "The Government have tried to meet the legitimate request of industry - we now look to management to demonstrate a new confidence and dynamism."

/But I am

But I am equally glad to agree with the TUC in face of our jointly perceived experiences of the hopelessness of statutory incomes policies, pay norms and pay sanctions, that responsible collective bargaining is the only way forward.

Once again there is no alternative. The TUC have recognised that. So they have recognised - and I quote from - their economic review for 1979 that "monetary factors cannot be ignored and the Government does have to ensure that the public sector demand for finance does not prevent industrial investment or dislocate financial markets." (paragraph 272).

/I quote this

I quote this not in order to score debating points but because it does show that it is perfectly possible, if we respect one another's views, to set aside outstanding differences in pursuit of common objectives.

This is the spirit in which my R.H.F. the Secretary of State for Employment, will shortly be bringing his proposals before the House. The Government's proposed reforms to industrial relations legislation are designed to correct the broad balance of power between employers and unions in collective bargaining - or most importantly perhaps to correct the balance between militancy and moderation.

/Last winter's



Last winter's disruptions to much-needed services and to industrial production showed how small groups - sometimes defying their own union leadership - could abuse the framework of industrial relations which had been warped by the legislation of 1974-76. Equally, the employment protection legislation, though well intentioned, has in all too many cases reduced employment rather than protecting it. The Bill[s] we are introducing [are] designed to remedy some of the plainest defects in our industrial relations framework. [We may need to take further action in relation to immunities following the House of Lords judgement in Express Newspapers v. McShane.] [If other abuses arise, we shall be ready to take action to remedy them.]

/The Government

The Government has, of course, already made many other changes designed to restore enterprise and the flexible working of market forces in the economy. The Price Commission has been abolished. Dividend controls have been allowed to lapse. On 23rd October, I announced the ending of the last exchange controls (except those for Zimbabwe-Rhodesia). These moves will help industry to make its own pricing and investment decisions with minimum Government interference.

In the same way, our tax policies are directed towards encouraging, assisting and rewarding skill and success.

I must, of course, give overriding priority to

/the need to

the need to keep borrowing down and the money supply under control. But as and when resources become available, I intend to do more in the same direction.

To that end, as I said in my Budget Speech, I am reviewing the capital taxes system. The haphazard accumulation of taxes, one on top of another, does much to inhibit the risk-takers, upon whom much of our success will depend.

I want too to encourage more employees to be able to share in the success of their employing companies. It is important to encourage a far wider spread of profit-sharing schemes, and I am urgently reviewing the possibilities here.

/I want also to

I want also to help small firms - the new and young businesses which will play such an important part in the future. The cuts I have made in income tax - and the changes which I hope, in due course, to make in capital taxes - are what these businesses need most of all. But I am also considering the possibility of identifying further points where fiscal adjustments might be appropriate, specifically to assist small firms.

Most forecasters, including those in the Treasury, agree that the prospect for the year immediately ahead is for some decline in output. Thereafter, however, the forecasts become increasingly divergent. Of course, these policies will not

/immediately

immediately transform the prospect. The Government has always made it very clear that its policies will take time to have their full effect. There are, however, solid reasons for hope that the medium-term outlook will be brighter.

[QUOTE FROM LBS forecast]

/I return to



I return to the theme with which I began.

The policies which the Government commends to the House and the nation are policies to which there is no sensible or realistic alternative.

They are, moreover, the policies which have enabled other countries to create and sustain economic success - even in today's difficult conditions.

Certainly there is no alternative on offer from the Party opposite.



63  
cc Mr. R. Allen  
Mr. P. Rayner  
Mr. Mower  
Mr. Monaghan  
Mr. Ridley  
Mr. Cropper

MR. P.G. DAVIES

SPEAKING NOTES ON INFLATION

The Chancellor has made one or two suggestions on the draft Ministerial speaking notes attached to Mr. Segal's minute to you of 8 August. He has asked Mr. Ridley and Mr. Cropper to cast an eye over it before final approval is given.

2. I suggested to the Chancellor that a short reference to the TPI might also be appropriate if it goes ahead as planned. He agrees.

*AB*  
A.M.W. BATTISHILL

9 August 1979



64

✓  
Dr have  
looked this  
points.  
AB

CHANCELLOR

cc Principal Private Secretary  
Mr Unwin  
Mr Hancock  
Mr Bridgeman  
Mr P G Davies  
Mr Bottrill

SPEAKING NOTES ON INFLATION

Mr Battishill asked for quick comments on IDT's draft. I suggest redrafting numbers 5 and 7 as follows:

5. The immediate outlook for inflation (to the end of 1979) remains substantially the same as in the Budget forecast.

7. Neither past nor expected movements in the RPI (or any other index) are a good guide to what is the proper basis for fixing pay increases. These must rather reflect the productivity and competitive position of individual organisations, their profitability and the constraints implied by the Government's cash limits and money supply target.

You may also be interested in this connection in glancing at a form of words with which Mr Dixon and I have been toying, of which I attach a version. I still think the paragraph you put in the Budget speech is the best short formulation of the message.

ADAM RIDLEY  
9 August 1979



MR DIXON

cc Principal Private  
Secretary

Mr Unwin  
Mr Hancock  
Mr Bridgeman  
Mr P G Davies  
Mr Bottrill

CHANCELLOR'S SPEECHES - INFLATION

I rather like the argument in your draft, and have tried my hand at another version, up to the point at which you repeat the argument about commonsense, where I begin to feel a lot less sure.

You may, incidentally, remember a useful "nuclear" passage from the Budget Speech of which I enclose an extract in case it is of use.

A handwritten signature in dark ink, appearing to be "AR".

ADAM RIDLEY  
8 August 1979

If pay settlements were made at levels no greater than productivity increases, we should have beaten inflation almost overnight. But, not only that, a policy of monetary targets which is tight when prices are rising need be much less restrictive once inflation is beaten. High unemployment is not necessarily the central ingredient in policies for beating inflation; but it is an inevitable consequence of them if managements and employees do not themselves help beat inflation by the route which is available to them - pay settlements which are properly related to profits, real productivity growth and the limits on money supply - settlements which can be met while still allowing businesses the profits and prospects needed for growing sales of employment.

2. So the remedies are to hand if people can face up to them; and they are available to individual firms, unions and workpeople. They are their responsibility, not that of Government. It should not be too difficult. Of course it is not easy to relate pay to what is produced rather than the retail price index; or to go by what can be afforded by one's own employer, rather than what some other (possibly unwise) employer has been forced to. But it is all simple commonsense; if we did this, we would not have to worry for long about the retail price index; it would look after itself.

67  
private sector.

Responsible bargaining necessarily means different things to different people and in different kinds of firms and industry. But on both sides of the table certain limitations must be recognised : in the public sector, what the rate payer and tax payer can afford; in industry, what the customer is prepared to pay, what the firm needs to invest, and what the pressure of competition demands; and, throughout the economy, the limits imposed by the need to control the money supply.





68

C  
M

✓  
2

CHANCELLOR

THE ECONOMIST'S "FINANCIAL REPORT" 2. 8.79

I have at last managed to speak to Marjorie Deane about the piece at X on p5 which you drew to my attention some while ago. She "took my points" and in so doing evinced some awareness of the fact that the BofE will be coming out with material on the monetary base in due course.

2. I infer from what she said that she did not write the story herself.

A handwritten signature in black ink, appearing to be 'AM'.

ADAM RIDLEY  
10 September 1979



C - I simply suggested a call rather than lunch on good housekeeping grounds, i.e. that we don't need to lunch candidates for jobs. MMF 14/9

CHANCELLOR

A (AM WD SE 3.57) 14/9

FLEMMING

The difficulties about lunch arrangements being what they are, I've provisionally arranged with Mr Hall that I will bring him round to No 11 at about 2.0 after lunching him myself (you have nothing else in your diary till 3.0 - when D Harrod comes to see you). If you wanted to, Mr Hall and I could, no doubt, somehow achieve the impossible and arrange for us to eat à trois, should you prefer that - I've no doubt JF himself would not object.

2. No doubt you will guide us.

ADAM RIDLEY  
11 September 1979



CHANCELLOR

c Chief Secretary  
Financial Secretary  
Minister of State (C)  
Minister of State (L)

BRITISH LEYLAND - SOME VERY QUICK POINTS FOR YOUR  
6.45 MEETING WITH THE PM - 12 SEPTEMBER

1. The kind of pressure Government is subjected to by unions/firms in difficulties/opponents of PE economies is suicidal, and very like a person who threatens to jump to his death from a high building if one does not do what he wants one to do.

2. Given the immediate responsibility of Sir L Murphy and the NEB for BL, Ministers have an unusually favourable opportunity to keep in the background. All the more so since we are not departing from the framework laid down by Varley and Labour. It is the combination of difficult circumstances and, above all, the failure of BL to improve its performance as much as it could and should which are together the cause of the trouble. Best of all if Ministers can avoid playing any overt part in the difficult decisions, and it can be made clear (by Murphy) that it is simply failure to meet past conditions for future assistance which is the reason why that assistance is not forthcoming.

3. So far we and Labour have been in the position of conceding the principle of assistance, and promised money before the firm has done much to improve. KJ's posture still remains in the same vein.



[He writes in his minute to the PM of September 7, of the new problems:

"I have made it clear to Leslie Murphy and Michael Edwardes that proposals for public funding of up to £225m will have to be fully justified in the Plan..."

That is to promise money before further improvement again. Is it not now true that BL shows it can help itself before calling on the taxpayer? Specifically, should its Labour force not:

- a. decline to participate in the Engineers' strike;
- b. show an improvement in respect for IR procedures, or even promise "no strikes";
- c. show substantial improvement in productivity, which is now at best static, has fallen for many years, and is (I believe) no higher than 10 years ago;
- d. Submit to a massive scrapping of restrictive practices, of the kind reputed to have forced the closure of the Albion plant which makes the "Titan" bus (occasionally).

AR

ADAM RIDLEY  
12 September 1979



B/F 3/xii

per P. 72  
Nov 29/11

C

for a min (etc) mtg  
when I.R. Mr. Hancock  
(see below)

cc Chief Secretary  
Financial Secretary  
Minister of State (Commons)  
Minister of State (Lords)  
Mr Ridley  
Mr Cardona

C

CHANCELLOR

TAX RELIEF FOR PRIVATE MEDICAL INSURANCE

1. Patrick Jenkin has written to you (22nd November) asking you to implement, "as soon as you judge possible", the Manifesto commitment to restore the position whereby lower-paid employees are not taxed on the assessed value of the benefit to them of private medical insurance provided by their employers.

2. I would argue for going further, by relieving all such employees (not just the "lower-paid") and by instituting tax relief (perhaps only at the standard rate of income tax) for private individuals' private health insurance premiums.

3. There seems to me a fundamental difference between private health insurance and the other "perks", for the State is being relieved of a substantial element of expenditure by the existence of private insurance schemes like BUPA. By contrast, an employer supplying his employee with a car or a free railway ticket is not saving the State anything.

only if you assume a counter-balance in education expenditure

What about

4. I have never myself understood why the Conservative Party is opposed to some form of rebate to those who educate their children at their own expense - thereby saving the State the cost of providing that number of school places. That rebate could easily take the form of tax relief (again, maybe, at the standard rate). Indeed I was taken aback to be slapped down by the Questions of Policy Committee in the General Election when I implied in a draft that this was a long-term (but at present unattainable) objective.

employer provides private education? Sorry → AB

What about it?

5. It seems to me entirely in keeping with Conservative policy to give tax relief both on private education and on private health provision. Obviously not at 100%, because one still expects to be picked up by a public ambulance if one is hurt in a car crash. But if one does, by private health insurance, save the State the full cost of one's gall-



stones or cataract operation, surely one is entitled to a rebate from the State. Relief at the standard rate of tax would be a rough and ready arrangement, which would, I imagine, still leave the NHS well in pocket.



PETER CROPPER

26th November 1979





MR BOTTRILL

c 74  
cc ✓ Principal Private Secretary  
PS/Financial Secretary  
PS/Minister of State (L)  
PS/Minister of State (C)  
Sir Douglas Wass  
Sir Anthony Rawlinson  
Sir Lawrence Airey  
Sir Kenneth Couzens  
Sir Fred Atkinson  
Mr Littler  
Mr Shepherd  
Mr Cassell  
Mr Middleton  
Mr Hancock  
Mr Bridgeman  
Mr Lovell  
Mr F E R Butler  
Mr Unwin  
Mr Mower  
Mr Dyer  
Mr Ridley  
Mr Cropper  
Miss Deyes

ECONOMIC DEBATE, WEDNESDAY 28 NOVEMBER

The Economic Debate next week is now to take place on Wednesday 28 November, and the Chief Secretary will be winding up for the Government.

2. This is to confirm various glosses, already mentioned to you, on the framework at Annex A of my minute of 20 November to Messrs. Unwin and Butler.

3. The Chief Secretary does not want to spend much time raking over the inherited situation. He wishes to divide his speech into three roughly equal sections dealing with:-

- i) the Callaghan/Healey policy;
- ii) the Tony Benn/New Cambridge philosophy (which he regards as the only intellectually coherent alternative to the Government's own philosophy, and which he therefore wishes to consider seriously rather than dismissing it out of hand);

75  
iii) the Government's own policies.

He wishes to use this as the framework for replying to particular points raised in debate, and would be grateful if your notes could include quotations which help to define the position of those who follow the Callaghan/Healey and the Benn/New Cambridge policies.

4. He will also be preparing to reply to the recent criticisms of Mr Geoffrey Rippon, and will be looking over Mr Rippon's recent letter to the Times and his speech in the Budget Debate in June. It would be helpful if your notes could suggest a line of response to Mr Rippon.

5. While most of this material could be in the form of notes and quotations for the Chief Secretary to work on himself, he would be grateful for a concluding section of five hundred words in fully worked out speaking form. This should give a firm affirmation of the Government's economic objectives, of the means by which they were seeking to achieve them, and of their belief that their economic policy is a policy for the lifetime of this Parliament. The Government neither seeks nor proffers quick results.

6. It would be helpful to have this material for the weekend if possible.



A C PIRIE  
23 November 1979



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CHANCELLOR

ECONOMIC DEBATE : MOTION

It now seems to be accepted that Wednesday's debate will be on a Government Motion. No doubt the Government Managers are looking to Treasury Ministers for a motion. You may like to explore at morning prayers tomorrow.

*M.A.H.*

(M.A.H.)  
22nd November 1979

NB  
—

Chief Secretary's proposal  
Coverage for the visit-up: note below 903



C 77

CHIEF SECRETARY

→ Doc Mr. Hall

MOTION FOR ECONOMIC DEBATE

I attach two possible motions (A and B), together with two possible riders (1 and 2) each of which could be added to either of A or B.

2. The provisional plan for the economic debate is that the Chancellor will open and you will close, but this remains provisional.

*G.C.*

GEORGE CARDONA

23 November 1979

A. "That this House congratulates Her Majesty's Government on their economic policy".

B. "That the House applauds the economic policy of Her Majesty's Government".

1. "which has as its objective a lasting reduction in the rate of inflation".

2. "which will bring about a permanent reduction in the rate of inflation, by stabilising public expenditure and maintaining firm control of the money supply".



BIF 29/xi

cc Chief Secretary  
 Financial Secretary  
 Minister of State (Commons)  
 Minister of State (Lords)  
 Mr Ridley  
 Mr Cardona

*In: Home  
 for Home only*

CHANCELLOR

CAPITAL TAXATION

1. Rather than speak up too loudly at Thursday morning's meeting, may I put on paper what seems to me to be the persuasive case for abolishing Capital Gains Tax rather than Investment Income Surcharge.
2. My view would be that we should abolish CGT for persons only, leaving companies to be catered for in a more general revision of the tax adjustments for inflation. This is in line with Lord Cockfield's suggestion.
3. I would envisage the abolition applying to gains arising after April 1980. Doing it that way would mean that the loss of revenue would only become apparent in 1981-82. There is no need to relieve "retrospectively" those gains that will have arisen in 1979-80. This will considerably soften the political impact of the proposal if Budget 1980 turns out to be one with few other tax reductions in it.
4. Capital gains tax is a bad tax in that it is assessed on unreal gains. The previous administration was unable to find a practical means of adjusting for inflation, and we are hardly likely to succeed either. Tapering is a crude and arbitrary concept with little to commend it since it will only in rare instances operate as an exact inflation adjuster. In any case, both inflation adjustment and tapering would remove three-quarters of the yield in present circumstances if they were designed to work fairly.
5. Capital gains tax operates particularly harshly on the person who establishes a business, builds it up and sells it. There are rollover provisions for the man who passes on his business to a successor; but not everybody - in these days of small families - has an heir who is capable of and willing to take over his parent's



business. CGT operates, therefore, as a levy on the value of the goodwill created by a successful businessman when he sells a flourishing firm to somebody else or to another company.

6. In the case of portfolio investments, capital gains tax involves very high compliance costs and the retention of intricate statistical records for long periods of years. The records required to be kept for capital gains tax are precisely those which would be needed as the basis of a Wealth Tax.

7. Investment Income Surcharge, by contrast, is easy to assess and collect, requires no on-going records, and now falls mainly on well-off people. It has little impact on the growth of small firms: a firm has done pretty well by the time it is paying dividends at a sufficient level to attract IIS in the hands of either the entrepreneur or his Aunt Agatha.

8. Furthermore there is nothing to stop the government from gradually reducing the rate of IIS by, say, five per cent per annum in later years, once CGT has been dealt with.

9. We have to accept realistically that the next left-wing - or centre-ist - government will introduce a wealth tax. That will be all the easier if CGT records already exist for each taxpayer. Investment income surcharge could easily be revived by an incoming Labour Government - in conjunction with a wealth tax. Capital gains tax would not so easily be revived.

10. Looked at in the abstract, I think there is a good case for believing that capital gains tax represents the conversion of private capital into state current account revenue. The proceeds of CGT go into the central pot. Whereas in nine times out of ten people reinvest their capital gains - especially when they know that they are unreal or inflationary in the first place.

11. Lord Cockfield, reporting on his American visit, states that the Americans have been reluctant to abolish CGT, preferring to apply a crude form of discount to the taxpayer's liability. (By exclusion of



0% of long-term gains from the charge.) They opposed indexation on the grounds that equity would require parallel tax reliefs to compensate bond holders for their inflationary losses. I suggest that this form of argument is much less relevant in the UK, where we are desperately in need of more individuals as entrepreneurs and equity holders. The UK has been ruled for most of the post-war period by governments that have regarded profit as a dirty word and which have done their best through dividend controls, price controls and discriminatory taxation to wipe out the private investor. We are now trying to redress the balance in order to get the economy growing again. A good way of doing this is to tilt the balance away from the bondholder and towards the equity holder. It will be time to start thinking about the taxation of capital gains again when they begin to arise.

12. A possible form of words is attached.



PETER CROPPER

26th November 1979

Draft passage on CGT abolition

I have been heavily influenced in my review of capital taxation by the argument that simplification would be best achieved by cutting out one of the five capital taxes altogether.

At present we have five capital taxes - Capital Transfer Tax, Capital Gains Tax, Development Land Tax, Investment Income Surcharge and Stamp Duty. Each one of these interacts on all the others, creating an evil and destructive brew that has been sufficient to poison a large number of very valuable businesses.

I cannot countenance the abolition of Development Land Tax; it deals with a particular form of gain which has nearly always been regarded as a fair object of taxation.

Neither can I envisage a situation in which there is no levy on the transfer of wealth from one generation to the next. This seems an appropriate way of preventing the undue concentration of wealth into large agglomerations. I therefore regard it as right to reform the Capital Transfer Tax rather than to abolish it. The same goes for Stamp Duties, which are an efficient means of raising a certain amount of revenue from a broad range of transactions. They should be reduced, not abolished.

The choice for abolition therefore boils down to Investment Income Surcharge or Capital Gains Tax. After the most careful consideration I have decided that it is Capital Gains Tax that should go.

This tax was introduced in the form of the Speculative Gains Tax by a Conservative government in 1964. It has never really settled down, and latterly it has turned out to work extremely badly at a time of inflation. Most of the gains falling into the CGT net are not gains at all - they are simply the reflection of inflation on monetary asset values.

The previous government published a Consultative Paper in 1977, and went to considerable trouble to find an efficient way of

/correcting

correcting the Capital Gains Tax for the effects of inflation. They failed. We have worked over the ground again and we have failed too.

I propose, therefore, that in the case of persons, Capital Gains Tax should cease to be levied on gains accruing from April 5th this year. Gains arising during 1979-80 will still be subject to the tax, which means that there will be no revenue impact from the abolition until the financial year 1981-82.

In the case of companies I propose that Capital Gains Tax should continue to be levied, pending a more thoroughgoing review of company taxation in all its forms in the light of the move towards inflation accounting.

I shall, of course, instruct the Inland Revenue to keep a close watch for abuse following the abolition of Capital Gains Tax in the case of persons. Ingenious systems may be invented for converting taxable income into untaxed capital gains; I shall be watching them. But I do not think that the risk of undetected evasion is sufficient to justify the retention of this very damaging tax.

Capital Gains Tax has fallen principally on the disposal of small businesses and on the sale of portfolio investments. Both of these represent forms of investment which are badly needed if the British economy is ever to flourish again. Instead of penalising business success, we have to try to encourage it in future. I believe that this proposal is one way to go about it.

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In yd?



✓ OIB  
PRINCIPAL PRIVATE SECRETARY —

cc. PS/ Financial Secretary  
Mr Cropper

MOTION FOR ECONOMIC DEBATE ON WEDNESDAY 28 NOVEMBER

The Chief Secretary has seen Mr Cropper's minute of 26 November (copy attached). He prefer a shorter motion, as follows:-

"Thas this House supports the economic policy of her Majesty's Government."

A C PIRIE  
26 November 1979

In name of Pw etc  
Thas "The Economy"

CHIEF SECRETARY

The Chancellor and Financial Secretary would be glad of your approval to the terms of a Motion for Wednesday's debate:-

*Confirms its*  
"This House ~~pledges~~ full support for the economic policies of Her Majesty's Government, which offer the only prospect of achieving a reduction in the rate of inflation and a recovery of the economy."

Would you kindly return this, amended if necessary, to the Chancellor's office.

*That this House supports the economic policy of Her Majesty's Government.*

*B*

*PC*

PETER CROPPER

26th November 1979



ppd p1 at X

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CHANCELLOR

A.B:

It is no doubt too late, so far as the letter is concerned: but I shall have to A.R.'s doubts - & shall hope

that we can discuss (first internally & then with P.S.) the principles & practicalities of the proposals, after consultation of (1) all work

DHSS ECONOMIES

I remain extremely uneasy about some aspects of the economies now proposed. If you now wish me to treat the matter as closed, I can well understand and will do so. But I feel that it may be worth pointing out a few issues even at this late stage. I refer to the proposals listed in an attachment immediately behind the draft letter submitted to the CS/T by Miss Peirson on December 18.

x |

so far have an impression generally (2) the work also going on / done on incentives. It is with

2. First, some of the suggested economies seem calculated to cause a big and justified fuss. The reduction in invalidity benefit is the most obvious. The suggested analogy with sickness benefit is painfully weak. Such a step makes the Party look as hardhearted and ruthless as all our opponents propaganda suggests. I also feel it is utterly inconsistent with our general line in Opposition of "more effective help for those in greatest need". But the failure to increase child benefit and, perhaps, the abolition of the earnings related supplement also look highly controversial. The latter is most inappropriate at a time when we seek to encourage the acceptance of redundancies and the need to switch jobs. It will also be interpreted as a breach of faith, as Jim Prior points out.

to make headway in a limited fashion, so far as poss.

what's a part of trouble with P.S.

3. Second, if as footnote 1. suggests it is deemed possible to reduce benefit levels in real terms in subsequent years, why not agree to do so earlier and get it over and done with while there is a Social Security Bill around to amend. This leaves 1980/81 as a problem, but would make life much easier in subsequent years.

while CS is a hand



The argument for doing this is strengthened by the fact that one would then be able to "play off" child and invalidity lobbies more explicitly against the pensioner interests and any other beneficiaries who are, on present proposals, being offered continued price protection. You could say you were holding them back to ensure a square deal for children, invalids or whomsoever, whose programmes would otherwise have to be reduced. Since the economies would form only a small proportion of the vast expenditure on pensions and other price-protected benefits, but a massive proportion of spending in the much more marginal programmes now isolated for special treatment, they would be far more defensible.

4. As far as I can gather from Mr Battishill, the shape of these proposals reflects various informal discussions you and the Chief Secretary have had with Messrs Prior and Jenkin on the margins of various meetings. But they have not been thrashed out very thoroughly here. Is there not a case - timetable permitting - for a discussion with the CS/T and Messrs Rawlinson and Kemp to think it all through a bit more? If the conclusion is that a different approach would be better, the present proposals could be treated as the first stage in a negotiation in which other less unacceptable proposals emerge and are grasped with enthusiasm by a relieved Patrick Jenkin.

The one  
on short term  
benefit  
was the  
pastoral  
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ADAM RIDLEY  
19 December 1979

PS. The CS/T's letter to Patrick is so potentially explosive politically (imagine it in Time Out) that I wonder whether it ought not to be dealt with specially



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IRENE RIPLEY

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