

Part A

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Part A

Monetary Statement

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1979

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B

May 1



I know Yemie is at a premium;

but there are v. important papers, including most of our originals on M.H.K. They must be sorted so that the masters are correctly filed, before

Clerks.

This should be the thing is lost to posterity.

Kept together, but properly sorted now. There are

(a) a lot of spams

(b) some originals of notes of meetings which ought to be put into their proper place in the filing system.

GB  
19/11



PERSONAL

AND

SECRET.

2

Keep together

PACKAGE.

Chanellors Papers.

SECRET

CHANCELLOR OF THE EXCHEQUER

- cc Chief Secretary
- Financial Secretary
- Minister of State (C)
- Minister of State (L)
- Sir Douglas Wass (o/r)
- Sir Lawrence Airey
- Sir Kenneth Couzens
- Sir Fred Atkinson
- Sir Anthony Rawlinson
- Mr Littler
- Mr Bridgeman
- Mr Middleton
- Mr Monck
- Mr Davies
- Mr Folger
- Mr Williams
- Mr Dyer
- Mr Ridley
- Mr Cropper
- Mr Cardona

MONETARY STATEMENT

I attach a final version of the statement as agreed in discussion with you following Cabinet this morning.

J B UNWIN

15 November 1979





HOUSE OF COMMONS  
LONDON SW1A 0AA

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Geoffrey.

well done indeed.

Erud.

With the permission of the House, Mr Speaker, I should like to make a statement on monetary policy.

2. The figures for October, just published, show that £M3 grew by 2 per cent in that banking month. The growth since mid-June, the beginning of the target period, has been equivalent to just over 14 per cent a year. Although the figure for banking October was erratically high, it is clear that the underlying growth of £M3 is still significantly above the target of 7-11 per cent.

3. There have been two principal causes of this excess: a higher than expected Public Sector Borrowing Requirement in the first half of the year and the persistently high level of bank lending.

4. Because of the timing of the Budget measures - in particular receipts from VAT and reductions in public spending - the PSBR was always expected to be higher in the first half of the year than in the second. In the event, the PSBR in the first half year has been further increased by strikes and other industrial action, which have delayed the collection of VAT and telephone bills. At the peak arrears on telephone bills are expected to reach £1 billion.

5. A large part of these arrears will be made good in the second half-year. Even so, the best estimate which



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could now be made of the PSBR for the year as a whole, if no action is taken, is that it would be about £9 billion, compared with the £8.3 billion Budget estimate.

6. The monthly growth of bank lending has averaged about £700 million over the last quarter. Although the timing is difficult to predict, its growth can be expected to fall in due course.

7. Nevertheless it is necessary to take action now to bring the growth of the money supply within the target range. The Bank of England accordingly announced this morning with my approval that Minimum Lending Rate would be increased to 17 per cent. This goes beyond the rise in market interest rates at home and demonstrates the Government's determination to act with the firmness foreshadowed by my Rt Hon Friend the Prime Minister earlier this week.

8. The House will realise that interest rates overseas have risen sharply as other countries have moved to fight inflation by limiting monetary growth. In the United States, for example, prime rates have risen from  $11\frac{1}{2}$  to  $15\frac{1}{2}$  per cent since the summer.

9. In addition to sales of gilts, we intend to secure further funding of the PSBR through National Savings. The limit on holdings of the index-linked National Savings Certificates Retirement Issue will be increased next month from £700 to £1,200. A new ordinary National

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Special Deposits scheme, or corset, has also played a part in monetary control. I am well aware of the limitations of this scheme and do not believe that it has a permanent role to play. Nevertheless, the Governor and I have agreed that it is right that it should continue for a further six months. The Bank announced the arrangements this morning.

13. In the future, other techniques, including one of the variants of monetary base control, could play a useful role, without the disadvantages of the SSD scheme. The Bank and Treasury will therefore shortly issue a discussion paper for consultation. I must, however, stress that no such scheme can avoid the need for the right fiscal and interest rate policies. Indeed, one of the possible advantages would be to improve the response of interest rates to monetary conditions.

14. Finally, I am extending the period covered by the present target range for  $\text{£M}_3$  of 7 to 11 per cent per annum. That target at present applies to the 10 months from mid-June 1979 to mid-April 1980. It will now cover the 16 months from mid-June to mid-October 1980. The effect will be to avoid building into the target for the new period the excess growth of the money supply in the recent past, while allowing a reasonable period in which to offset that excess.

15. Mr Speaker, Britain's future depends above all on mastering inflation. This can only be done if we bring the money supply under firm control, progressively



Savings Certificate will be introduced early next year. The interest rate on the National Savings Bank Investment Account will be raised to 15 per cent from 1 January next.

10. Although much of the increase in the estimate of this year's PSBR is due to the timing of receipts, further action is required to bring the PSBR down. In the light of this we shall require oil companies to make a payment on account of Petroleum Revenue Tax at the time when they make their returns. This will have the effect from now on of advancing the due date for collection by 2 months, thus bringing the arrangements for PRT into line with those for collecting royalties. This will ensure that PRT reaches the Exchequer with the minimum of delay at a time when oil prices are rising.

11. The Bill to achieve this will be introduced shortly. It will reduce this year's PSBR by £700 million and thus bring the estimated level back to the original Budget figure of £8.3 billion. It will also yield an extra £300 million next year, in addition to £400 million or so from the deferred payment of telephone bills.

12. I set in hand some months ago a review of methods of controlling the growth of the money supply. The main instruments must continue to be our public expenditure and tax policies, which together determine both the size and the composition of the PSBR, and interest rate policies. Recently the Supplementary

reduce the rate of monetary growth over the years, and pursue the most rigorous restraint on public spending. The supposed alternatives to these policies are a delusion. None of them would be responsible and none of them would be sustainable. The action I have taken today underlines the Government's total and continuing commitment to getting inflation down.

- UNEMPLOYED \* MAS
- TIGHTEN ON MONET. POLICY
- DEBTORS

(LA) M.I. 400M FOREIGN  
PSBR

① FALL IN OVERSEAS INVESTMENTS  
↳ SAVINGS / INVESTMENT

② PUB EXP > GDP — CBPAI LHM  
- WILL NOT REDUCE

③ EX. CONTROL  
- ~~LOW~~  
- PUL: NOT WORKS  
- LOW ON

~~(4) ...~~

(4) M | — NOT WORKS



SECRET AND PERSONAL UNTIL  
4 pm 15th NOVEMBER 1979  
UNCLASSIFIED

CHANCELLOR

copy addressees  
as on attached list

MONETARY STATEMENT: BRIEFING

I attach briefing for your use in presenting the monetary statement this afternoon. This has been prepared by CG and HF with the help of the other divisions concerned.

2. The briefing is organised as follows:-

*Note amendment to A3*

<u>Brief</u>	<u>Subject</u>
A	( 1. Recent monetary developments 2. Monetary target 3. Interest rates (including implications for Building Societies) 4. SSD scheme and monetary control techniques
B	National Savings
C	Advancing collections of PRT
D	PSBR for 1979-80
E	PSBR and public expenditure for 1980-81
F	Effects on industry, GDP and employment
G	Prospects for tax cuts
H	Public Expenditure White Paper on the later years
J	Medium term financial plan
K	Exchange control and the monetary position

*M. T. Folger*  
(M. T. FOLGER)

15th November, 1979.

COPY RECIPIENTS OF BRIEFING FOR CHANCELLOR'S MONETARY STATEMENT, 15 NOVEMBER

- Chief Secretary
- Financial Secretary
- Minister of State (C)
- Minister of State (L)
- PCC (inc Mr Kyrie UKTSD)
- Mr Bridgeman HF
- Miss Brown GEA
- Mr Butler GEP
- Mr Cassell MP
- Mr Hancock EF
- Mr Lovell FP
- Mr Middleton FEU
- Mr Monck PE
- Mr Shepherd SD
- Mr Bottrill EB
- Mr Williams HF3
- Mr Broadbent CU

- Mr Ridley
- Mr Cropper
- Mr Cardona

Mr Lankester No 10

PS/Governor  
PS/Inland Revenue

UNTIL 4 pm 15 NOVEMBER,  
THEN UNCLASSIFIED

A1 RECENT MONETARY DEVELOPMENTS

factual

1. £M3 grew by 2% in banking October (figures published 2.30 pm today). Bank lending was main expansionary factor (increased by £1½ billion).
2. In four months since mid-June, £M3 grown at annual rate of just over 14% (14.2%), ie above 7-11% target range. If allowance made for take-up of acceptances outside banking sector, underlying growth somewhat higher.
3. Details of recent developments in Annex.

positive

1. Latest figures suggest taking longer than hoped to bring down money supply growth from rate inherited but Government determined to bring back within target range.
2. Excess growth largely due to even higher PSBR than expected in first half of year and sustained growth of bank lending.
3. Can expect some slowing in £M3 growth. Budget measures reducing the PSBR will take effect in second half of the year. Further reduction from bringing forward PRT due date. Bank lending growth should moderate with lower activity, and interest rate increases.

defensive

1. Banking October:

- (i) Banking October figures swollen by a number of distortions to normal financial flows.
- (ii) CGBR in banking October affected by delays to some receipts from higher rate of VAT; expected low CGBR meant no receipts from part paid gilts were planned.
- (iii) High demand for credit in banking October following small rise in banking September. Special factors operating



other way and tending to increase lending in October, eg ending of engineering strike; also impact of tax rebates on companies' cash flow.

(iv) Outflows across exchanges from non-bank private sector, as in other recent months. Probably associated with exchange control relaxations.

(v) M1 growth substantial (3.4%) but rise in interest bearing sight deposits accounted for much of it; possibly associated with funds awaiting longer term investment.

2. Government borrowing: PSBR expected to be higher in first half of year; and swollen further by PO strike (peak effect about £1 billion) and delays in VAT collection. Greater part of short fall made good in second half, when also expect receipts from higher rate VAT and benefit from bringing forward PKT due date. <sup>public expenditure reductions</sup>

3. Bank lending: Remained strong, since beginning of year (increased about £700 million in last 5 months). Affected in some months by special factors, but expect increases to moderate not least as a result of higher interest rates and lower activity. But timing difficult to predict.

4. Acceptances: Recognise underlying growth in bank-type credit understated by published figures. Substantial take-up of acceptances outside banking sector (£1.1 bn in last 5 months). A side effect of SSD scheme (see separate brief). Action to prevent leakage would be counterproductive - force credit into more damaging and hidden channels.

5. Debt sales: Substantial sales until September. Sales affected by market uncertainties. Receipts in banking October affected by lack of part payments in anticipation of low CGER and substantial redemptions and buying in of next maturities.

6. Exchange control abolition: Net effect on monetary growth difficult to assess but likely to be small this year (see separate brief).

## RECENT MONETARY DEVELOPMENTS

I. Monetary Growth

	Banking <u>October</u>	£bn seasonally adjusted Banking July - <u>Banking October</u> (4 months)
CGBR	0.94	3.65
Purchases of central government debt by non bank private sector (increase:-)	+0.04	-2.02
Other public sector	-0.62	-0.18
Sterling bank lending to:		
private sector	1.24	2.48
overseas	<u>-0.03</u>	<u>0.05</u>
DCE	1.57	3.98
External and foreign currency finance adjustment	-0.40	-1.28
Net non deposit liabilities etc.	<u>-0.09</u>	<u>-0.31</u>
£M3	<u>1.08</u>	<u>2.39</u>
%	<u>2.0</u>	<u>4.5</u>

II. Cumulative £M3 growth (at an annual rate in target period)

<u>Target</u>	<u>August</u>	<u>September</u>	<u>October</u>	banking months %
7-11% (annual rate)	11.6	10.3	14.2	

III. Bank lending and acceptances

	<u>July</u>	<u>August</u>	<u>September</u>	<u>October</u>	£bn
Bank lending	0.4	0.7	0.2	1.2	
Acceptances	<u>0.1</u>	<u>0.3</u>	<u>0.2</u>	<u>0.2</u>	
Total	0.5	1.0	0.4	1.4	
Average bank lending to private sector, adjusted for bill leak		last 6 months £900m		last 3 months £920m	

## A2 MONETARY TARGET

Factual

reducing inflation

1. Objective remains to reduce monetary growth as key factor in with progressive reduction of target range.
2. Present target period extended: £M3 target now 7-11% (at annual rate) to apply from mid June 1979 to mid October 1980 (16 months).
3. Growth of 7-11% for whole period implies substantially lower rate over next 12 months - 7.4%
4. Target to be rolled forward again in Budget.

Positive

1. Keeping £M3 growth within target vital to improving inflation and prospect for revitalisation of industry.
2. Keeping same base avoids building-in recent excess growth (ie avoids 'base drift': to rebase on October 1979 would be less restrictive since £M3 growth to mid October above target range).
3. Target allows us to offset recent rapid growth over reasonable period. Growth at middle of range (9%) over whole 16 months implies 7.4% mid October 1979 - mid October 1980.
4. Provided private sector exercises restraint in pay bargaining, expect room within target for necessary finance for industry.

Defensive

1. Lower target: To reduce target now would be unnecessarily restrictive; new target implies sharp deceleration. Still intend to reduce target in longer term.
2. Higher target: To be less restrictive would be contrary to commitment to progressive deceleration of monetary growth. An increase in inflation would be much more damaging to investment and growth.
3. Turnaround excessive: Much sharper switch achieved in 1976-77 /£M3 growth in 6 months to mid November 1976 was 15% at an annual rate; in following 6 months just 1%.
4. Medium term targets: Chancellor considering whether to formulate more precisely longer term objectives (see separate brief on medium term financial plans).
5. Too complicated: No, simply applies to longer period. Necessary to avoid base drift.
6. Other aggregates: We monitor and take account of movements in other measures of money supply and liquidity. Additional targets would overconstrain the system. £M3 has a number of advantages as a target and is well understood by markets.
7. Exchange control makes £M3 less relevant: Not necessarily, but will monitor developments and reconsider appropriate definitions if and when necessary.

## A3 INTEREST RATES (including implications for building societies)

factual

1. Bank announced at 12.30 today increase in MLR by 3% to 17% from today.
2. Bank statement also gave details of roll forward of SSD scheme and foreshadowed statement this afternoon (see separate briefs).
3. Recent interest rates developments in Annex.

positive

1. Increase demonstrates Government's determination to bring money supply under control. Recent increases in market rates reflect [~~both developments in wage negotiations, and~~] general increase in interest rates overseas.
2. High nominal rates of interest essential, given present rate of inflation, to slow demand for credit.
3. Increase will help bring down recent rapid growth in bank lending. Reflects Government's determination to meet monetary objectives.
4. Future interest rates crucially dependent on future inflation and earnings growth. If progress in reducing inflation is slower than expected then would not hesitate to take further fiscal or monetary action required.

defensive

1. Building societies: Recent rises in market rates will inevitably put some strain on societies. Impact will depend on societies' reactions to effects of package. (Money market rates now some 3% above societies' grossed up share rate of 12½%). See separate brief for impact of national savings measures.
2. Future mortgage rates: Matter for the societies. The decisions will doubtless depend on how long higher interest rates

last, which in turn depends on progress in restraining  $\text{£M3}$  growth and reducing inflation.

3. Lower rates: As factors boosting monetary growth fall away, should be possible to see lower interest rates. Timing of fall will depend on external and internal developments, and we will want to be sure monetary growth is under control.

4. Still higher rates: MLR rise is sufficient to meet present situation.

5. Exchange rate: Increase in interest rates needed on internal grounds. Overseas interest rates also risen, therefore may be little net impact on exchange rates. But unchecked expansion of domestic credit would have put pressure on exchange rate in longer term.

6. Industry and investment: Higher interest rates may have some impact on activity, and will add to companies' costs. But surge in rate of inflation would be more damaging to output and employment (see separate brief).

7. High interest rates inflationary: No, high rates restrain demand for credit and reduce monetary growth. This helps to reduce inflation. [For reference: increase of 1% in mortgage rate adds  $\frac{1}{4}$ % to RPI.]

8. U-turn: No, Government remains determined to bring money supply under control. In time, as inflation comes down and public expenditure is restrained, this should be possible with lower interest rates. 'Consistency and continuity' about policy.



## INTEREST RATES: RECENT DEVELOPMENTS

1. Sterling Rates

1979	MLR	Clearing Banks' Base Rate	3 month Interbank	5 years	Gilt Yields*	
					10 years	20 years
25 May	12	12	11 <sup>13</sup> / <sub>16</sub>	11.4	11.9	12.2
29 June	14	14	14 <sup>1</sup> / <sub>16</sub>	12.3	12.8	12.9
27 July	14	14	14	12.4	12.3	12.3
31 Aug	14	14	14 <sup>5</sup> / <sub>16</sub>	12.1	12.3	12.4
28 Sept	14	14	14 <sup>1</sup> / <sub>8</sub>	12.2	12.3	12.6
19 Oct	14	14	14	12.6	12.9	13.0
26 Oct	14	14	14 <sup>3</sup> / <sub>4</sub>	13.5	13.6	13.5
2 Nov	14	14	14 <sup>3</sup> / <sub>4</sub>	13.3	13.5	13.4
9 Nov	14	14	15 <sup>5</sup> / <sub>8</sub>	14.8	14.5	14.3
14 Nov	14	14 <sup>+</sup>	16 <sup>1</sup> / <sub>16</sub>	15.4	14.9	14.6

\*on nearest convenient date  
(for 14 November, on that day)  
+ except for Nat West, at 15<sup>1</sup>/<sub>2</sub>%

2. U.S. Rates

	3 month Eurodollar	3 month Interbank	Covered* differential
28 Sept	12 <sup>7</sup> / <sub>8</sub>	14 <sup>1</sup> / <sub>8</sub>	-
19 Oct	14 <sup>7</sup> / <sub>8</sub>	14	- <sup>7</sup> / <sub>16</sub>
26 Oct	15 <sup>13</sup> / <sub>16</sub>	14 <sup>3</sup> / <sub>4</sub>	- <sup>5</sup> / <sub>16</sub>
2 Nov	15 <sup>11</sup> / <sub>16</sub>	14 <sup>3</sup> / <sub>4</sub>	- <sup>1</sup> / <sub>4</sub>
9 Nov	15 <sup>11</sup> / <sub>16</sub>	15 <sup>5</sup> / <sub>8</sub>	+ <sup>1</sup> / <sub>8</sub>
14 Nov	15	16 <sup>1</sup> / <sub>16</sub>	+ 1/16

\* - indicates differential against sterling

## A4 SSD SCHEME AND MONETARY CONTROL TECHNIQUES

Factual

1. SSD scheme (the 'corset') continued for further 6 months.
2. Government aware of SSD scheme's limitations, and do not see it as permanent.
3. Current guideline extended to mid June 1980; allows for further growth of 1% per month in banks' interest bearing eligible liabilities (IBELs). Details announced in Bank press release at 12.30 pm.
4. Bank and Treasury to undertake issue discussion paper and consultations with those most concerned on monetary base schemes.

Positive

1. Whatever the control system, main methods of control must be policies on PSBR and interest rates. Other controls no substitute for this.
2. SSD scheme despite its defects still some role to play.
3. Consultations on monetary base control to assess whether it could help smooth monetary growth or bring about better response of interest rates to changes in monetary conditions.
4. Directional guidance remains in force: asks banks to give priority to finance for industry and exports and, in order to ensure they can meet priority requirements, to exercise strict restraint on lending to persons, property companies, and for purely financial requirements.

Defensive

1. Distortions: Recognise SSD scheme and other direct controls encourage development of alternative channels of liquidity and credit - SSD scheme particularly encouraged take-up of acceptances outside bank sector. Also has damaging structural impact on financial sector. But, even allowing for this, has effects on credit conditions.
2. Adjust figures: Can only estimate total impact of distortions; preferable to remove cause.
3. Other controls distort: Depends on form of control and how they are used. No substitute for getting PSBR and interest rates right.
4. Monetary base now: Highly technical subject with wide ranging institutional implications. Hence need for consultations. Not sensible to introduce before new system fully understood and widely accepted.
5. Exchange control: Transactions abroad potentially a further loophole of SSD scheme. But high sterling interest rates bite on demand for sterling credit whatever its source. Ability to get the fundamentals right not significantly affected by abolition of exchange controls (see separate brief).

A4 (continued)

6. Guideline still too tight: Relationship between IBELs and £M3 very complex. Tightness depends, inter alia, on money market developments. But guideline growth somewhat greater than targeted £M3 growth rate. Would hope that bank lending moderates sufficiently to allow some reversal of distortions.
7. Industry squeezed: Availability of finance to industry depends on pay bargains agreed. Providing these are reasonable, room within guidelines for necessary finance to industry.
8. Restrict personal lending: Directional guidance remains in force. More direct controls would only increase distortions. Lending to persons relatively small part of total.
9. Increase HP controls: HP controls have a discriminatory impact between industries and between forms of credit; and the net effect on credit growth would be small.

B NATIONAL SAVINGS

i) factual

i. The National Savings Bank Investment Account rate will be increased on 1 January 1980 from 12½% to 15%.

ii. The maximum holdings limit on the Retirement (15th) Issue of National Savings Certificates will be increased on 3 December from £700 to £1200. The ~~National~~ <sup>Retirement</sup> Issue is index-linked and is only available to those of national retirement age.

iii. A new (19th) Issue of National Savings Certificates will be introduced in February in place of the current 18th Issue. The new Issue will be sold in units of £10 with a minimum purchase of £10 and maximum individual holdings of £1500 (the same as the 18th issue). A £10 certificate will increase in value to £16.35 over 5 years (equivalent to overall compound interest rate of 10.33% tax free). The grossed up yield to the standard rate taxpayer is 14.75%. This compares with 8.45% or 12.07% gross for the 18th Issue. The incremental structure for a £10 certificate is as follows:-

	Interest P	Total £	Annual Yield %	Cumulated Yield %
End of Year 1:	50	10.50	5	5
Year 2:	90	11.40	8.57	6.79
Year 3:	115	12.45	9.21	7.59
Year 4:	165	14.10	13.25	9.01
Year 5:	225	16.35	15.96	10.33

ii) positive

These changes are intended to ensure that these savings media remain an attractive form of investment for the personal saver thereby ensuring that National Savings plays a full part in financing the Public Sector Borrowing Requirement from outside the banking system. This will enable the Government to achieve its money supply targets at a generally lower level of interest rates than would otherwise be the case.

ii. The substantial increase in the holdings limit for the Retirement Issue will provide a considerably greater measure of protection against the effects of inflation for the savings of the section of the population least able to protect themselves.

iii) defensive

i. The higher rates of interest offered on the Investment Account and the new certificate reflect the rise in the general level of market interest rates in recent weeks. Prompt action was required to ensure that the competitive position of National Savings was not eroded thus making it more difficult for the Government to achieve its monetary targets.

ii. It is impossible to say how much additional investment the changes will generate. The savings media concerned have generally proved to be attractive forms of investment for savers and we would therefore expect quite a substantial response.

iii. The exact impact on competing savings institutions will depend on how they react to the movement in the market rates. The National Savings changes are, however, likely to result in some reduction in their inflows.



C ADVANCING COLLECTIONS OF PRT

i) factual

At present PRT is normally paid four months after the end of the 6-monthly chargeable periods. The proposal is to require, by legislation, that companies should make their payment with the return they already submit two months after the end of each chargeable period. These payments would be received at the beginning of March and September. Assessed tax is, and continues to be, due at the beginning of May and November.

ii) defensive

The proposal will bring the payments arrangements for PRT into line with those which already operate for the collection of royalties by the Department of Energy.

The proposal does not conflict with the assurances about stability of the North Sea fiscal regime. There is no change in the rate of tax, only in the arrangements for collection.

The problem on the PSBR has arisen in large part from late payment of telephone bills or of tax. It is appropriate to correct this by a measure that brings forward the timing of tax collections.

[If questioned on IMPLICATIONS FOR RECENT BP SHARE SALE: This is a general measure affecting all oil companies paying PRT.]

iii) positive

The effect of the change, which will be permanent, will be to increase the PRT receipts in 1979-80 by £700 million and to raise receipts for 1980-81 by £300 million. The beneficial effects will continue so long as taxable profits from the North Sea are on a rising trend.

D PSBR for 1979-80

i) factual

The Budget forecast for the PSBR was £8.3 billion. The first estimate for the first half of the financial year will be published on 22 November. The material is not yet complete but the main component - the central government borrowing requirement has already been published. It was about £6 billion, after allowing for seasonal factors (the actual figure was about £6½ billion). The total PSBR in the half year was probably close to £6½ billion (seasonally adjusted) with an actual total near £7 billion. It was always to be expected that the bulk of the year's PSBR would lie in the first six months. But the latest evaluation is for a PSBR for the year of about £9 billion before allowing for the acceleration of PRT collection. This means about £8.3 billion after taking PRT into account.

Factors pointing to an excess if some action were not taken included the Post Office telephone billing excess. Though bills are now going out again, recovery will not be completed in this financial year: a net excess of about £400 million is now expected this year. Secondly, local authorities have been borrowing more than was expected in June; and this is now expected to continue.

ii) defensive

The wide margins of error in any forecast of the PSBR are well known, but it would have been unsafe not to heed the evidence so far. We seemed to be heading for a figure of about £9 billion.

The acceleration of PRT collection will improve the prospective public sector cash flow by about £700 million and so lessen the borrowing needed in the remainder of this year. After taking account of this, the 1979-80 PSBR is estimated at about £8.3 billion, in line with the Budget forecast.

IMPORTANT NOTE  
THESE FIGURES  
ARE NOT  
PRECISE AND  
THE SEASONAL  
ADJUSTMENT IS  
SUBJECT TO  
CORRECTION  
BEFORE 22  
NOVEMBER

SECRET AND PERSONAL  
UNTIL 4 PM 15 NOVEMBER 1979 THEN  
RESTRICTED

The programme of gilt sales and the improvements to the terms of National Savings will help to finance the PSBR in a non-inflationary way.

iii) positive

The extra receipts from the change in the PRT collection arrangements will help to ensure that the PSBR for the year as a whole is in line with the Budget forecast of £8.3 billion. We have demonstrated therefore our determination to take steps to keep borrowing under control.

E

E PSBR AND PUBLIC EXPENDITURE FOR 1980-81

i) factual

Government expenditure plans for 1980-81 were given in Cmnd 7746 on 1 November. They provide for stabilisation of the volume of public expenditure at the 1979-80 level. Treasury Ministers will not wish to say anything which rules out categorically a possible further review of 1980-81 spending plans, in time for the Budget say.

It is intended to publish a forecast figure for the 1980-81 PSBR in the Industry Act forecast to be published in the next ten days or so. The proposal to accelerate collection of PRT will itself benefit next year's PSBR to the tune of some £300 million. Telephone bills not collected this year will benefit it by a further £400m.

ii) defensive

As demonstrated by the statement today the Government will be ready to adjust the fiscal balance as necessary to help secure observance of the monetary target. We will be considering the PSBR for 1980-81 on this basis.

Apart from relatively minor adjustments, such as further savings as a consequence of the Lord President's exercise on Civil Service staff costs, there are no plans at present for further reductions in planned public spending.

A final view on the PSBR and fiscal plans for 1980-81 will be taken in next spring's Budget.

iii) positive

The 1980 Budget will be framed in the light of the monetary target, which is paramount.

As the Prime Minister has said, the Government is embarking on a sustained programme of trying to get public expenditure down as a proportion of national income. We cannot go on spending money which the nation does not earn.



A forecast figure for the 1980-81 PSBR will be given in the Industry Act forecast to be published shortly. [IF PRESSED ON TIMING OF PUBLICATION: I must ask the House to be patient - the forecast will be published soon.] But decisions on the PSBR and the fiscal balance will be taken later.

The proposal to accelerate collection of PRT will itself ease the PSBR position for 1980-81 by about £300 million. In addition the telephone bills not collected this year will benefit the 1980-81 PSBR by some £400 million.

## EFFECTS ON INDUSTRY, GDP AND EMPLOYMENT

i) factual

1. Impossible to give reliable figures for impact on GDP of recent upward trend in interest rates.
2. Interest rates not necessarily the most important determinant of investment; prospect for economy generally much more important.
3. The Industry Act forecast will probably be published in the next day or so but not by 20 November, which on one interpretation is the deadline implied by the Act. It will take account of the monetary package, and will contain a figure for the 1980-81 PSBR. A garbled story about the alleged content of the draft forecast appeared in the Financial Times on 14 November. It stressed the alleged pessimism on the outlook, especially for the path of GDP.

ii) positive

1. Reduction in monetary growth and hence inflation crucial to give the right conditions for investment and revitalisation of industry.
2. The acceleration of PRT collections will benefit public sector cash flow and hence reduce need for public sector borrowing.
3. As inflation and money supply brought under control it should be possible to meet objectives with lower interest rates.
4. Financial prospects for industry depend crucially on moderation in pay negotiations. Interest rate rises should help by confirming government's unwavering commitment to reduce monetary growth.

iii) defensive

1. The Industry Act forecast will be published shortly. Meanwhile it would not be right to give a detailed account of the economic outlook. However, nearly all forecasters are expecting some fall in GDP next year. This is a cost that we must be ready to bear if inflation is to be brought under control. [IF PRESSED

ON THE PUBLICATION DATE: I must ask the House to be patient - the forecast will be published soon.]

2. Higher interest rates damaging to Investment, Output and Jobs: Higher inflation would be much more damaging to investment, output and employment over the longer term.
3. Monetary target too tight: Provided private sector exercises restraint in pay bargaining, expect room within target for necessary finance for industry. (See brief A2 on new target.)
4. Impact on liquidity: Recognise that higher interest rates will add to burden on many companies, and liquidity already depleted following strikes, bad weather last winter, and recent cost pressures. But Government no intention of financing inflationary wage increases; companies will benefit in longer term from reduction in inflation.
5. Two Tier Interest Rates: There are objections of practice and principle to such schemes. Financial system too sophisticated; and protective for one sector would require greater restraint on others.

## G PROSPECTS FOR TAX CUTS

i) factuali. Main tax points in Chancellor's speech to Tax Reform Conference

- chances of economic and industrial recovery will certainly be improved by further pruning and re-shaping of the damaging tax structure that was inherited; but even that important task cannot be allowed to blunt the determination to keep borrowing down and the money supply under control
- certainly hope to be able in the years ahead to make further cuts in the basic rate of income tax
- also want to bring further relief to those at the bottom of the income tax scale, by raising the thresholds
- and to make improvements in company taxation
- but must have regard to the constraints imposed by the combination of low growth and in-built public spending.

ii. Chancellor's intentions for the next (and subsequent) Budgets

We recommend against being drawn into any discussion of prospects for tax adjustments in 1980 and the medium term, or of timing and form of specific tax changes that might be introduced. Budget fiscal policy will have to be consistent with the overriding need to contain monetary growth.

iii. Tax reductions expensive - for example:

- 1p off basic rate: over £500m (full year)
- £100 on basic personal allowances: over £700m (full year)

ii) positivei. Much already achieved.

3p off basic rate. Allowances increased by double the amount needed to keep up with inflation. Substantial cuts in higher rates - threshold up from £8,000 to £10,000, 60% maximum on earned income. Aim has been to improve incentives, reward hard work, responsibility and success. Direct tax reduced by £4,300m in full year.

ii. Long-term objectives unchanged

Budget cuts in income tax only a first step. Objective remains 25% basic rate and to raise thresholds as high as possible. Need for a simpler and less oppressive system of capital taxation.

iii) defensive

i. Burden of tax to be increased in next Budget?

Determined to cut burden of income tax further. Too early to be specific about scope for action. Tax Reform speech said: "No Chancellor at this time could encourage over-generous expectations."

ii. Thresholds?

As outlined in Tax Reform speech, there is a strong case for raising thresholds - best way of widening gap between those in and those out of work and improving incentive to work.

iii. 1977 Finance Act indexation?

Action on thresholds will naturally be a major priority. [Recommend - avoid specific commitment to raise thresholds in line with 1979 price inflation (ie 17% plus).]

iv. Specific duties

To be considered in usual way in framing Budget.

v. VAT

No intention of going back on commitment not to raise 15% rate ceiling.

vi. Why consider cuts in capital taxes, when no more being done on income tax?

Income tax was given priority this year - bulk of the benefit went to helping those liable at basic or reduced rate. Right to review capital taxes as the second stage.

vii. Reliefs/exemptions/mortgage interest relief ceilings etc

Will all be considered in usual way in framing Budget judgement. No question of withdrawing mortgage interest relief.



## H PUBLIC EXPENDITURE WHITE PAPER ON THE LATER YEARS

i) Factual(a) Date of publication

It has been the general practice recently to publish a White Paper in January giving details of public expenditure plans for a five year period. In the Press Conference held on publication of Cmnd 7746 on 1 November Treasury Ministers said that a White Paper on the years to 1983-84 would be published at around "the turn of the year". In his statement to the House the Chief Secretary said simply that plans for later years would appear in a "subsequent" White Paper. The intention to publish in January, or indeed whether to publish at all, is being reviewed by Treasury Ministers. Therefore for the moment as little as possible should be said publicly about the publication date: neither to give a stronger commitment on January nor to give rise to speculation about delay or cancellation.

(b) Economic content

Treasury Ministers warned at the Press Conference on 1 November that the White Paper on the later years might not contain all the detailed "futuresology" that was in recent White Papers. Treasury Ministers are reviewing the economic content of the next White Paper. Therefore little should be said, neither to imply that there will be a detailed forecast of revenue etc nor to suggest that decisions on expenditure are proving difficult for Cabinet to reach.

ii) defensive

By presenting Cmnd 7746 on public expenditure for 1980-81 the Government has already provided a basis for planning for next year. Plans for later years will be announced later. [IF PRESSED ON PRECISE PUBLICATION DATE: There is nothing to add at this stage to what the Chief Secretary said in his statement to the House on Cmnd 7746.] [IF PRESSED ON ECONOMIC CONTENT: We shall be considering the details of the next White Paper in due course.]

iii) positive

Spending plans for the years after 1980-81 will be announced later. Public expenditure in the years ahead will be consistent with the observance of monetary targets. As the Prime Minister has said, we must try to get public expenditure down as a proportion of national income. We cannot go on spending money which the nation does not earn.

## J MEDIUM TERM FINANCIAL PLAN

i) factual

The Chancellor has said in the House that he is considering whether there would be advantage in adopting and publishing a medium term financial plan. Such a plan would contain specific medium term commitments on the progressive reduction of the rate of growth of the money supply. It could also contain supporting data, such as revenue and expenditure projections.

ii) defensive

A medium term financial plan could be helpful in further demonstrating that the government is absolutely determined to control inflation. But, as the Chancellor said in the House on 8 November, this is not the only argument to be taken into account. It would not be right to rush a decision on this important matter.

iii) positive

The government has already given a firm commitment to reduction of the rate of growth of the money supply. The announcement of a tight monetary target for next year and the measures adopted to help meet it are further moves in discharging that commitment. The Government will remain ready to adopt whatever measures prove necessary to secure observance of the monetary target.

## K EXCHANGE CONTROL AND THE MONETARY POSITION

i) factual/positive

1. Abolition of controls removed an artificial distortion of capital markets which discriminated against private investment overseas.
2. Domestic monetary implications complex, and have been somewhat overplayed. An outflow from the UK private sector would put downward pressure on money supply whereas our present problem is excessive monetary growth.
3. Net effect likely to be spread over months or even years. Net effect this year likely to be small, and could go either way.

ii) defensive

1. Detailed effects: Contractionary impact as private sector seeks investment opportunities abroad. But offset if bank borrowing increased to finance overseas investment or repayment of foreign currency debt; and foreign assets may be purchased at expense of gilts. Net impact will also depend on size and nature of offsetting inflows.
2. Domestic economy exposed: Abolition does mean we are more sensitive to developments overseas. But recent increases in overseas interest rates, especially in US, have been so dramatic that a UK response would have been necessary regardless.
3. Domestic Monetary Control: Abolition weakens SSD scheme (see separate brief). But as always the key things are an appropriate fiscal policy and the right level of interest rates. We remain determined to get these fundamentals right and our ability to do so not significantly affected by abolition. Higher sterling interest rates bite on demand for sterling credit whatever its source.

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Sir D Wass  
Sir F Atkinson  
Sir A Rawlinson  
Miss Brown  
Mr Cassell  
Mr Kitcatt  
Mr Middleton  
Mr Shepherd  
Mr Unwin  
Mr Hawtin  
Mr Ridley  
Mr P G Davies  
Mr Denham

PSBR IN 1979-80

You asked for a note on the PSBR. The position has not changed materially over the past week. We still expect - subject to a margin of error which may exceed £1 bn - a PSBR this financial year of about £9 bn. This takes account of a small contribution from the reduction in the contingency reserve, and extra forward oil sales.

2. The attached note, which it may be convenient to add to the background briefing, explains why the estimate of the PSBR this year has been revised upwards. For public use, the £400 m loss of PO revenue (caused by the billing dispute) is the main identifiable factor; one of the other main factors is a forecast higher level of borrowing by local authorities: this mainly reflects lower receipts rather than any failure of public expenditure control.

HPE

H P EVANS

SD1

15 November 1979

ENC

THE PSBR IN 1979-80

In the June budget, the PSBR forecast for 1979-80 was put at £8.3 bn. In the Statement of 15 November the PSBR this year is estimated at £9 bn.

2. Accurate estimates of the 1979-80 PSBR will not be available until May 1980: until then, estimates are subject to an uncomfortably wide margin of error.

3. The main factors accounting for the higher PSBR this year are:

(i) Extra borrowing by nationalised industries, above all by the Post Office: the dispute which delayed the sending out of bills is estimated, very roughly, to cost the PO £400m (at current prices) in this financial year - none of which was allowed for in the budget forecast.

(ii) Extra borrowing by local authorities. Partly because of higher borrowing to end September than had been expected, partly because of downward revisions to the forecasts of local authority revenues (including rates), we now think that LA borrowing will be £500m or so higher this year than expected at the time of the budget. We have not changed significantly our forecast of local authority expenditure: at constant prices their current expenditure on goods and services may be slightly lower than the level allowed for in the RSG settlement (but rather above the level implied by Mr Heseltine's optimistic target of a 3% cut in expenditure below the RSG settlement level).

(iii) A large number of minor revisions, many of them offsetting. These include higher interest rates and so higher debt interest payments by central government.

4. Our best estimate of the PSBR in the first half of 1979-80 (ie the April-September period) is about £6½ bn, with £2½ bn in the second half of the year. The first half of the year was inflated by the effects of the PO dispute; the second half of the year will benefit from asset sales, partial recovery of the PO position, and the full effect of the budget increase in VAT.



## EFFECT OF THE MEASURES ON PRICES

Factual

1. None of the measures in the statement will have a direct effect on retail prices. However if the increase in MLR prompts a further increase in mortgage interest rates, each 1% of such an increase would cause about a  $\frac{1}{4}\%$  increase in the RPI. Additionally industrial costs will rise as a result of higher costs of borrowing, but how far the increase will be passed on in prices will depend on market conditions.

Defensive

2. None of the measures I have announced will have a direct effect on prices but higher interest rates will work through into industrial costs if they have to be maintained for long.

Positive

3. There are no direct effects on <sup>prices</sup>~~inflation~~. And the key point is that action to restrain monetary growth is vital if we are to strike at the roots of the inflation problem.

M J Felps  
15. 11. 79

SECRET



*See Lord C 39  
Comment on para 5*

CHANCELLOR

cc Sir A K Rawlinson  
Sir L Airey  
Sir K Couzens  
Mr Littler  
Mr Unwin  
Mr Bridgeman  
Mr Middleton  
Mr Monck  
Mr Davies  
Mr Mower  
Mr Folger  
Mr Williams  
Mr Cardona

STATEMENT

I attach a redraft prepared in the light of your comments this morning. With the exception of the £1 billion figure for the Post Office arrears in billing, all figures are, as far as we know, correct, subject to any final comments, which should be submitted to Mr Unwin.

*AR*

ADAM RIDLEY

15th November 1979

SECRET

With the permission of the House, Mr Speaker, I should like to make a statement on monetary policy.

2. The figures for October, just published, show that £M3 grew by 2 per cent in that banking month. The growth since mid-June, the beginning of the target period, has been equivalent to just over 14 per cent a year. Although the figure for banking October was erratically high, it is clear that the underlying growth of £M3 is still significantly above the target of 7-11 per cent.

3. There have been two principal causes of this excess: a higher than expected Public Sector Borrowing Requirement in the first half of the year and the persistently high level of bank lending.

4. Because of the timing of the Budget measures - in particular receipts from VAT and reductions in public spending - the PSBR was always expected to be higher in the first half of the year than in the second. In the event, the PSBR in the first half year has been further increased by strikes and other industrial action, which have delayed the collection of VAT and telephone bills. At the peak arrears on telephone bills are expected to reach [£1] billion.

/ 5. A large part

5. A large part of these arrears will be made good in the second half-year. Even so, the best estimate which <sup>could</sup> ~~can~~ now be made of the PSBR for the year as a whole <sup>if no action were taken</sup> is that it would be about £9 billion, compared with the £8.3 billion Budget estimate.

6. The monthly growth of bank lending has averaged about £700 million over the last quarter. Although the timing is difficult to predict, its growth can be expected to fall in due course because of the likely decline in the level of economic activity.

7. Nevertheless it is necessary to take action now to bring the growth of the money supply within the target range. The Bank of England accordingly announced this morning with my approval that Minimum Lending Rate would be increased to 17 per cent.

8. This goes beyond the rise in market interest rates at home and demonstrates the Government's determination to act with the firmness foreshadowed by my Rt. Hon. Friend the Prime Minister earlier this week. The recent increase in our interest rates reflects the general increase in interest rates overseas. In the USA prime rates have risen from  $11\frac{1}{2}$  to  $15\frac{1}{2}$  since the summer.

/ 9. In addition

9. In addition to sales of gilts, we intend to secure further funding of the PSBR through National Savings. The limit on holdings of the index-linked National Savings Certificates Retirement Issue will be increased next month from £700 to £1,200. A new ordinary National Savings Certificate will be introduced early next year. The Interest Rates on National Savings Bank Investment Account will be raised to 15 per cent from 1st January next.

10. Although much of the increase in the estimate of this year's PSBR is due to the timing of receipts, further action is required to bring the PSBR down. As an additional <sup>therefore, we shall require</sup> measure, ~~oil companies~~ to make a payment on account of Petroleum Revenue Tax at the time when they make their returns. This will have the effect of advancing the due date for collection by 2 months and will bring the arrangements for PRT into line with those for collecting royalties. We shall thus ensure that PRT reaches the Exchequer with the minimum of delay, when oil prices are rising.

11. The Bill to achieve this will be introduced shortly. It will reduce this year's PSBR by £700 million and thus bring the estimated level back to the original Budget figure of £8.3 billion.

/ As a result

As a result of this measure, next year's PSBR will also be reduced by £300 million. And telephone bills not paid this year will reduce it by about a further £400 million.

12. I set in hand some months ago a review of methods of controlling the growth of the money supply. The main instruments must continue to be our public expenditure and tax policies, which together determine both the size and the composition of the PSBR, and interest rate policies. Recently the Supplementary Special Deposits scheme, or corset, has also played a part in monetary control. I am well aware of the limitations of this scheme and do not believe that it has a permanent role to play. Nevertheless, the Governor and I have agreed that it is right that it should continue for a further six months. The Bank announced the arrangements this morning.

13. In the future, other techniques, including one of the variants of monetary base control, could play a useful role, without have the disadvantages of the SSD scheme. The Bank and Treasury will therefore shortly issue a discussion paper for consultation. I must, however, stress that no such scheme can replace the right fiscal and interest rate policies. Indeed, one of the possible advantages would be to improve the

/ response of



response of interest rates to monetary conditions.

14. Finally, I am extending the period covered by the present target range for  $\text{\pounds M3}$  of 7 to 11 per cent per annum. That target at present applies to the 10 months from mid-June 1979 to mid-April 1980.

It will now cover the 16 months from mid-June to mid-October 1980. The effect will be to avoid building into the target for the new period the excess growth of the money supply in the recent past, while allowing a reasonable period in which to offset that excess.

15. Mr Speaker, the restoration of the economy depends above all on mastering inflation. This can only be done if we bring the money supply under firm control, progressively reduce its rate of growth over the years, and maintain the most rigorous restraint on public spending. There may still appear to be easier alternatives to the policies we are pursuing, but none of them would be responsible and none of them would be sustainable. That is why I have taken action today which demonstrates the Government's total and continuing commitment.

C  
45

MR PAGE

cc: Chancellor  
 Chief Secretary  
 Financial Secretary  
 Mr Bridgeman  
 Mr Unwin  
 Mr Middleton  
 Mr Riley  
 Mr Bottrill  
 Mr Butt  
 Mr Folger

## STATEMENT: CONSUMER CREDIT

The Financial Secretary has suggested that the defensive briefing available on consumer credit should be expanded (there are short references in brief A4). I offer the following additional guidance to meet suggestions that the Chancellor should have increased HP controls or otherwise acted to reduce lending to persons.

1) Direct controls over banks' lending would increase distortions. It would not be very effective; there would be an incentive to channel business outside the control. This would in turn be difficult to monitor and tend to damage the financial system (compare impact of direct ceilings in 1960s which contributed to growth of 'fringe banks').

2) Bank lending to persons is a relatively small part of total. (About 12% of outstanding bank <sup>represent advances</sup> advances to persons, other than for house purchase. If only the clearers are considered, the total rises only to 16%.) *These bank*

~~The banks'~~ figures include bank lending to persons via credit card companies and a large part of lending for HP, etc via Finance Houses and other credit grantors. *(see also footnote)*.

3) HP controls currently apply only to a limited range of <sup>(relatively expensive)</sup> goods (mainly cars, but also domestic electrical goods). To tighten the controls would probably have some effect in relation to the particular goods involved. But this particularly would be discriminatory and could be damaging for some of the industries concerned.

- 4) HP controls also discriminate between different forms of credit. There is a variety of ways that consumers can obtain credit (overdrafts, personal loans, credit cards, option accounts, charge cards, etc) and any tightening could be evaded. Moreover it would be more easily evaded by those with access to other forms of credit; ie it would be discriminatory as between persons.
- 5) Money advanced on credit cards is within total of bank lending to persons. Repayment requirements could be tightened, but it would be difficult to justify singling out this one form of (relatively expensive) personal credit.
- 6) Bank's guidance to banks on the direction of their lending remains in force.

To summarise: restrictions on credit to consumers would be discriminatory, have undesirable side effects and, because consumer credit is a small part of the total, do little alone to bring bank lending and money supply growth under control. Instead the increase in interest rates will bite equally on all forms of credit.

*M L Williams*

M L WILLIAMS

15 November 1979

\* (relevant to point 2 above). So far as we can tell - and there are difficulties with the figures - consumer credit has been growing slightly slower than, and certainly no faster than, lending as a whole.

cc Chief Secretary  
Financial Secretary  
Minister of State (L)  
Minister of State (C)  
Sir Douglas Wass  
PEX  
Mr Kitcatt  
Mr Unwin  
Mr P G Davies  
Mr Ridley

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PSBR 1979-80 : GOVERNMENT EXPENDITURE

As an addendum to today's briefing the following summarises public expenditure aspects of the PSBR excess this year.

2. Central government expenditure, at around £53 billion, is now expected to be over  $\frac{1}{4}$  billion higher than at Budget time.
3. Cash limited expenditure is generally on course. On cash limits other than the RSG an underspend of about £300 million is expected, the same as at Budget time.
4. The cost of the Clegg comparability awards (for which the RSG and other cash limits were increased) is however now <sup>put</sup> ~~just~~ higher than at Budget time, increasing total expenditure.
5. Some excess is to be expected on expenditure not subject to cash limits; on housing subsidies, export credit and other interest support costs which will be affected by higher interest rates.

Public corporations

6. The main element in the higher borrowing in the first half year by public corporations was caused by the delay in issuing telephone bills (probably around £1 billion).

Local authorities

7. Local authority borrowing is now forecast £500 million higher than expected at Budget time. This is mainly a downward revision of forecast receipts (rates, rents etc). The forecast of expenditure (volume) is little changed since Budget time, i.e. current expenditure slightly below the level in the November 1978 RSG settlement, not as much below as Mr Heseltine asked for, but what we regarded as realistic at Budget time.

PRINCIPAL PRIVATE SECRETARY

cc Mr Riley

11 48

SUPPLEMENTARY FIGURES FOR NO. 10

I attach the additional information on the PSBR, gilt sales and MLR changes requested by No. 10



P SHERIDAN  
15 November 1979



PSBR

Financial years	unadjusted	seasonally adjusted
1974/75	7,947	7628
1975/76	10,588	10513
1976/77	8,500	8886
1977/78	5,555	5497
1978/79	9,251	9409

Total net gilt sales by sector

	Total	non bank private sector	banking sector	overseas
1974/75	2177	2290	-52	-38
1975/76	4159	3860	356	-59
1976/77	6290	5785	173	326
1977/78	6684	4907	961	816
1978/79	6256	6203	-84	21

Gilt sales to non banks 1979/80

banking May -  
 banking October inclusive                      £3,927 m.



MLR CHANGES

1974			%
April	5	12 $\frac{1}{4}$	
	11	12	
May	24	11 $\frac{3}{4}$	
Sept	20	11 $\frac{1}{2}$	

1975		
Jan	17	11 $\frac{1}{4}$
	24	11
Feb	7	10 $\frac{3}{4}$
	14	10 $\frac{1}{2}$
Mar	7	10 $\frac{1}{4}$
	21	10
April	18	9 $\frac{3}{4}$
May	2	10
July	25	11
Oct	3	12
Nov	14	11 $\frac{3}{4}$
Nov	28	11 $\frac{1}{2}$
Dec	24	11 $\frac{1}{4}$

1976		
Jan	5	11
	16	10 $\frac{3}{4}$
	23	10 $\frac{1}{2}$
	30	10
Feb	6	9 $\frac{1}{2}$
	27	9 $\frac{1}{4}$
Mar	5	9
April	23	10 $\frac{1}{2}$
May	21	11 $\frac{1}{2}$
Sept	10	13
Oct	7	15
Nov	19	14 $\frac{3}{4}$
Dec	17	14 $\frac{1}{2}$
	24	14 $\frac{1}{4}$

1977		
Jan	7	14
	21	13 $\frac{1}{4}$
	28	12 $\frac{1}{4}$
Feb	3	12
Mar	10	11
	18	10 $\frac{1}{2}$
	31	9 $\frac{1}{2}$
April	7	9 $\frac{1}{4}$
	15	9
	22	8 $\frac{3}{4}$
	29	8 $\frac{1}{4}$
May	13	8
Aug	5	7 $\frac{1}{2}$
	12	7
Sep	9	6 $\frac{1}{2}$
	16	6
Oct	7	5 $\frac{1}{2}$
	14	5
Nov	25	7

1978			%
Jan	6	6 $\frac{1}{2}$	
April	11	7 $\frac{1}{2}$	
May	5	8 $\frac{3}{4}$	
May	12	9	
June	8	10	
Nov	9	12 $\frac{1}{2}$	

1979		
Feb	8	14
Mar	1	13
April	5	12
<hr/>		
June	12	14

average MLR calendar years

1974	11.94
1975	10.79
1976	11.77
1977	8.45
1978	9.12

SECRET AND PERSONAL

CHANCELLOR

c M. Unwin

BRIEFING FOR 15 NOVEMBER STATEMENT

1. I attach as much of the briefing as we have been able to get typed this evening. The material is still subject to final revision as it has had to be drafted without a final version of the statement being ready. You may nevertheless find it useful to have to clear your mind for tomorrow.

2. A final full set of briefs will be submitted to you, and copied to your Treasury colleagues and No. 10, early tomorrow morning. A list of the briefing is attached as an annex to this note.

3. We shall be submitting separately in the morning a briefing note on points to make in response to the kind of suggestions put forward by Mr Healey in his "World at One" interview on 12 November. (Mr Hall's note of today refers.)

M J Folger CU  
14.11.79

BriefSubject

A	( 1. Recent monetary developments 2. Monetary target 3. Interest rates (including implications for Building Societies) 4. SSD scheme and monetary control techniques	52
B	National Savings	
C	Advancing collections of PRT	
D	PSBR for 1979-80	
E	PSBR and public expenditure for 1980-81	
F	Effects on industry, GDP and employment	
G	Prospects for tax cuts	
H	Public Expenditure White Paper on the later years	
J	Medium term financial plan	
K	Exchange control and the monetary position	

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UNTIL 4 pm 15 NOVEMBER,  
THEN UNCLASSIFIED

## A1 RECENT MONETARY DEVELOPMENTS

factual

1. £M3 grew by 2% in banking October (figures published 2.30 pm today). Bank lending was main expansionary factor (increased by £1 $\frac{1}{4}$  billion).
2. In four months since mid-June, £M3 grown at annual rate of just over 14% (14.2%), ie above 7-11% target range. If allowance made for take-up of acceptances outside banking sector, underlying growth somewhat higher.
3. Details of recent developments in Annex.

positive

1. Latest figures suggest taking longer than hoped to bring down money supply growth from rate inherited but Government determined to bring back within target range.
2. Excess growth largely due to sustained rapid growth of bank lending and high PSBR in first half of year.
3. Can expect some slowing in £M3 growth. Budget measures reducing the PSBR will take effect in second half of the year. Further reduction from bringing forward PRT due date. Bank lending growth should moderate with lower activity, and interest rate increases.

defensive

1. Banking October:
  - (i) Banking October figures swollen by a number of distortions to normal financial flows.
  - (ii) CGBR in banking October affected by timing of receipts from higher rate of VAT; expected low £M3 growth meant no receipts from part paid gilts were planned.
  - (iii) High demand for credit in banking October following small rise in banking September. Special factors operating

other way and tending to increase lending in October, eg ending of engineering strike; <sup>also</sup> impact of tax rebates on companies' cash flow.

(iv) Outflows from non-bank private sector, as in other recent months. Probably associated with exchange control relaxations.

(v) M1 growth substantial (3.4%) but rise in interest bearing sight deposits accounted for much of it; possibly associated with funds awaiting longer term investment.

2. Government borrowing: Has been running at high level; impact on receipts of Budget tax rebates in large part taken effect. But in second half of year expect asset sales, receipts from higher rate of VAT, partial recovery by Post Office of arrears, and benefit of bringing forward PRT due date.

3. Bank lending: Remained strong since beginning of year (increased about £700 million in last 3 months). Affected in some months by special factors, but expect increases to moderate not least as a result of higher interest rates and lower activity. But timing difficult to predict.

4. Acceptances: Recognise underlying growth in bank-type credit understated by published figures. Substantial take-up of acceptances outside banking sector (£1.1bn in last 5 months). A side effect of SSD scheme (see separate brief). Action to prevent leakage would be counterproductive - force credit into more damaging and hidden channels.

5. Debt sales: Substantial sales until recent weeks. Sales affected by market uncertainties but also lack of part payments in anticipation of low £M3 growth and substantial redemptions and buying in of next maturities.

6. Exchange control abolition: Net effect on monetary growth difficult to assess but likely to be small this year (see separate brief).

## RECENT MONETARY DEVELOPMENTS

I. Monetary Growth

	Banking <u>October</u>	£bn seasonally adjusted Banking July - <u>Banking October</u> (4 months)
CGBR	0.94	3.65
Purchases of central government debt by non bank private sector (increase:-)	+0.04	-2.02
Other public sector	-0.62	-0.18
Sterling bank lending to:		
private sector	1.24	2.48
overseas	<u>-0.03</u>	<u>0.05</u>
DCE	1.57	3.98
External and foreign currency finance adjustment	-0.40	-1.28
Net non deposit liabilities etc.	<u>-0.09</u>	<u>-0.31</u>
£M3	<u>1.08</u>	<u>2.39</u>
%	<u>2.0</u>	<u>4.5</u>

II. Cumulative £M3 growth (at an annual rate in target period)

<u>Target</u>	<u>August</u>	<u>September</u>	banking months % <u>October</u>
7-11% (annual rate)	11.6	10.3	14.2

III. Bank lending and acceptances

	<u>July</u>	<u>August</u>	<u>September</u>	£bn <u>October</u>
Bank lending	0.4	0.7	0.2	1.2
Acceptances	<u>0.1</u>	<u>0.3</u>	<u>0.2</u>	<u>0.2</u>
Total	0.5	1.0	0.4	1.4
Average bank lending to private sector, adjusted for bill leak		last 6 months £900m		last 3 months £920m



## A2 MONETARY TARGET

Factual

1. Objective remains to keep firm monetary control with progressive reduction of target range.
2. Present target period extended: £M3 target now 7-11% (at annual rate) to apply from mid June 1979 to mid October 1980 (16 months).
3. Growth of 7-11% for whole period implies substantial deceleration over next 12 months.
4. Target to be rolled forward again in Spring.

Positive

1. Keeping £M3 growth within target vital to improving inflation and prospect for revitalisation of industry.
2. Keeping same base avoids building-in recent excess growth (ie avoids 'base drift': to rebase on October 1979 would be less restrictive since £M3 growth to mid October above target range).
3. Target allows us to offset recent rapid growth over reasonable period. Growth at middle of range (9%) over whole 16 months implies 7.4% mid October 1979 - mid October 1980.
4. Provided private sector exercises restraint in pay bargaining, expect room within target for necessary finance for industry.

Defensive

1. Lower target: To reduce target now would be unnecessarily restrictive; new target implies sharp deceleration. Still intend to reduce target in longer term.
2. Higher target: To be less restrictive would be contrary to commitment to progressive deceleration of monetary growth. An increase in inflation would be much more damaging to investment and growth.
3. Turnaround excessive: Much sharper switch achieved in 1976-77 /£M3 growth in 6 months to mid November 1976 was 15% at an annual rate; in following 6 months just 1%/. M
4. Medium term targets: Chancellor considering whether to formulate more precisely longer term objectives (see separate brief on medium term financial plans).
5. Too complicated: No, simply applies to longer period. Necessary to avoid base drift.
6. Other aggregates: We monitor and take account of movements in other measures of money supply and liquidity. Additional targets would overconstrain the system. £M3 has a number of advantages as a target and is well understood by markets.
7. Exchange control makes £M3 less relevant: Not necessarily, but will monitor developments and reconsider appropriate definitions if and when necessary.

## A3 INTEREST RATES (including implications for building societies)

factual

1. Bank announced at 12.30 today increase in MLR by 3% to 17% from today.
2. Bank statement also gave details of roll forward of SSD scheme and foreshadowed statement this afternoon (see separate briefs).
3. Recent interest rates developments in Annex.

positive

1. Increase confirms rises in market rates that have already taken place (in response to domestic monetary situation and rise in rates overseas), and shows Government's determination to bring money supply under control.
2. High nominal rates of interest essential, given present rate of inflation, to slow demand for credit.
3. Increase will help bring down recent rapid growth in bank lending. Reflects Government's determination to meet monetary objectives.
4. Future interest rates crucially dependent on future inflation and earnings growth. If progress in reducing inflation is slower than expected then would not hesitate to take further fiscal or monetary action required.

defensive

1. Building societies: Recent rises in market rates will inevitably put some strain on societies. If high interest rates continue, they will have to increase rates for both borrowers and savers if flow of funds for housing is to be sustained. (Money market rates now some 3% above societies' grossed up share rate of 12½%.) See separate brief for impact of national savings measures.
2. Future mortgage rates: Matter for the societies. The decisions will doubtless depend on how long higher interest rates

SB

last, which in turn depends on progress in restraining  $\text{£M3}$  growth and reducing inflation.

3. Lower rates: As factors boosting monetary growth fall away, should be possible to see lower interest rates. Timing of fall will depend on external and internal developments, and we will want to be sure monetary growth is under control.
4. Still higher rates: MLR rise is sufficient to meet present situation.
5. Exchange rate: Increase in interest rates needed on internal grounds. Overseas interest rates also risen, therefore may be little net impact on exchange rates. But unchecked expansion of domestic credit would have put pressure on exchange rate in longer term.
6. Industry and investment: Higher interest rates may have some impact on activity, and will add to companies' costs. But surge in rate of inflation would be more damaging to output and employment (see separate brief).
7. High interest rates inflationary: No, high rates restrain demand for credit and reduce monetary growth. This helps to reduce inflation. [For reference: increase of 1% in mortgage rate adds  $\frac{1}{4}$ % to RPI.]
8. U-turn: No, Government remains determined to bring money supply under control. In time, as inflation comes down and public expenditure is restrained, this should be possible with lower interest rates. 'Consistency and continuity' about policy.

## INTEREST RATES: RECENT DEVELOPMENTS

1. Sterling Rates

1979	MLR	Clearing Banks' Base Rate	3 month Interbank	Gilt Yields*		
				5 years	10 years	20 years
25 May	12	12	11 <sup>13</sup> / <sub>16</sub>	11.4	11.9	12.2
29 June	14	14	14 <sup>1</sup> / <sub>16</sub>	12.3	12.8	12.9
27 July	14	14	14	12.4	12.3	12.3
31 Aug	14	14	14 <sup>5</sup> / <sub>16</sub>	12.1	12.3	12.4
28 Sept	14	14	14 <sup>1</sup> / <sub>8</sub>	12.2	12.3	12.6
19 Oct	14	14	14	12.6	12.9	13.0
26 Oct	14	14	14 <sup>3</sup> / <sub>4</sub>	13.5	13.6	13.5
2 Nov	14	14	14 <sup>3</sup> / <sub>4</sub>	13.3	13.5	13.4
9 Nov	14	14	15 <sup>5</sup> / <sub>8</sub>	14.8	14.5	14.3
14 Nov	14	14 <sup>+</sup>	16 <sup>1</sup> / <sub>16</sub>			

\*on nearest convenient date  
(for 14 November, on that day)  
+ except for Nat West, at 15<sup>1</sup>/<sub>2</sub>%

2. U.S. Rates

	3 month Eurodollar	3 month Interbank	Covered* differential
28 Sept	12 <sup>7</sup> / <sub>8</sub>	14 <sup>1</sup> / <sub>8</sub>	-
19 Oct	14 <sup>7</sup> / <sub>8</sub>	14	- <sup>7</sup> / <sub>16</sub>
26 Oct	15 <sup>13</sup> / <sub>16</sub>	14 <sup>3</sup> / <sub>4</sub>	- <sup>5</sup> / <sub>16</sub>
2 Nov	15 <sup>11</sup> / <sub>16</sub>	14 <sup>3</sup> / <sub>4</sub>	- <sup>1</sup> / <sub>4</sub>
9 Nov	15 <sup>11</sup> / <sub>16</sub>	15 <sup>5</sup> / <sub>8</sub>	+ <sup>1</sup> / <sub>8</sub>
14 Nov	15	16 <sup>1</sup> / <sub>16</sub>	+ <sup>1</sup> / <sub>16</sub>

\* - indicates differential against sterling



## A4 SSD SCHEME AND MONETARY CONTROL TECHNIQUES

Factual

1. SSD scheme (the 'corset') to be phased out in due course.
2. Current guideline extended to mid June 1980; allows for further growth of 1% per month in banks' interest bearing eligible liabilities (IBELs). Details announced in Bank press release at 12.30 pm.
3. Bank and Treasury to undertake consultations with those most concerned on monetary base schemes.

Positive

1. Whatever the control system, main methods of control must be policies on PSBR and interest rates. Monetary base control no substitute for this.
2. Recognise that SSD scheme has nearly outlived its usefulness, therefore to be phased out. Inappropriate in present circumstances to dismantle completely.
3. Consultations on monetary base control to assess whether it could help smooth monetary growth or bring about more readily necessary interest rate changes.
4. Directional guidance remains in force: asks banks to give priority to finance for industry and exports and, in order to ensure they can meet priority requirements, to exercise strict restraint on lending to persons, property companies, and for purely financial requirements.

Defensive

1. Distortions: Recognise SSD scheme and other direct controls encourage development of alternative channels of liquidity and credit - SSD scheme particularly encouraged take-up of acceptances outside bank sector. Also has damaging structural impact on financial sector. Hence decision to phase out scheme.
2. Adjust figures: Can only estimate total impact of distortions; preferable to remove cause.
3. Other controls distort: Depends on form of control and how they are used. No substitute for getting PSBR and interest rates right.
4. Monetary base now: Highly technical subject with wide ranging institutional implications. Hence need for consultations. Not sensible to introduce before new system fully understood and widely accepted.
5. Exchange control: Transactions abroad potentially a further loophole of SSD scheme. But high sterling interest rates bite on demand for sterling credit whatever its source. Ability to get the fundamentals right not significantly affected by abolition of exchange controls (see separate brief).

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6. Guideline still too tight: Relationship between IBELs and £M3 very complex. Tightness depends, inter alia, on money market developments. But guideline growth somewhat greater than targeted £M3 growth rate. Would hope that bank lending moderates sufficiently to allow some reversal of distortions.

7. Industry squeezed: Availability of finance to industry depends on pay bargains agreed. Providing these are reasonable, room within guidelines for necessary finance to industry.

8. Restrict personal lending: Directional guidance remains in force. More direct controls would only increase distortions. Lending to persons relatively small part of total.

9. Increase HP controls: HP controls have a discriminatory impact between industries; and the net effect on credit growth would be small.



C ADVANCING COLLECTIONS OF PRT

i) factual

At present PRT is normally paid four months after the end of the 6-monthly chargeable periods. The proposal is to require, by legislation, that companies should make their payment with the return they already submit two months after the end of each chargeable period. These payments would be received at the beginning of March and September. Assessed tax is, and continues to be, due at the beginning of May and November.

ii) defensive

The proposal will bring the payments arrangements for PRT into line with those which already operate for the collection of royalties by the Department of Energy.

The proposal does not conflict with the assurances about stability of the North Sea fiscal regime. There is no change in the rate of tax, only in the arrangements for collection.

The problem on the PSBR has arisen in large part from late payment of telephone bills or of tax. It is appropriate to correct this by a measure that brings forward the timing of tax collections.

[If questioned on IMPLICATIONS FOR RECENT BP SHARE SALE: This is a general measure affecting all oil companies paying PRT. It has no special implications for BP.]

iii) positive

The effect of the change, which will be permanent, will be to increase the PRT receipts in 1979-80 by £700 million and to raise receipts for 1980-81 by £300 million. The beneficial effects will continue so long as taxable profits from the North Sea are on a rising trend.

D PSBR for 1979-80

i) factual

The Budget forecast for the PSBR was £8¼ billion. The first estimate for the first half of the financial year will be published on 22 November. The material is not yet complete but the main component - the central government borrowing requirement has already been published. It was about £6 billion, after allowing for seasonal factors (the actual figure was about £6½ billion). The total PSBR in the half year was probably close to £6½ billion (seasonally adjusted) with an actual total near £7 billion. It was always to be expected that the bulk of the year's PSBR would lie in the first six months. But the latest evaluation is for a PSBR for the year of about £9 billion before allowing for the acceleration of PRT collection. This means about £8¼ billion after taking PRT into account.

IMPORTANT NOTE  
THESE FIGURES  
ARE NOT  
PRECISE AND  
THE SEASONAL  
ADJUSTMENT IS  
SUBJECT TO  
CORRECTION  
BEFORE 22  
NOVEMBER

Factors pointing to an excess if some action were not taken included the Post Office telephone billing excess. Though bills are now going out again, recovery will not be completed in this financial year: a net excess of about £400 million is now expected this year. Secondly, local authorities have been borrowing more than was expected in June; and this is now expected to continue.

ii) defensive

The wide margins of error in any forecast of the PSBR are well known, but it would have been unsafe not to heed the evidence so far. We seemed to be heading for a figure of about £9 billion.

The acceleration of PRT collection will improve the prospective public sector cash flow by about £700 million and so lessen the borrowing needed in the remainder of this year.

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The PSBR for the current year is now estimated at about £8 $\frac{1}{4}$  billion.

The improvements to the terms of National Savings will help to finance the PSBR in a non-inflationary way.

iii) positive

The extra receipts from the change in the PRT collection arrangements will help to ensure that the PSBR for the year as a whole is in line with the Budget forecast of £8 $\frac{1}{4}$  billion. We have demonstrated therefore our determination to take steps to keep borrowing under control.

E PSBR AND PUBLIC EXPENDITURE FOR 1980-81

i) factual

Government expenditure plans for 1980-81 were given in Cmnd 7746 on 1 November. They provide for stabilisation of the volume of public expenditure at the 1979-80 level.

Treasury Ministers will not wish to say anything which rules out categorically a possible further review of 1980-81 spending plans, in time for the Budget say.

It is intended to publish a forecast figure for the 1980-81 PSBR in the Industry Act forecast to be published in the next ten days or so.

The proposal to accelerate collection of PRT will itself benefit the PSBR to the tune of some £300 million next year.

ii) defensive

As indicated by the statement today the Government will be ready to adjust the fiscal balance as necessary to help secure observance of the monetary targets. We will be considering the PSBR for 1980-81 on this basis.

Apart from relatively minor adjustments, such as further savings as a consequence of the Lord President's exercise on Civil Service staff costs, there are no plans at present for further reductions in planned public spending.

A final view on the PSBR and fiscal plans for 1980-81 will be taken in next spring's Budget.

iii) positive

The 1980 Budget will be framed in the light of the monetary targets, which are of paramount importance.

As the Prime Minister has said, the Government is embarking on a sustained programme of trying to get public expenditure

down as a proportion of national income. We cannot go on spending money which the nation does not earn.

A forecast figure for the 1980-81 PSBR will be given in the Industry Act forecast to be published shortly. [IF PRESSED ON TIMING OF PUBLICATION: I must ask the House to be patient - the forecast will be published soon.]

But decisions on the PSBR and the fiscal balance will be taken later.

The proposal to accelerate collection of PRT will itself ease the PSBR position for 1980-81 by about £300 million.

## F EFFECTS ON INDUSTRY, GDP AND EMPLOYMENT

i) factual

1. Impossible to give reliable figures for impact on GDP of recent upward trend in interest rates.
2. Interest rates not necessarily the most important determinant of investment; prospect for economy generally much more important.
3. The Industry Act forecast will probably be published in the next day or so but not by 20 November, which on one interpretation is the deadline implied by the Act. It will take account of the monetary package, and will contain a figure for the 1980-81 PSBR. A garbled story about the alleged content of the draft forecast appeared in the Financial Times on 14 November. It stressed the alleged pessimism on the outlook, especially for the path of GDP.

ii) positive

1. Reduction in monetary growth and hence inflation crucial to give the right conditions for investment and revitalisation of industry.
2. The acceleration of PRT collections will benefit public sector cash flow and hence reduce need for public sector borrowing.
3. As inflation and money supply brought under control it should be possible to meet objectives with lower interest rates.
4. Financial prospects for industry depend crucially on moderation in pay negotiations. Interest rate rises should help by confirming government's unwavering commitment to reduce monetary growth.

iii) defensive

1. The Industry Act forecast will be published shortly. Meanwhile it would not be right to give a detailed account of the economic outlook. However, nearly all forecasters are expecting some fall in GDP next year. This is a cost that we must be ready to bear if inflation is to be brought under control. [IF PRESSED



ON THE PUBLICATION DATE: I must ask the House to be patient - the forecast will be published soon.]

2. Higher interest rates damaging to Investment, Output and Jobs: Higher inflation would be much more damaging to investment, output and employment over the longer term.

3. Monetary target too tight: Provided private sector exercises restraint in pay bargaining, expect room within target for necessary finance for industry. (See brief A2 on new target.)

4. Impact on liquidity: Recognise that higher interest rates will add to burden on many companies, and liquidity already depleted following strikes, bad weather last winter, and recent cost pressures. But Government no intention of financing inflationary wage increases; companies will benefit in longer term from reduction in inflation.

5. Two Tier Interest Rates: There are objections of practice and principle to such schemes. Financial system too sophisticated; and protective for one sector would require greater restraint on others.

## G PROSPECTS FOR TAX CUTS

i) factuali. Main tax points in Chancellor's speech to Tax Reform Conference

- chances of economic and industrial recovery will certainly be improved by further pruning and re-shaping of the damaging tax structure that was inherited; but even that important task cannot be allowed to blunt the determination to keep borrowing down and the money supply under control
- certainly hope to be able in the years ahead to make further cuts in the basic rate of income tax
- also want to bring further relief to those at the bottom of the income tax scale, by raising the thresholds
- and to make improvements in company taxation
- but must have regard to the constraints imposed by the combination of low growth and in-built public spending.

ii. Chancellor's intentions for the next (and subsequent) Budgets

We recommend against being drawn into any discussion of prospects for tax adjustments in 1980 and the medium term, or of timing and form of specific tax changes that might be introduced. Budget fiscal policy will have to be consistent with the overriding need to contain monetary growth.

iii. Tax reductions expensive - for example:

- 1p off basic rate: over £500m (full year)
- £100 on basic personal allowances: over £700m (full year)

ii) positivei. Much already achieved.

3p off basic rate. Allowances increased by double the amount needed to keep up with inflation. Substantial cuts in higher rates - threshold up from £8,000 to £10,000, 60% maximum on earned income. Aim has been to improve incentives, reward hard work, responsibility and success. Direct tax reduced by £4,300m in full year.

ii. Long-term objectives unchanged

Budget cuts in income tax only a first step. Objective remains 25% basic rate and to raise thresholds as high as possible. Need for a simpler and less oppressive system of capital taxation.

iii) defensive

i. Burden of tax to be increased in next Budget?

Determined to cut burden of income tax further. Too early to be specific about scope for action. Tax Reform speech said: "No Chancellor at this time could encourage over-generous expectations."

ii. Thresholds?

As outlined in Tax Reform speech, there is a strong case for raising thresholds - best way of widening gap between those in and those out of work and improving incentive to work.

iii. 1977 Finance Act indexation?

Action on thresholds will naturally be a major priority. [Recommend - avoid specific commitment to raise thresholds in line with 1979 price inflation (ie 17% plus).]

iv. Specific duties

To be considered in usual way in framing Budget.

v. VAT

No intention of going back on commitment not to raise 15% rate ceiling.

vi. Why consider cuts in capital taxes, when no more being done on income tax?

Income tax was given priority this year - bulk of the benefit went to helping those liable at basic or reduced rate. Right to review capital taxes as the second stage.

vii. Reliefs/exemptions/mortgage interest relief ceilings etc

Will all be considered in usual way in framing Budget judgement. No question of withdrawing mortgage interest relief.

## H PUBLIC EXPENDITURE WHITE PAPER ON THE LATER YEARS

i) Factual(a) Date of publication

It has been the general practice recently to publish a White Paper in January giving details of public expenditure plans for a five year period. In the Press Conference held on publication of Cmnd 7746 on 1 November Treasury Ministers said that a White Paper on the years to 1983-84 would be published at around "the turn of the year". In his statement to the House the Chief Secretary said simply that plans for later years would appear in a "subsequent" White Paper. The intention to publish in January, or indeed whether to publish at all, is being reviewed by Treasury Ministers. Therefore for the moment as little as possible should be said publicly about the publication date: neither to give a stronger commitment on January nor to give rise to speculation about delay or cancellation.

(b) Economic content

Treasury Ministers warned at the Press Conference on 1 November that the White Paper on the later years might not contain all the detailed "futurology" that was in recent White Papers. Treasury Ministers are reviewing the economic content of the next White Paper. Therefore little should be said, neither to imply that there will be a detailed forecast of revenue etc nor to suggest that decisions on expenditure are proving difficult for Cabinet to reach.

ii) defensive

By presenting Cmnd 7746 on public expenditure for 1980-81 the Government has already provided a basis for planning for next year. Plans for later years will be announced later. [IF PRESSED ON PRECISE PUBLICATION DATE: There is nothing to add at this stage to what the Chief Secretary said in his statement to the House on Cmnd 7746.] [IF PRESSED ON ECONOMIC CONTENT: We shall be considering the details of the next White Paper in due course.]

iii) positive

Spending plans for the years after 1980-81 will be announced later. Public expenditure in the years ahead will be consistent with the observance of monetary targets. As the Prime Minister has said, we must try to get public expenditure down as a proportion of national income. We cannot go on spending money which the nation does not earn.

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## 5 MEDIUM TERM FINANCIAL PLAN

i) factual

The Chancellor has said in the House that he is considering whether there would be advantage in adopting and publishing a medium term financial plan. Such a plan would contain specific medium term commitments on the progressive reduction of the rate of growth of the money supply. It could also contain supporting data, such as revenue and expenditure projections.

ii) defensive

A medium term financial plan could be helpful in further demonstrating that the government is absolutely determined to control inflation. But, as the Chancellor said in the House on 8 November, this is not the only argument to be taken into account. It would not be right to rush a decision on this important matter.

iii) positive

The government has already given a firm commitment to reduction of the rate of growth of the money supply. The announcement of a tight monetary target for next year and the measures adopted to help meet it are further moves in discharging that commitment. The Government will remain ready to adopt whatever measures prove necessary to secure observance of the monetary target.



## K EXCHANGE CONTROL AND THE MONETARY POSITION

i) factual/positive

1. Abolition of controls removed an artificial distortion of capital markets which discriminated against private investment overseas.
2. Domestic monetary implications complex, and have been somewhat overplayed. An outflow from the UK private sector would put downward pressure on money supply whereas our present problem is excessive monetary growth.
3. Net effect likely to be spread over months or even years. Net effect this year likely to be small, and could go either way.

ii) defensive

1. Detailed effects: Contractionary impact as private sector seeks investment opportunities abroad. But offset if bank borrowing increased to finance overseas investment or repayment of foreign currency debt; and foreign assets may be purchased at expense of gilts. Net impact will also depend on size and nature of offsetting inflows.
2. Domestic economy exposed: Abolition does mean we are more sensitive to developments overseas. But recent increases in overseas interest rates, especially in US, have been so dramatic that a UK response would have been necessary regardless.
3. Domestic Monetary Control: Abolition weakens SSD scheme (see separate brief). But as always the key things are an appropriate fiscal policy and the right level of interest rates. We remain determined to get these fundamentals right and our ability to do so not significantly affected by abolition. Higher sterling interest rates bite on demand for sterling credit whatever its source.

PRIME MINISTER

MONETARY POLICY

Following our meeting last Friday and my minute to you of 9 November I have been discussing further with the Governor and with officials the proposals I shall need to announce tomorrow in the light of the latest monetary and other developments.

2. We are faced with an exceedingly difficult situation. It is widely known that the PSBR for this year is out of line (and, even if we were to volunteer nothing further on this ourselves tomorrow, it will be apparent from the PSBR figures for the first 6 months due to be published next week); market rates have already moved upward in anticipation of a significant increase in MLR; and the publication of a revised (and very tight) monetary target for the next 12 months is bound to create strong adverse expectations about interest rates. This is especially true if it becomes thought - as it is already in some quarters - that the corset is a piece of self delusion on the part of the authorities.

3. If we are to hold confidence and create the atmosphere in which there is a reasonable prospect of achieving the large gilt sales that are needed quickly (£1.5 to £2 billion over the next 3 months), we must announce proposals that do not disappoint market expectations. This entails - as you have recognised - an increase, unwelcome though it is, in interest rates. But it is also essential, as I think we are both agreed, to be seen to be taking action to correct the overshoot in this year's PSBR that is now apparent. To a substantial degree the overshoot is due to adventitious factors (notably the Post Office strike and delayed VAT payments) which can and will be explained. But - particularly given the other bad news that the markets will have to absorb, such as today's trade figures - I do not believe explanation alone is enough and that we need to supplement an increase in MLR with specific fiscal action.

4. This is easier said than done and the range of choice is a narrow one. It is too late to make any significant changes in public expenditure this year; and, although I have gone into this in detail with Customs and Excise, I do not think we can announce any steps to

accelerate VAT payments which would not risk being counterproductive (most of the big firms pay promptly already; and there would have to be a de minimis limit that would exclude most of the little ones).

5. The only major proposal that I consider feasible is an advancement of PRT receipts by 2 months into 1979-80. This would require immediate legislation (a short Bill) and would yield an extra £700 million or so this year and around a further £300 million next year. Although in one sense an accounting transaction it would nevertheless bring forward a stream of payments with continuous benefit to the PSBR for some years to come and would, I believe, be the only effective response to the PSBR problems now facing us.

6. In view of the instability of the world oil situation it would not in itself be an attractive proposal. There could be accusations of bad faith and perhaps even law suits in relation to the BP issue, although this would depend on what happens to the BP share price (BP will pay about two-thirds of the £700m on top of their share of the BNOG forward oil sales). Any row that might ensue could to some extent offset the beneficial effects of our overall proposals. But I am satisfied that there is no viable fiscal alternative; and I am convinced that without the inclusion of a measure of this magnitude there is a serious risk that the statement will prove inadequate and that we should be faced with the prospect of even higher interest rates and a further deterioration in the prospects for gilt sales and confidence in the Government generally. The fact is that a new situation has arisen since the BP issue and the action we must unavoidably take is one answer to any criticisms of the kind referred to above.

7. I also propose to announce three National Savings measures designed to produce a net inflow of some £700m in the present financial year. This will produce a valuable contribution to funding the PSBR at a slightly lower average interest rate and help to reassure the gilts market. The additional funding of the PSBR will come at a time when the gilts market may be very uncertain. In the judgement of the Governor and myself this addition will significantly increase the chance of the package succeeding. However, much of the inflow (perhaps a half) would be at the expense of the building societies and consequently at the expense of mortgage lending early next year.

Their immediate reaction might be to slash any new mortgage commitments for the period February to April. It could also bring forward the date of a further mortgage rate increase. But the alternative is running a greater risk that the general level of interest rates will have to increase even further.

8. I propose, therefore, that my statement tomorrow should in addition to the MLR change which the Bank will have announced at 12.30 pm, include:-

(i) The PRT advancement described above;

(ii) a roll-forward of the £M3 target at the present 7-11% target range for the 16 months from mid-June to mid-October 1980 (thus avoiding any "base drift" arising from the excessive rate of growth in recent months);

(iii) extension of the "corset" at the present rate for a further 6 months, although announcing that it will be phased out in due course and that there will be early consultations on monetary base control;

(iv) The National Savings measures referred to above.

9. I attach a draft of the statement I have in mind. As you will see I have left open the crucial figure for the MLR increase. I fear that the movement in market rates has been such that 16% would no longer be sufficient. But I think we must leave this open until tomorrow morning. It would be fatal to undershoot; but I shall be reviewing the position with the Governor and with officials further this afternoon before I see you.

10. I thought it would be helpful to set out my conclusions, and to let you see a draft of my statement, before our discussion this afternoon. Among other things I should like to take your view on how we might present the proposals to our colleagues at Cabinet tomorrow morning when final decisions will have had to be taken.

G. H.

Geoffrey Howe  
14 November 1979



Mr Speaker with the permission of the House I would like to make a statement on monetary policy.

The figures for banking October, published earlier this afternoon, show that **£M3** grew by £1,080 million, or **2%** in that month. The rate of growth over the 4 months since mid-June, the beginning of the present target period, has therefore been equivalent to just over **14%**. Although a number of factors point to the figure for banking October being erratically high, just as that for the previous month was erratically low, it is clear that the underlying growth of **£M3** is still significantly above the top of the target range which I set, namely **7-11%** per annum for the 10 months from mid-June 1979 to mid-June 1980.

The excess has been largely due to the sustained rapid growth of bank lending and the high PSBR in **the** first half of the year.

It had always been expected that the **PSBR** would be higher in the first half of the year than the second, because many of the effects of the Budget - notably the receipts from the higher rate of **VAT** and reductions in public expenditure, would mainly affect the second half. But the **PSBR** was further increased in the first half year by the effects of industrial action, notably on telephone bills and **VAT** collection. The greater part of ~~the~~ <sup>this shortfall</sup> will be made good **in** the second half year. But the best estimate which can now be made for the PSBR for the year as a whole is that it would be **£9½** billion, if no action were taken. This compares with the estimate of **£8½** billion at the time of the Budget. The Public Sector Borrowing Requirement

£9m  
INCA  
R 4000: £100m  
DISPOSALS £100m  
£9m

U.S. BANK  
ARRANG  
TOTAL: \$3-6Bn  
UN  
\$2Bn

£200m - 60% 70p  
£350m '89  
200/12003: £1Bn  
13-3/4

EARNINGS GROWTH  
LIND. ACTION  
L.A./IND. SPANISH

AR/LA/GR  
CON: PRG

Am/MB/NL -17%

will be significantly lower in the second half of the financial year not only because of the factors originally envisaged but because of the partial recovery of the receipts in the first half year. Thus monetary conditions will be tighter on this account in the second half than in the first.

Some of the causes of the recent high rate of growth of the money supply are essentially matters of timing; and there are good reasons to expect it to decline somewhat in the future. But the

The other main factor contributing to the high rate of monetary growth has been the growth of bank lending to the private sector. This has fluctuated markedly from month to month but over the last 3 months has averaged about £700 million a month. This level can be expected to fall in due course from the changes in interest rates earlier in the year [and with the decline in the level of economic activity], although its timing is difficult to predict.

~~While there are good reasons to expect that the rate of growth of the money supply will decline somewhat in the future, the~~

Government consider that it is necessary to take action now in order to bring the growth of the money supply back within the target range. Accordingly, we will be seeking to reduce the PSBR by bringing forward by [2] months <sup>(in place of the present)</sup> the due date for payment of petroleum revenue tax. The Bill to achieve this will be introduced shortly. This change will yield £700 million this year, and a further £300 million next. Next year's PSBR will also benefit from some £400 million of telephone bills not collected this year.

Take in new paragraphs at end.



The Bank of England announced this morning, with my approval, that Minimum Lending Rate would be increased to [17%]. This



both confirms the recent rise in market interest rates which have been generated by reactions both to the domestic monetary situation, and to the general rise in interest rates in other countries, notably the United States and shows the Government's determination to act in the way which my r.h.f. the Prime Minister foreshadowed on Monday.

In addition to operations in the markets, we will be taking steps to secure a further funding of the PSBR through National Savings. The limit on holdings of the National Savings Certificates Retirement Issue - the Granny Bonds - will be increased next month from £700 to £1,200. A new ordinary National Savings Certificate will be introduced early next year. The Interest Rate on National Savings Bank Investment Account will be raised to 14½% from 1 January next.

The Government have been reviewing the methods which are available to the authorities for controlling the growth of the money supply. The main methods must continue to be the policies on public expenditure and tax, which together determine both the size and the composition of the PSBR, and interest rate policies, both at the short end and in the gilts market. However, successive governments have supported these methods by some more direct method of control of the banking system such as the ceilings on lending used in the 1960s or the supplementary special deposits scheme, usually referred to as the corset, which has been applied at various times since December 1973. The efficacy of the SSD scheme has diminished

over time with the development of alternative channels of liquidity and credit outside the control, and it has nearly outlived its usefulness.

It would be inappropriate in present circumstances to dismantle the scheme completely. I have therefore agreed with The Governor that the scheme should be phased out over a period rather than brought to an abrupt end: the Bank of England announced, with my approval, this morning the basis on which it would be extended for a further 6 months.

It is possible that other techniques of control, possibly one of the variants of monetary base control, might have a useful role to play in the future, without having the disadvantages of the SSD scheme. The Bank and Treasury will accordingly shortly be starting technical consultations on the basis of a discussion paper with those most concerned to establish whether such a scheme is technically feasible, and whether it would have the desired effects of either smoothing the growth of the money supply, or of bringing about more readily the interest rate changes which may be necessary for monetary control. But I must stress to the House that any such scheme of monetary base control is not a substitute for the appropriate fiscal policy and interest rates: indeed one of the possible advantages is that they improve the response of interest rates to changes in monetary conditions.

Finally I intend to extend by 6 months, to mid-October next year, the period for which the present target range of 7-11%

per annum for the rate of growth of £M3. That target at present applies to the 10 months from mid-June to mid-April next, and it will now apply to the 16 months from mid-June to mid-October. I am extending it in this way, because to adopt the more normal procedure of setting the target for the 12 months from mid-October this year to mid-October next year would involve building into the new target the excess growth of the money supply in the recent past. It would be totally at variance with this Government's philosophy of controlling the money supply to allow that, and to do what the experts call "base drift". Instead, we are allowing a reasonable period over which we can offset the more rapid growth which has already taken place.

Mr Speaker, this Government is committed to bringing the money supply under control, and thereafter to reduce progressively the rate of monetary growth over the years. The measures which I have announced today show that we are ready to take the action which appears necessary to achieve that objective.

~~ANNOUNCEMENT~~

[ Additional paragraphs for insertion  
on page 2. ]

~~2~~ I am not satisfied that the present arrangements for collecting petroleum revenue tax are entirely satisfactory as regards the speed with which this tax, as distinct from royalties, reaches the Exchequer. This is not a criticism of the oil industry but, rather, of the tax collection rules themselves in the Oil Taxation Act 1975. The House will appreciate that very large sums are involved and that we must ensure that PRT reaches the Exchequer with the minimum delay consistent with collection arrangements that are workable in practice. I therefore intend to bring before the House a short Bill, before the recess, containing the Government's proposals for changing the present PRT collection rules.

~~2~~ Further details are given in a Press Notice being issued by the Board of Inland Revenue.



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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
 Financial Secretary  
 Sir Douglas Wass  
 Sir Lawrence Airey  
 Sir Fred Atkinson  
 Sir Kenneth Couzens  
 Sir Anthony Rawlinson  
 Mr Littler  
 Mr Bridgeman  
 Mr Lovell  
 Mr Monck  
 Mr Middleton  
 Mr Folger  
 Mr Ridley  
 Sir Douglas Lovelock  
 PS/Governor  
 Mr Fforde  
 Chief Cashier

BARNARD  
 LEVER  
 HEALEY / view

## THURSDAY ANNOUNCEMENTS

For discussion at your meeting tomorrow morning I attach the following further papers:-

*NB*  
*Also the Home*  
*letter (Flag E)*  
*just*  
*annul*  
*OB*  
Flag A: A note by PE on the PRT and other oil sale/disposal proposals (£100 m extra BNOC forward oil sales and sale to BP of Wytch field); and a further note from OF (Mr. Barnard) on the international implications; and a note on practicalities from Revenue.

Flag B: A note by Customs on the possibilities of accelerating VAT payments by charging interest on deferred payments;

Flag C: A note by HF on National Savings and the implications for the building societies;

Flag D: A draft statement which assumes that the PRT proposal goes ahead.

2. I suggest that it might be helpful to tackle the main questions in the following sequence:-

(1) PRT: Are the disadvantages of advancing payments (legal risks etc, implications for BP, narrowing of options for 1980-81, etc) outweighed by the risks to confidence (and therefore prospects of adequate gilt sales) of not including a substantial fiscal component in the package? The markets have so far reacted favourably in anticipation

of Thursday's statement (assumed at least to increase MLR and announce the roll-forward). But there is further bad news (PSBR and trade figures) not yet discounted and which the announcement must take account of.

(2) If the PRT proposal is ruled out, what further action needs to be taken to reassure the markets? The other "fiscal" components mentioned below would certainly not in themselves be enough. One possibility would be to announce now tough measures in next Spring's Budget in the hope that this, although not directly affecting this year's PSBR, would hold confidence until the Budget. The only alternative to this may prove to be to increase MLR by more than at present proposed.

(3) Timing of VAT etc payments: Do the arguments in the Customs note rule this out entirely? A separate possibility - which Inland Revenue have accepted - is to increase the interest rate (now 9%) on those taxes for which there is a due date for payment. If this is done, we need to decide the new rate and form of the announcement.

(4) National Savings: Are Ministers prepared to secure about  $\frac{1}{2}\%$  reduction in the money supply, and so reduce risk of further general interest rate increase, by extra National Savings sales? These would affect flow of funds to housing market in New Year and possibly hasten timing of further mortgage rate increase. If so, when should Mr Heseltine be informed?

(5) Gilts: Decisions will need to be taken on new gilt issues before the end of the week. HF and the Bank will advise orally in the light of the latest market developments.

(6) Statement: In the light of discussion of the above, any revisions to the draft statement?

3. You will need to clear your lines with the Prime Minister as quickly as possible. You will be seeing her on Thursday morning but there would be advantage in reaching decisions before then if this is at all possible - ie at a meeting with the Prime Minister later



tomorrow. We should aim, therefore, to prepare a minute for you to send to the Prime Minister, together with a revised draft statement, as soon as possible after tomorrow morning's discussion. Among the matters you will also want to clear with the Prime Minister is how you should present your proposals at Cabinet on Thursday morning (and a fortiori how Mr Heseltine should be handled in relation to the implications of the proposals for the building societies).



J B UNWIN

13 November 1979



SECRETARY OF STATE FOR ENERGY  
THAMES HOUSE SOUTH  
MILLBANK LONDON SW1P 4QJ  
01 211 6402

Rt Hon Geoffrey Howe QC MP  
Chancellor of the Exchequer  
Treasury Chambers  
Parliament Street  
LONDON SW1 3HE

87C  
Sent 13/11  
At our request,  
It has not copied  
this; but he went  
v much to see  
it to Douglas Howard  
(Pis). Would  
you be content  
with this?  
13/11

13 November 1979

*See Summary*

PSBR 1979-80

I am writing to explain the concern which I feel at your proposals for bringing forward some public sector receipts from oil and gas into this financial year from next.

First, the international oil situation is as tense and uncertain as ever. It would make no sense for us to do anything which would increase instability, as I believe the wrong handling of some of your proposals would do.

Second, we cannot retain the co-operation - which I believe to be essential - of the oil companies, if we spring major decisions on them at short notice, without preparation or consultation. This is particularly important in the field of tax, given all that has been said both by them and by us about the need for a relatively stable fiscal regime.

It follows that I should strongly urge you not to make an announcement about the possibility of bringing forward PRT in the next few days. If, however, you believe that such an announcement is inevitable, I would urge you no less strongly that time must be found to give representatives of the oil industry some indication of our proposals and chance to react to them. (If this is done by way of a meeting, I should like Hamish Gray to be present). Obviously, the need for consultation and careful presentation would be even greater if there were any question that further legislation for another increase in PRT might follow legislation to advance payment.

As for forward oil sale, BNOC believe that it would be possible to secure up to £100m above the higher figure of £500m previously set for the exercise without offering additional oil or reopening negotiations, and I can therefore offer you this amount. It is not, however, possible to go beyond this, since the existing forward commitments, coupled with the additional commitments to BP

*2000  
initial  
into gov  
for a  
moment  
not at  
2000  
No manual  
13/11*



88

resulting from the renegotiation of the BNOC/BP sales agreements, have now effectively committed the whole of BNOC's available oil in 1980. I must, however, emphasise the harm that would be done by any public statement that we were raising additional money in this way. It would merely increase the instability of the international oil market, as well as reviving all the criticism which the forward oil sales have already attracted.

As you asked, I have considered again the possibility of selling the Wytch Farm field. I confirm that, on the basis of the Law Officers' advice as well as for other reasons, it would simply not be possible to complete such a sale by 31 March.

Yours  
David

D A R Howell



CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Minister of State (L)  
Minister of State (C)  
Sir Douglas Wass  
Sir Fred Atkinson  
Sir Kenneth Couzens  
Sir Anthony Rawlinson  
Mr Barratt  
Mr F Jones  
Mr Littler  
Mr Monck  
Mr Unwin  
Mr Wicks  
Mr Ridley

(NB. This minute was written before your meeting with the Attorney General this afternoon.)

G.

PRT AND BP

Mr Unwin is putting up a note for discussion at your meeting tomorrow morning about the various measures under consideration for Thursday's statement. This minute is concerned solely with the PRT proposal, and in particular its implications for BP. It does not deal with the legal aspects arising from the BP share sale on which Mr Wicks will be advising separately, on the assumption (which may turn out to be unfounded) that these will not present a conclusive obstacle.

2. The PRT proposal - in effect to advance payments by two months - is the largest item under consideration. It would bring £700 million of 1980/81 tax receipts into 1979/80. Of this total, some two thirds would come from BP. Since BP is also going to contribute £300 million of the £500 million forward oil sales, plus a share of any further amount to be raised by this means, the implications for BP's cash-flow need very careful consideration.

3. Unfortunately it is not possible to deduce with any certainty from BP's published figures how far they are in a position to bear this double burden. Clearly they have made considerable paper gains from recent oil price rises, and some of this will in due course materialise as cash, but a good deal of it simply represents increased value of stocks, which is no immediate help in meeting a demand for additional tax payments. Their half year statement shows that they have got a lot of cash (£500 million in the UK at mid-year) and are generating a lot. But not all of this would be available for meeting tax bills. Almost certainly BP would rely on additional bank borrowing for a good deal of the necessary funds, and this would simply add to the money supply - except insofar as the effect on the PSBR helped us to sell more gilts.

4. I doubt if we can carry the analysis of BP's ability to pay much further than this. They certainly indicated no objection to advancing PRT at the recent lunch with the Financial Secretary, but it could be that they were considering this as an alternative, and not as an addition, to the forward oil sales. I do not think it is worth our trying to sound the company in advance about the effect on them: they are virtually bound to express the strongest possible objection to this imposition (which of course comes on top of their disappointment about the non-sale of BNOC assets, and their supply troubles in different parts of the world). I do think however that if this proposal is agreed it would only be courteous to give Sir David Steel a little advance notice of any announcement, and if you agree, I will arrange to see him during Thursday morning to tell him in confidence the terms of the afternoon statement insofar as it relates to PRT.

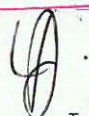
5. Whether the PRT measure will be necessary can only be judged in the context of the monetary outlook, and the alternative measures, if any, that could be put in place at very short notice. These will be discussed tomorrow morning. But I would particularly like to draw your attention to two aspects apart from the direct impact on BP:

(a) the effect on the world oil situation of the example set by the UK government taking yet another step to raid the oil companies' profits. No doubt the PRT proposal is less damaging in this context than the forward oil sales on which Mr Barratt is minuting separately, but the point is still there;

(b) more importantly, to take this step now could preclude the imposition of a higher rate of PRT in next year's Finance Bill, so that over the two years as a whole we might in fact be worse off. Whether this is so depends largely on the amount of opposition which the present proposal would arouse, which again turns to some extent on the impact on BP, as main sufferer.

6. The one conclusion I would draw from all this in advance of tomorrow's meeting is that we should only proceed with this measure if it is judged inescapably necessary to restore the monetary situation. It is certain to worsen relations with BP still further, as well as casting a certain doubt (whatever the lawyers may say) over the Government's good faith at the time of the BP share sale.

13 November 1979

  
L AIREY



## NORTH SEA OIL AND GAS

Note by PEAdvancing PRT Receipts

The Inland Revenue will be making a separate submission on the method of achieving this and what might be said in a statement. The Attorney General is considering his advice on the relationship between this option and the BP sale. We understand that his current view is that although there is no absolute legal obstacle, the Government would be sailing very close to the wind and that if the BP share price falls there may well be law suits. There would also be broader accusations of bad faith.

2. Apart from the legal aspects, this measure would have other disadvantages. It would damage BP's cash flow at a time when it is very likely to have to resort to the spot market to get sufficient crude oil. Of the total yield in advance PRT receipts of £700 million, BP is estimated to contribute two-thirds (or £460 million.) This would come on top of the £300 million which it will already be paying early as part of the £500 million so far raised by BNOG's forward oil sales. BP itself might well protest publicly and this could be used as evidence in any litigation brought by shareholders.

3. Secondly, if Ministers advance PRT payments into 1979-80, they will be shifting into 1979-80 some of the effect they could otherwise get in 1980-81, though there would be no net loss over the whole period. Acting in the Budget next spring would yield £1 billion in 1980-81. Acting now would bring in £700 million this year and only £300 million in 1980-81. The Revenue have also suggested that the row caused by advancement now might in practice mean that Ministers could not raise the PRT rate in the Budget. But the yield from raising the rate would be of the order of <sup>only</sup> £85-170 million in <sup>1980-81</sup> (if the PRT rate were raised by 5 or 10 percentage points). <sub>added next year.</sub>

4. Clearly Ministers will wish to weigh these disadvantages or risks against the chance that advancing PRT now could make the difference between a convincing and an unconvincing statement next Thursday. It is relevant to this judgement that although the advancement of PRT payments would reduce the PSBR by £700 million, it would not reduce the money supply directly by that amount. The reason is that the advance payments would no doubt be partly financed by additional bank borrowing. From the monetary point of view, therefore, the judgement turns on the effect on confidence, particularly in the gilts market of being seen to do something to correct an overrun of the PSBR.



5. Other Measures

We think it doubtful whether the additional £100 million of forward oil sales is large enough to justify the criticism that this might eventually cause. A separate submission from the overseas finance side argues against mentioning this even if it decided to ahead with it. A further point is that forward oil sales, unlike advanced PRT payments, have to be unwound and thus present a problem for the PSBR in later years.

6. I understand that Mr Howell ruled out a sale of Wytch Farm by the British Gas Corporation in this financial year. The Chancellor's tactic on this might be to agree reluctantly not to press it now provided that Mr Howell undertakes to pursue the option for 1980-81 and reports back early in the new year.



A

MM

N MONCK

13 November 1979



THE BOARD ROOM  
INLAND REVENUE  
SOMERSET HOUSE

13 November 1979

CHANCELLOR OF THE EXCHEQUER

ADVANCING PAYMENTS OF PRT

1. We understand that Ministers are considering measures to bring forward the payment of some Petroleum Revenue Tax (PRT) from 1980/81 to 1979/80; and have in mind to announce this on Thursday.
  
2. The Revenue has been considering ways in which this could be done. We recommend a scheme which requires a licensee to calculate and make a payment on account of his PRT liability at the time he submits a return for the chargeable period, 2 months after the end of that chargeable period. Thus the payments on account would be due on March 1 and September 1 (whereas assessed PRT is normally due on May 1 and November 1). The payment would be based on the gross revenues, valuations and royalties shown in the return, expenditure incurred but not so far allowed, and allowances (such as oil allowance and safeguard) as provided by existing legislation. This is in fact closely analogous to the method used by Department of Energy for collecting royalties. We would estimate that the legislation might be about 2 pages in length.

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cc	Chancellor of the Exchequer Chief Secretary Financial Secretary Minister of State (Lords) Sir Douglas Wass Sir Lawrence Airey Mr F Jones Mr Monck Mr Wicks	Sir William Pile Mr Dalton Mr Adams Mr Pollard (origin) Mr Boyles (2) Mr Walton Mr Whitear
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3. We estimate that if all PRT due on 1 May 1980 were paid on account, about £700m would be brought forward into 1979/80. For future years smaller amounts would be brought forward for as long as PRT receipts continue to increase.

4. The drawback to this scheme (and similar ones) is that we would have no effective sanction to enforce compliance. Unpalatably severe measures would be needed to stop the companies simply delaying this payment on account if they were so minded. Hence we have concluded that we have largely to rely on the companies' co-operation. The only inducement to prompt payment we propose is to charge interest on PRT finally assessed or determined, not covered by a payment on account. This interest, currently at 9 per cent per annum, would run from two months after the end of the chargeable period, rather than the present four months. There would be symmetrical provisions for interest on tax overpaid.

5. We think that, in the interests of good relations, it would be desirable for some advance warning to be given, preferably by Ministers. Obviously, a meeting with all potential PRT payers could hardly be arranged for Thursday morning but we suggest that at least the majors (and other potential large PRT payers - about fifteen in all) should be invited. If Ministers wish, we will arrange a meeting by telephone.

6. We understand that Treasury officials are examining the implications of a scheme such as we propose on the BP share sale - BP will be paying roughly two-thirds of the £m700 (the rest will be spread over four companies).

7. It is for consideration whether any "sweeteners" should be offered to the oil companies. The most obvious contender, and one for which the industry has pressed, is a change to the rules for "gas banking" where associated gas is produced with oil. This would be of little cost, and would be of some benefit to the companies immediately affected by these proposals except

BP. But as Ministers have yet to take decisions on any such changes, we think it would be premature to announce specific "sweetners".

... 8. A draft statement and Press Notice is attached. We would be grateful for early confirmation that the proposal is to proceed (so that we can instruct Parliamentary Counsel; and whether and for when we should arrange a meeting (see paragraph 5 above)).



Private Secretary



## ANNOUNCEMENT

1. I am not satisfied that the present arrangements for collecting petroleum revenue tax are entirely satisfactory as regards the speed with which this tax, as distinct from royalties, reaches the Exchequer. This is not a criticism of the oil industry but, rather, of the tax collection rules themselves in the Oil Taxation Act 1975. The House will appreciate that very large sums are involved and that we must ensure that PRT reaches the Exchequer with the minimum delay consistent with collection arrangements that are workable in practice. I therefore intend to bring before the House a short Bill, before the recess, containing the Government's proposals for changing the present PRT collection rules.

2. The new rules will require payment of PRT two months after the end of the chargeable period, in place of the present four months; and will apply to the chargeable periods ending on or after 31 December next. I estimate that this will result in about an extra £700m tax being received in 1979/80.

3. Further details are given in a Press Notice being issued by the Board of Inland Revenue.

SECRET

DRAFT PRESS RELEASE

COLLECTION ARRANGEMENTS FOR PETROLEUM REVENUE TAX (PRT)

The Chancellor announced today that measures would be introduced before the Christmas recess to speed the collection arrangements for PRT.

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Current collection arrangements

1. Under the provisions of the Oil Taxation Act 1975, PRT is assessed for successive chargeable periods, normally of six months and ending on 30 June and 31 December. A licensee must submit a return within two months after the end of a chargeable period. An interval of at least four months from the end of a chargeable period normally elapses before the PRT for the period becomes due for payment. Thus, PRT in respect of the chargeable period 1 July to 31 December 1979 would normally be payable on 1 May 1980.

Proposed changes

2. It is the Government's intention to speed the flow of this revenue to the Exchequer. Companies make estimated payments of royalties to the Department of Energy when they send in their Statements of Value within two months after the end of a chargeable period. These Statements are examined by that Department and adjustments made if necessary. It is intended to introduce an analogous payment-on-account system for PRT.

3. It is proposed that the licensee should calculate and make a payment on account of



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Effect on Government revenues

7. These proposals are expected to increase PRT receipts in 1979/80 by about £700m.

SIR KENNETH COUZENS

(not seen)

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Minister of State (C)  
Minister of State (L)  
Sir Douglas Wass  
Sir Lawrence Airey  
Mr Jordan-Moss  
Mr F Jones  
Mrs Hedley-Miller  
Mr Hancock  
Mr Monck  
Mr Slater  
Mr Peretz

## FORWARD OIL SALES BY BNOG

The Chancellor is at present considering whether or not to include in a package intended to reduce this year's PSBR a further £100 million worth of forward oil sales by BNOG.

2. He will want to take fully into account the likely international repercussions of announcing a step of this kind. The original announcement about forward oil sales has, as he will know, brought protests from the United States, Germany and France. The Americans have been the most vocal. The US Secretary for Energy wrote to Mr Howell in effect asking him not to go ahead with the sales. Secretary Miller telephoned the Chancellor. Other Americans have also protested.

3. The French and German protests have been in a lower key, though Count Lambsdorff did raise the matter with the Chancellor in Bonn at the end of last month.

4. If the Government were now to announce further forward sales, those who have protested to the Chancellor about what we have already done would certainly take this as a direct affront. The Americans would be especially upset, and though our Community partners' original protests were fairly muted, their second round of protests would not be. If OPEC did indeed start selling oil forward in a big way, the consequences for the world could, as Secretary Miller has said, be very damaging. The risk of OPEC doing so must be somewhat increased by a second announcement from the UK. But whether OPEC follows suit or

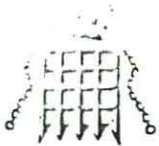
not (and it is possible to argue that if they are going to sell oil forward in a damaging way, they will do so whatever BNOC does), the immediate point is that an announcement about further BNOC forward sales would have potentially damaging effects on our relations with our major partners - the United States in particular, but also France and Germany. It could be expected to cast a cloud over the Dublin Summit, where it would certainly be quoted against us, and might have an adverse effect on our position on the much more important issues which will be at stake at the European Council.

5. The question accordingly is whether the advantage of being able to announce a further £100 million of forward oil sales will be sufficient to offset the serious potential harm to our relations with our friends and partners, and to our other interests.

6. If in the light of the foregoing, the Chancellor decides against an announcement but still wants £100 million off the PSBR, it is our understanding that BNOC could extend their negotiations with their customers so as to raise £600 million rather than the £500 million now contemplated. The fact that additional money had been raised in this way would become known in due course, but would, one would hope, attract little publicity. In that case, the damage would be less than could result if the Government were now publicly to announce the further sale and to take credit for it.

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F R BARRATT  
13 November 1979



101

Board Room  
H.M. Customs and Excise  
Kings Beam House  
Mark Lane London EC3R 7HE

SIR DOUGLAS WASS

cc Sir L Airey  
Mr Littler  
Mr Bridgeman  
Mr Lovell  
Mr H Griffiths

INTEREST CHARGE ON OUTSTANDING VAT

1. You asked for advice on a suggestion made at No.10 by Mr D Wolfson that paying and charging 9% interest on deferred VAT repayments and delayed VAT payments could improve the PSBR by about £600 million.
2. We have considered on a number of occasions the possible introduction of provisions for payments and charges of interest ... on VAT. Attached is a copy of a paper on this subject which we submitted to Treasury Ministers only last month. So far it has not been discussed with them.
3. In our view charging interest on delayed payments of VAT is unlikely to have any marked effect on the PSBR unless the rate of interest is penal - much higher than the 9% suggested by Mr Wolfson. Relevant factors are as follows:-
  - a. Special attention is already paid to firms who are very large payers of VAT. The 1,800 largest taxpayers will be paying a total of about £7,500 million a year now the 15% rate is fully effective. This represents about 50% of the gross yield of the tax or 75% of the net yield.\*

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\* VAT repayments are equivalent to about one-half of the £10,000 million full year net yield of the tax. Mr Wolfson's reference to £150 million yield per week and his comment that repayments are small in relation to payments are both inaccurate.

Currently these very large taxpayers are paying tax on average 17 days after the due date. This delay is longer than in the past, mainly due to the after effects of 14 weeks industrial action in the Spring. We hope to reduce the delay to 12 or 13 days by the end of 1979-80.

b. For practical reasons it would be necessary not to try to collect very small amounts of interest. The Government has accepted a recommendation of the Select Committee on the PCA that Inland Revenue charge interest only where it exceeds £20. However, only 12% of all traders who normally pay VAT would be liable (at 9%) to pay interest of £20 or more if every payment of VAT were to be delayed by one month beyond the due date.

c. Interest charging provisions could delay as well as speed payments of VAT. Unless there were to be no period of grace at all, the end of that period of grace would then become the normal date of payment for many traders who currently pay promptly. Furthermore, the practical need not to charge interest unless the amount involved exceeded, say, £20 would encourage small traders to delay payments even longer until the potential interest charge approached that figure.

4. Charging a penal rate of interest on outstanding VAT (comparable to the French rate of 25 per cent per month) might be effective. We assume that it would be unacceptable in the UK. We should like stronger powers to enforce earlier payment of VAT but would instead favour halving the existing 30 day period which must elapse before we can enforce an assessment issued to a trader who has failed to submit his VAT return.





5. For the reasons set out above, we have serious doubts about the effectiveness of Mr Wolfson's proposal. We will of course consider further and report in more detail if required. Needless to say legislation will be necessary.



12 November 1979

M J ELAND  
Private Secretary

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1. MR BRIDGEMAN *gub*
2. CHANCELLOR OF THE EXCHEQUER

cc Financial Secretary  
Sir D Wass  
Sir L Airey  
Mr Littler  
Mr Kitcatt  
Mr Unwin  
Mr Riley  
Mr Culpin  
Mr Pickford  
Mr Waller

Chief Cashier - B/E

THURSDAY ANNOUNCEMENT : NATIONAL SAVINGS ETC

One way of meeting the monetary target at a slightly less interest cost than otherwise would be to sell more National Savings. The major drawback is that much of the likely inflow would be at the expense of the building societies and consequently of mortgage lending.

2. The rest of this note attempts to give an initial view of the possible components of a National Savings package and their likely housing and monetary effects. Possible measures are being discussed with the Department, for National Savings and a submission and recommendations can be made tomorrow. Two points to note:-

- i. some action on National Savings may be needed to prevent outflows (especially from the National Savings Bank);
- ii. no measures actually have to be announced on Thursday in order to be brought into effect at the earliest possible date for each. The decision whether to include any National Savings component turns on whether it would add to the "impact" of Thursday's measures as whole.

National Savings

3. We conclude that if there are changes in National Savings they should include some, or all, of the following:-

- a. an increase in the interest rate on the National

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Savings Bank Investment Account (from 12½% to 14 - 14½% from 1st January).

b. an increase to £1000 or £1200 in the limit on holdings of the 15th (Retirement) Issue (in mid-December);

c. a new, aggressively priced National Savings Certificate yielding, say, 10¼% tax free for 4-5 years (on sale by mid-February).

Building Societies

4. Whatever the building societies do on interest rates, their competitive disadvantage is already so great that a National Savings package containing all the elements described above could deprive them of, say, £400 million of net inflows (i.e. almost two months worth at trend levels) and could lead to a BSA announcement, fairly soon, that given ~~their~~ present commitments in the pipeline there would be little or no mortgage finance available in, say, February or March of next year.

5. Coming to figures we would take the following view:-

i. raising the INVAC rate might produce £100 million in 1979-80 much of which would be switched from bank deposit accounts but, say, £50 million from the building societies;

ii. inflows into Granny Bonds (say £200 million in 1979-80) would come almost entirely from building societies;

iii. a new savings certificate to raise £500 million gross might cost the building societies about £200 million net inflow in 1979-80.



Monetary effects

6. All the figures in this note are extremely approximate. To assess the monetary effect of a National Savings package requires a number of difficult assumptions. However, the best guess we can make is that the money supply effect is likely to be about a third of the net inflow to national savings, and in any case is unlikely to be more than a half. If, therefore, the extra net inflow to National Savings were of the order of £700 million, the saving to £M3 might be of the order of £250 million, or  $\frac{1}{2}\%$ . To achieve the same saving to £M3 without a National Savings package might require the general level of interest rates to be about  $\frac{1}{4}\%$  higher than would be necessary with the package.

R.G.

MRS R E J GILMORE  
13 November 1979

**D**

Mr Speaker with the permission of the House I would like to make a statement on monetary policy.

The figures for banking October, published earlier this afternoon, show that  $\text{£M3}$  grew by  $\text{£1,080}$  million, or 2% in that month. The rate of growth over the 4 months since mid-June, the beginning of the present target period, has therefore been equivalent to just over 14%. Although a number of factors point to the figure for banking October being erratically high, just as that for the previous month was erratically low, it is clear that the underlying growth of  $\text{£M3}$  is still significantly above the top of the target range which I set, namely 7-11% per annum for the 10 months from mid-June 1979 to mid-June 1980.

The excess has been largely due to the sustained rapid growth of bank lending and the high PSBR in the first half of the year.

The best estimate which can be made for the PSBR for the year as a whole is that it would be  $\text{£}9\frac{1}{2}$  billion, if no action were taken, compared with the estimate of  $\text{£}8\frac{1}{4}$  billion at the time of the Budget. But the Public Sector Borrowing Requirement is still expected to be significantly lower in the second half of the financial year than it was in the first, since it will then benefit from the proceeds of asset sales, <sup>from</sup> for receipts of VAT at the higher rate and from the partial recovering by the Post Office of the arrears in collecting telephone bills. Thus monetary conditions will be



tighter on this account in the second half than in the first.

The other main factor contributing to the high rate of monetary growth is the growth of bank lending to the private sector. This has fluctuated markedly from month to month but over the last 3 months has averaged about £700 million a month. This level can be expected to fall in due course from the changes in interest rates earlier in the year [ ] and with the decline in the level of economic activity [ ], although its timing is difficult to predict.

While there are good reasons to expect that the rate of growth of the money supply will decline somewhat in the future, the Government consider that it is necessary to take action now in order to bring the growth of the money supply back within the target range. Accordingly, we will be seeking to reduce the PSBR by bringing forward by [ 2 ] months the due date for payment of petroleum revenue tax. The Bill to achieve this will be introduced shortly. This change will yield £ [ 700 ] million this year, and a further £ [ ] million next. Next year's PSBR will also benefit from some £400 million of telephone bills not collected this year.

[ ] Passage on due date for payment of taxes, if decided to announce this.

Passage on interest on unpaid tax - only worth including in the statement if there is also action on due dates.]

The Bank of England announced this morning, with my approval, that Minimum Lending Rate would be increased to [16%]. This confirms the recent rise in market interest rates which have been generated by reactions both to the domestic monetary situation, and to the general rise in interest rates in other countries, notably the United States.

The Government have been reviewing the methods which are available to the authorities for controlling the growth of the money supply. The main methods must continue to be the policies on public expenditure and tax, which together determine both the size and the composition of the PSBR, and interest rate policies, both at the short end and in the gilts market. However, successive governments have supported these methods by some more direct method of control of the banking system such as the ceilings on lending used in the 1960s or the supplementary special deposits scheme, usually referred to as the corset, which has been applied at various times since December 1973. The efficacy of the SSD scheme has diminished over time with the development of alternative channels of liquidity and credit outside the control, and it has nearly outlived its usefulness.

It would be inappropriate in present circumstances to dismantle the scheme completely. I have therefore agreed with

the Governor that the scheme should be phased out over a period rather than brought to an abrupt end: the Bank of England announced, with my approval, this morning the basis on which it would be extended for a further 6 months.

It is possible other techniques of control, possibly one of the variants of monetary base control, might have a useful role to play in the future, without having the disadvantages of the SSD scheme. The Bank and Treasury will accordingly shortly be starting technical consultations on the basis of a discussion paper with those most concerned to establish whether such a scheme is technically feasible, and whether it would have the desired effects of either smoothing the growth of the money supply, or of bringing about more readily the interest rate changes which may be necessary for monetary control. But I must stress to the House that any such scheme of monetary base control has to be thought of as a means of supplementing fiscal policy and interest rates: it is no substitute for getting those right.

Finally I intend to extend by 6 months, to mid-October next year, the period for which the present target range of 7-11% per annum for the rate of growth of  $\text{£M3}$ . That target at present applies to the 10 months from mid-June to mid-April next, and it will now apply to the 16 months from mid-June to mid-October. I am extending it in this way, because to adopt the more normal procedure of setting the target for the

Chancellor  
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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM AT THE TREASURY AT 4.30 P.M. ON MONDAY, 12TH NOVEMBER

Present:

Chancellor of the Exchequer.	Deputy Governor of the
Chief Secretary	Bank of England
Financial Secretary	Mr. Fforde
Sir Douglas Wass	Chief Cashier
Sir Kenneth Couzens	Mr. Goodhart
Mr. Littler	
Mr. Bridgeman	
Mr. Middleton	
Mr. Unwin	
Mr. Ridley	

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MONETARY SITUATION

The meeting considered the content and timing of the proposed announcement of a monetary package. The following records the main conclusions and points made in discussion.

Fiscal Measures

2. RSG. The Chancellor reported that Treasury Ministers had decided against re-opening the RSG decision, having examined the political and practical difficulties involved. The settlement should be presented as a firm and realistic one. The cash limit would not be increased.

3. Energy Measures. The Chancellor reported his discussion earlier in the day with the Secretary of State for Energy. None of the three proposals for reducing the PSBR was free from difficulty.

(a) BNOC Forward Sales of Oil. Additional forward sales would squeeze the liquidity of the oil companies, including BP; and invite further international complaint, especially from the US Administration.



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(b) Sale of Wych Farm. This seemed as elusive as ever. The Law Officers had advised that legislation would be needed. BP were unenthusiastic.

(c) Advancing of Payment of PRT. A one month advancement would yield £700 million in 1979/80. There were doubts both about the legal implications for the sale of BP shares and about the uncertain effects on confidence of tackling an excessive PSBR by adjusting the flow of Government revenue. On the first point the Financial Secretary and the Deputy Governor were inclined to discount the problem of the BP sale. The Law Officers' advice was being sought. As to the second, it was difficult to judge market reactions to a purely cash flow adjustment; but accelerating PRT could be represented as a legitimate response to a deterioration in PSBR due to delayed receipts of VAT and £400 million of Post Office telephone accounts. To ignore a prospective £1 billion PSBR overshoot would invite criticism of the Government for benign neglect. The market could be expected to show relief at the prospect of the oil companies taking a share of the additional funding requirement that would otherwise be needed. Against this, Mr. Fforde suggested that the funding benefit might be offset, perhaps significantly, by reduced holdings by the oil companies of certificates of tax deposit during the period from March to May.

(d) VAT Penalties. Customs and Excise had been asked to give urgent advice on the possibility of legislating for an interest charge on delayed payments of VAT as a means of deterring companies from retaining VAT balances in times of tight liquidity and high interest rates. If feasible, this could form useful



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support for a fiscal package, indicating the Government's resolve to check growth in PSBR.

(e) PAYE Receipts. Similarly, the Inland Revenue should be asked to consider whether more could be done to encourage prompter payment of PAYE receipts and national insurance contributions by employers.

(f) Stock Relief. The Financial Secretary mentioned the distorting effect on credit of artificially high end-year stocking by companies intended to maximise the tax advantages of the stock relief scheme. It was noted that this was a problem for longer-term consideration.

Monetary Measures

(g) SSD Scheme. After some discussion, the Chancellor decided to announce a continuation of the present 1 per cent guideline to June 1980. On the basis of the NIF, the Bank judged that this would maintain at least the same level of tightness in bank credit as recently. Despite the perceived re-entry problem of coping with offshore credit when controls were finally removed, it was not thought desirable to raise the guideline to 1½ per cent as a move to encourage re-intermediation before the SSD scheme can to an end. This would seem like a loosening of the Government's monetary control and there were presentational advantages in not disturbing the present guideline during the remaining months of the scheme. In any event, the problem of re-accommodating offshore credit could diminish if the level of bank lending came down in the next six months. The Chancellor's announcement should not include a terminal date for the SSD scheme, but should make clear the Government's intention



not to continue indefinitely with physical controls on bank lending. A further announcement could follow in the Budget statement.

(h) Roll Forward of Monetary Targets. Of the three options in paragraph 9 of Mr. Bridgeman's note of 7th November, the first was open to the objection that it failed to remove base drift from the roll-forward. It would cast doubt on the Government's determination to keep the money supply under control. The second and third options implied much the same rate of monetary growth in the coming 12 months. The third had a spurious appearance of tightness because it retained base drift but reduced the target range. On balance, the second option appeared preferable: namely 7 to 11 per cent to apply for the 16 months from mid-June 1979. This combined recognition of the slippage of monetary growth in the past 4 months with acceptance of the need to regain lost ground and achieve the announced target over the following 12 months. A 7 to 11 per cent range could represent a very considerable deceleration of the underlying rate of M3 growth if some of the Bill leak was assumed to come back into the money supply figures. Careful presentation would be required. Even a reduction in the underlying figures from 14 per cent to 7 per cent could be thought to imply continuing high interest rates for some time to come. At the technical level, the progressive widening of the target band over a 16 month period made it desirable to focus more sharply on the middle of the range once money supply came back into control.



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(i) Monetary Base Control (MBC). Mr. Fforde said there were important prior questions for Ministers before decisions on a MBC could be made. The Chancellor said both he and the Prime Minister were anxious to see consideration of this issue brought to a speedy conclusion. His statement would need to include a firm undertaking by the Government to proceed quickly to consultations on an alternative basis of monetary control, though without showing predisposition towards a particular solution.

(j) Interest on Unpaid Tax. Mr. Bridgeman reported that this would have to be raised in the light of the MLR increase.

(k) Certificates of Tax Deposit. The interest on these, although increased only a week earlier, would also need to be raised again.

(l) National Savings Certificates. The possibility of a new issue would need to be settled in the next week or two. A £600 million issue could represent 1 per cent off the money supply over 6 months; but the effects on building societies would need careful assessment. The Financial Secretary asked if an increase in the geriatric bond limit could be considered also.

(m) Gilt Sales. The Chancellor referred to the importance of restoring gilt sales in the wake of the announcement. The Deputy Governor said the Bank would be better able to judge likely market response when they saw the completed package. It was crucial to persuade the institutions that interest rates had peaked. The Chief Cashier suggested that, market conditions permitting, the



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Bank should announce a £1 billion new long dated stock maturing in 2003 for offer by tender in the usual way. The choice between an announcement on Thursday afternoon (up to 5.30 p.m.) or on Friday morning should be left for decision in the light of market reactions to the Chancellor's statement.

(n) Bank Lending. The Deputy Governor said the Bank would continue to give thought to ways of influencing the clearers. He did not think there was any particular action the Government could take to help the situation.

PSBR

4. Discussion showed no disposition to advance publication of the Industry Act forecast from 20th November to coincide with the statement. But Mr. Bridgeman thought the Chancellor should refer to the slippage in the 1979/80 PSBR, to avoid the risk to gilt sales if the information appeared a week later. The Chancellor said he was inclined to accept this advise provided he was able to include convincing references to corrective fiscal measures.

Timing of Announcement

5. It was provisionally agreed that:

(a) the Bank should announce an increase in MLR at 12.30 p.m. in the usual way;

(b) together with the continuation of a 1 per cent guideline for the SSD scheme;

(c) the Chancellor's statement at 3.30 p.m. would include



- (i) the roll-forward of the monetary targets;
- (ii) the forecast overshoot of the 1979/80 PSBR;
- (iii) relevant fiscal measures;
- (iv) reference to consultations on MBR;
- (v) any other relevant information on bank lending etc.

(d) the tone of the statement, and its subsequent presentation to the media, would need to be judged carefully to avoid appearance of crisis, whilst giving due recognition to the boldness of the measures and the Government's resolution to take necessary action to contain monetary growth.

Sterling

6. A number of references were made to the foreign exchange markets. The Chancellor recalled the agreed strategy to use intervention to support the stock shift abroad following removal of exchange controls, thereby helping the monetary aggregates. Sir Kenneth Couzens said that about £½ billion of net intervention had taken place since 23rd October; but this had naturally tailed off with the recent renewed strength of the pound. Private outflows in the same period had been about £1 billion. After a short discussion, the Chancellor confirmed that intervention policy should continue to aim to hold the pound broadly and at its present level.

Next Steps

7. A further meeting would be called on Wednesday, 14th November to consider the draft of the Chancellor's statement.



Chancellor

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A note by Mrs Gilman in case Mr Heseltine ever <sup>118</sup> al-

DRAFT BRIEF

Cabinet.

Y.H.H.

THURSDAY PACKAGE: EFFECT ON BUILDING SOCIETIES

It is impossible to predict the precise effect on the building societies except to say that including National Savings measures will both increase their immediate <sup>range</sup> ~~range~~ and further reduce the funds they have available for mortgage lending over the period for which the new instruments are on sale. A crude 'rule of thumb' is that National Savings measures designed to produce a net inflow to National Savings of £700 million could switch as much as £400 million away from the building societies (but the precise amount will depend on decisions about their own rates).

The relevant facts about building society rates are as follows:-

- i. The basic share rate was raised to 8.75% (12.5% grossed up) on 1 August 1979 and the corresponding mortgage rate - 12.5% - comes into effect on 1 January, so that the societies will have been incurring a running loss for five months;
- ii. recently inflows have held up remarkably well despite the increases in competing rates, primarily because of the October/November tax rebates which may prove to be volatile money (the societies are guarding against a pre-Christmas outflow but it may not occur if <sup>retail sales continue</sup> ~~consumers' expenditure remains~~ sluggish);

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- iii. the December Council meeting is probably too late to raise the share rate from 1 January or to alter the amount of the increase in the mortgage rate;
- iv. thus, higher rates are more likely to come in from 1 February or 1 March;
- v. the largest single increase ever made in the mortgage rate was the 2% increase recommended in October 1978;
- vi. the 12.5% mortgage rate from 1 January will be the highest ever;
- vii. signs of strain within the recommended rate system may mean that some societies will move fast and out of line with the rest - effectively breaking the cartel is one possible outcome of the present measures;
- viii. working on the rule of thumb above the societies will be deprived of about two months' inflow (at current differentials in interest rates) corresponding to at least one month's mortgage lending;
- ix. the societies' preferred position is to have the recommended share rate at about  $\frac{1}{2}\%$  above what they have traditionally regarded as the 'proxy' competitor rate - namely the three month local authority rate;
- x. but the basic share rate might not need to move by so much as this implies to restore at least part of their competitive position since term shares are sold at some 2% above the basic rate.

PS/CHANCELLOR

Chancellor

I presume the  
annual is no,  
to be consistent  
with past years

cc Mr Davies  
Mr Godfrey  
Mr Ingham - No.10

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REQUEST FROM BBC TELEVISION *Request*

Mark Rogerson has requested an interview with the Chancellor this afternoon following reports from his speech this morning which have dampened hopes of further tax cuts next year. Rogerson's approach would undoubtedly be to suggest that things were not going as well as had been expected.

I think it unlikely that the Chancellor would want to expose himself to this type of questioning at this point and I have indicated to Rogerson that I did not think he will accept. I have pointed out that there is not a great deal he could possibly add to expectations for next year's Budget.

The Chancellor will probably like to know that Denis Healey was on the World at One suggesting, among other things, that the Government should now speak to the trade unions with a view to introducing a incomes policy.

If the Chancellor decided that he did wish to accept the invitation, we could probably fit it in at Norman Shaw studios in the course of the afternoon.



B L MOWER

12 November 1979

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Sir Douglas Wass  
Sir Lawrence Airey  
Sir Fred Atkinson  
Sir Ken Couzens  
Mr Barratt  
Mr Hancock  
Mr Middleton  
Mr Unwin  
Mrs Gilmore  
Mr Riley  

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Mr Ridley  

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PS/Deputy Governor  
Mr Fforde  
Chief Cashier  
Mr Goodhart

THURSDAY ANNOUNCEMENTS

It will be necessary to decide what should be announced on Thursday, and you may find the following useful as an aide-memoire.

2. There are two fixed points:-

- i. an announcement by the Bank at 12.30pm of MLR.

This cannot be delayed - to do so would create a false market from 12.30pm for 3 hours or so, on the basis that MLR is not changing this week.

- ii. the announcement by you of the roll forward of the monetary target to the House at 3.45pm (or thereabouts).

This is very much a matter for the Government to announce to the House.

3. The question is then which of the other components of the package are announced at 12.30pm, and then commented on in the statement, and which are announced in the statement. In June 1978 a Treasury press



release was made at 12.30pm on the tax element (the National Insurance Surcharge) in order to gain the maximum market impact from having the announcement of MLR and the fiscal change at the same time. The circumstances were then somewhat different, in that the knowledge that the PSBR would be off course was public, because it is the result of amendments to the Finance Bill: this time the knowledge that the PSBR is off course is not public, although it is surmised.

4. The items to be covered on Thursday are:-

- i. MLR: must be 12.30pm;
- ii. The Roll Forward of the Target: must be 3.45pm;
- iii. Future of the SSD Scheme: the details have to go in a notice to banks, to be issued by the Bank, and covered by a Bank press notice. That notice could be at either 12.30pm (as it has been in the past over "quasi-automatic" extensions) or timed to coincide with the Chancellor's statement (as it has been in the past when it has been significantly altered). On this occasion the link to the roll forward of the target, and the fact that the scheme is to be phased out, both point to it being announced in context in the afternoon statement, with a parallel release by the Bank;
- iv. Consultation on Future Forms of Monetary Control: this again should clearly be in the statement, linked to iii.
- v. PSBR for 1979-80: it seems unavoidable that this should be included in the Industry Act forecast to be published on the 20th or thereabouts. (A PSBR figure for 1980-81 might be avoided by the announcement to have a MTEP.) There would be considerable advantage in



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referring to the 1979-80 PSBR prospect in the statement on two counts. First, it will set in context such measures as are being announced for this year. Second, it will avoid the risk of an adverse market reaction on this account when the Industry Act forecast is published in the following week, and so possibly checking gilt sales;

Rest  
of  
forecast

vi. Measures to be taken on the PSBR this year:  
• this list depends on the further work being done;

vii. RSG Percentage for 1980-81: the Chancellor will presumably not want to pre-empt Mr Heseltine's announcement of the figure the following day, but (if the figure is changed) he may want to indicate that the over-run on local authority borrowing was one of the factors which the Government had in mind in arriving at the figure.

5. The other issue on which it would be useful to have guidance before drafting is whether the announcements should be presented in a high or a low key. Clearly it is necessary to avoid descriptions of it being a second budget. But too low a key might be counter productive in leading to expectations of further measures. The emphasis should presumably be that this group of measures is of the type that will be necessary from time to time to achieve a monetary target and this represents what the Government considers to be necessary for the present purpose. (It is not the old fiscal fine tuning!) !

Conventions

J. M. B.

J M BRIDGEMAN  
12 November 1979

COVERING SECRET

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10 DOWNING STREET

From the Private Secretary

12 November 1979

CHIEF CLERK  
 12 NOV 1979  
 PS/CJ  
 PS/FJ  
 PS/MS(C)  
 PS/MS(L)  
 SIR D. WASS  
 SIR H. AIRLEY  
 SIR K. LOUGHS

Mr Tony.

MR LITTLER  
 MR MIDDLTON  
 MR BRIDGEMAN  
 MR UNWIN MERIDAY

I enclose my note of the meeting on monetary policy which followed the Prime Minister's lunch last Friday with Treasury Ministers, the Secretary of State for Trade, the Governor of the Bank of England and senior officials.

I am sending a copy of this letter and enclosure to Stuart Hampson (Department of Trade), John Beverly (Bank of England), Sir Robert Armstrong and Sir Kenneth Berrill.

ln w.

Tim Lambert.

A.M.W. Battishill, Esq.,  
 HM Treasury.



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NOTE OF A MEETING HELD AT 10 DOWNING STREET AT 1400 HOURS ON  
FRIDAY 9 NOVEMBER 1979

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Present:           The Prime Minister  
                  The Chancellor of the Exchequer  
                  The Secretary of State for Trade  
                  The Chief Secretary  
                  The Financial Secretary  
                  The Governor of the Bank of England  
                  The Chief Cashier  
                  Mr. Fforde  
                  Mr. Goodhart  
                  Sir Douglas Wass  
                  Sir Kenneth Berrill  
                  Mr. Bridgeman  
                  Mr. Middleton  
                  Mr. David Wolfson  
                  Mr. Adam Ridley  
                  Mr. Tim Lankester

The meeting had before it the Chancellor's minute of 9 November.

The Chancellor said that an increase in MLR up to 16%, or possibly over, next Thursday was inescapable. Against the background of the very bad money supply figures for October and rising market interest rates, failure to raise MLR would precipitate a crisis of confidence. It was essential to get gilt sales under way again on a substantial scale, and a sizeable increase in MLR was an essential pre-requisite for this. In addition, higher interest rates would moderate the expansion of lending to the private sector, though they could not be expected to have a big impact immediately. Ideally, interest rates ought to be accompanied by action to bring down the PSBR. The PSBR was running at a higher rate than had been forecast, and it was making the achievement of the Government's monetary targets that much more difficult. However, there could be no question of a fiscal package. The Government had only just announced its public expenditure decisions for 1980/81, and use of the regulator had to be ruled out on counter-inflationary grounds. But there were still certain possibilities for increasing revenue before the end of the financial year. One such option was to oblige the oil companies to make advance payments of PRT. Although this would require legislation, it could bring in £700 million; and it was worth considering. Speeding up the payment of VAT should also be looked at.

The Chancellor went on to say that he would need to make a statement next Thursday. Besides announcing the MLR increase, he

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/ proposed

proposed to announce the roll forward of the monetary target; on this, he would be bringing forward separately a specific proposal next week. He would also announce the intention to phase out the "corset", and he would also say that the Treasury and the Bank intended to begin consultations shortly on possible forms of monetary base control.

The Prime Minister said that the October money supply figures were far worse than she had been advised they were likely to be, when she had discussed monetary developments with the Chancellor and the Governor in September and early October. This appeared to be partly due to the fact that the borrowing requirement in October had been forecast at a much lower level than had transpired, and as a consequence the authorities had not planned on any substantial receipts from gilt sales. It was a pity that the forecast had been so badly wrong. As regards lending to the private sector, it seemed that the existing policy levers were having no effect. High interest rates seemed to be having little effect on loan demand, and existing controls on the supply of credit had proved ineffective. It was disappointing that the Treasury had been unable to come forward with any new proposals for controlling credit on the supply side.

In discussion, it was generally agreed that there was no alternative to increasing MLR to at least 16% if the money supply was to be brought under control. It was suggested that an additional measure might be to intervene in the exchange market so as to push sterling up. Against the background of bad trade figures next week, intervention in support of sterling might be necessary in any case. On the other hand, it was pointed out that supporting sterling would not necessarily improve the figures for M3. In recent months, there had been counter-balancing factors on the external side and it could not be assumed that these would not continue.

As regards lending to the private sector, it was pointed out that it was very hard for the authorities, and even the banks themselves, to bring this under control as long as the demand for credit remained high. Since industrial customers were normally borrowing within existing lines of credit, it was hard - even if they wanted to - for the banks to cut back their lending. As for

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the authorities, measures to control bank lending other than by moving interest rates simply did not work. Schemes such as the "corset", while they might have some effect on bank lending, all too easily led to credit creation outside the banking system. And with the abolition of exchange controls, the opportunities for evasion were now all the greater.

The Prime Minister asked whether there was nonetheless scope for putting pressure on the banks to reduce their lending. The Governor said that he saw the Chairmen of the Clearers every month, and he was ready to use what influence he had. But there was a risk in putting too much overt pressure upon them: if this happened, borrowers might well draw down their overdrafts against the expectation of a worsening credit situation and thus aggravate the position. The Chancellor commented that, while applauding the Government's strategy in principle, the banks did not seem to be taking the message of tight money to heart and putting it into practice.

It was further pointed out that the demand for credit was inelastic in the short run. But consideration should be given to ways of making demand more responsive to interest rate changes. One such approach would be to change the provisions for tax relief on interest payments. The Chancellor said that although changes of this kind could not be introduced until the next Finance Bill, he would consider the possibilities. The Prime Minister suggested that borrowing on credit cards would be lower if people were better aware of the high cost of interest which they were paying on them. More generally, it was argued that the demand for credit would only fall significantly when the economy moved into recession.

As regards measures to reduce the PSBR, the Prime Minister asked about the possibilities of holding back our contributions to the EEC budget. The Chancellor replied that he had had this fully examined, and it was possible to introduce some delay. There had been the possibility, for example, of delaying payment of £50 million earlier that week; but he had decided that in the

/run-up

SECRET



run-up to the European Council that would be unwise. However, this should not be ruled out for the future.

Other possibilities for action on the PSBR were mentioned. First, the Rate Support Grant for 1980/81 was still to be announced. Could it not be reduced below 61%? The Prime Minister said that she did not think it would be possible to re-open the decision which Cabinet had taken on this. Second, additional forward sales of oil - possibly £100 million - might be contemplated for 1979/80. Third, asset sales for the current financial year might be increased somewhat: for example, BGC could be directed to sell Wytch Farm. On the other hand, there was no possibility of selling further BP shares at least for another 18 months: this was effectively ruled out by the prospectus for the recent 5% sale.

The Prime Minister said that she was worried that MLR might be increased to 16%, and gilts sales would still not get under way. She was also concerned about the general psychological effect of raising interest rates still further. She thought the Treasury might be showing excessive zeal in their effort to demonstrate that they were sticking to a policy of monetary discipline. The Financial Secretary commented that, on the contrary, the MLR increase proposed was absolutely essential if the Government's monetary strategy was to have any continued credibility. The Chancellor added that the Government's attitude to interest rates was regarded as an area of weakness. The reports that we were trying to prevent the mortgage rate increase in July had been damaging. It was essential to avoid any further impression that the Government would resist interest rate increases where they were necessary. The Governor said that he was reasonably confident that, following the increase in MLR, gilts sales would start moving again. If they did not, there would indeed be a real crisis; and a fiscal package might then be unavoidable.

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As regards the Chancellor's statement on Thursday, it was argued that it was important to avoid the impression of a crisis. On the other hand, latest developments showed that the Government's decisions on public expenditure were, if anything, insufficiently tough; and it might well be necessary to reconsider the spending plans for 1980/81 in the run-up to the Budget. Reducing public expenditure was much the most effective way of bringing the money supply under control.

As for the announcement of consultations on MBC, it was pointed out that an MBC scheme would not obviate the need for interest rate increases when the demand for credit was excessive. On the contrary, such increases would be more automatic, and possibly larger, than under the present system. It was possible with MBC that interest rates would move in the wrong direction. For example, a large inflow of foreign exchange, by pushing up M3, would tend to push interest rates up automatically. By contrast, under the present system the authorities at least had some discretion to prevent this from happening. It was essential to have adequate time for consultations before any decision to introduce an MBC scheme.

In conclusion, the Prime Minister said that she reluctantly agreed that MLR should be increased to 16% next Thursday. She also agreed that the Chancellor's statement should cover the roll-forward of the monetary target, the phasing out of the "corset", and the intention to start consultations on MBC. The statement should not suggest that further expenditure cuts would now have to be considered. However, the Treasury should pursue the options for reducing the PSBR which had come up in discussion.

R.

12 November 1979

SECRET



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CHANCELLOR

cc Chief Secretary  
Sir D Wass  
Mr Bridgeman  
Mr Middleton

REFLECTIONS ON FRIDAY'S MEETING

1. Mood. We have a theoretical choice between playing down and playing up; between saying that everything is more or less on course, that we have simply had one month's freak figures, but that these do require an adjustment as was implied by our already-stated determination to adhere to monetary targets etc; or on the other hand <sup>to</sup> dramatising the situation in order to demonstrate our determination to adhere to our declared targets and root out inflation come what may, and to affect expectations favourably by the very drama of what we are doing.

I see no sense in any middle course; and if that is so, it seems to me that we are forced towards the second: I see no way in which an all-time record high MLR, higher even than in the crisis of 1976, can be presented as a routine adjustment. In which case I see no point in shrinking from sensible measures merely because they might smack of a 'second budget'.

2. The PSBR. We have to accept that the prospect is of a £1 bn overshoot this year - which, because of the peculiar profile of this year's PSBR, will become apparent before the year is out and may indeed appear even worse than is really the case. I am not too worried by the £400m phone bill shortfall, but it remains highly desirable to take fiscal action to cancel out the rest of the overshoot. The immediate announcement of legislation to advance payment of PRT by a month, which I suggested at your meeting on 7 November, and which the Revenue in their note of 9 November reckon would bring in £700m in 1979-80, looks the best bet. I would be strongly opposed, incidentally, to any further increase (to £600m) in BNOG forward oil sales, although we

should certainly ensure we get the full £500m originally planned.

One major reason for the PSBR overshoot this year is likely to be delayed payment of VAT. From soundings I have made over the weekend, substantial companies are indulging in this on a significant scale, and deliberately. It is not all that surprising: the higher the rate of interest, and the greater the amount of VAT involved, the greater the incentive to delay payment and enjoy a substantial interest-free loan. It seems clear that we must seriously consider legislating<sup>in</sup> the Finance Bill to charge interest on overdue VAT. It would be helpful to have an early decision on this, since we may wish to announce our intention to legislate in advance. In the meantime, are there any ways in which IR or Customs and Excise could or should retaliate by delaying tax refunds due to traders?

3. Bank lending. On a previous occasion I have sought official advice as to the effect of stock relief on the level of bank lending, with inconclusive results. However, anecdotal evidence is unanimous that stock relief is causing a deliberate and massive artificial build up of stocks, much of which is financed by bank lending. No company with a calendar year ending on 31 December (and there are a very large number of these) is going to run down its stocks now and thus incur a corporation tax liability: the (tax-deductible) interest rate penalty is peanuts when set against this consideration. This, too, is something we clearly cannot put right until the 1980 Finance Bill; but if we are in a position to do so there might be some gain from announcing in advance our intention to legislate then.

4. Pay. The break in inflationary expectations we are seeking has to affect all markets, of which the labour market is one. Here the only sensible direct action, which I greatly hope we will take, is to engineer a situation this winter in which we take a firm stand on a specific public sector pay claim and win.

5. Public expenditure. Clearly nothing can be done in the context of 1979-80, but 1980-81 is a different matter. The most hopeful prospect would appear to be a substantial increase in the disposals figure, via BNOC.



NIGEL LAWSON  
12 November 1979

SECRET.

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You will  
also wish to see  
Adrian's note  
below.

AD

In midst of all this,  
I forgot to say the fact!  
(M 11.30h - a buddy - f  
(inquire his new job)

Call the J.W. get some things

then to J.P. or J.H.

urgently: 2(a) is better  
the main point

- but all are with

DW has  
done this

12/11

CHANCELLOR

MONETARY MEASURES

The Governor will be in Gloucestershire at the weekend.  
His telephone number is:

Miserden 355

The code from London is 028582.

2. I suggest there are three things you might want to  
say to him in the wake of this afternoon's discussion with  
the Prime Minister:

(a) Now that Ministers are about to grasp the  
nettle and take difficult decisions on monetary  
and fiscal policy it really is up to the Bank  
to take all possible steps to ensure a successful  
and sustained funding operation over the coming  
weeks. You probably will not want to go too far  
in suggesting how this should be done, though the  
Financial Secretary's note below suggests one  
possible approach. The mechanics of the operation  
must be for the experts in the Bank to advise. But  
there can be no doubt about the objective, or the  
resolution needed to achieve it. Whether the  
objective should be quantified is a matter you  
might want to discuss.



(b) How best does the Governor think the Bank can get through to the banking system the doubts which exist about their general attitudes and resolution at present. Partly this is about bank lending, but not wholly (as I understand it).

(c) We need to press ahead very fast now with consideration of an alternative system of monetary control. Finishing touches to the papers need to be made quickly. How quickly can the Bank do their bit?

3. I have been thinking ahead a little about timing. Provisionally, we have pencilled in a meeting on Monday afternoon at which I suggest you try to reach decisions on the SSD scheme and the roll-forward of monetary targets. This will need to be followed by a minute to the Prime Minister recording your conclusions and seeking her assent to them. Now that E Committee has been cancelled there is a useful slot on Tuesday morning which I suggest we keep in reserve. You will need a meeting to consider a draft statement for Thursday and a first reading on monetary base control. These could be taken separately. At the latest, the meeting on the draft statement will need to take place by Wednesday morning, so that it can be revised and sent to the Prime Minister Wednesday night. This would then leave your Thursday morning with her to clear any final points. Even this timetable requires a completed draft to be in your box on Tuesday night.

4. There is one complication in all this: the Governor has to be in Basle throughout Monday and Tuesday morning. Subject to anything which passes between you on the telephone I have told his office that we must proceed as far as possible

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without him. He can be represented at the meetings by  
the Deputy Governor. I do not think you need persuade<sup>him</sup> to  
change his plans.

AW

(A.M.W. BATTISHILL)

9th November, 1979



CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Sir D Wass  
Mr Bridgeman  
Mr MiddletonMONETARY SITUATION

Following the decisions taken at today's meeting with the Prime Minister, I consider it essential that we do everything possible to ensure a major (and sustained) funding success in the wake of next week's announcement. Clearly, this is not the time to think of new methods of funding. But it may be necessary for the Bank to adopt slightly unorthodox market tactics - in particular, to launch a major new long tap at an unusually attractive price and on outstandingly attractive payment terms.

*SAL* Lodge

NIGEL LAWSON

9 November 1979

(Dictated by the Financial Secretary, and signed in his absence)

SECRET

10.00 AM



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NB New

bringing papers  
in.

AB

Chancellor

Monetary package

BARNETT  
LEVINE

1. The MST(C) has reminded us of his interest in PRT. He has not received any of the papers on the monetary package; but he does have a case.
2. Also there is an argument for having someone on hand from the Revenue who knows about PRT.
3. I don't think we should add unnecessarily to those going to the monetary matters. But if you were prepared

To have PRT first, we  
could reinforce the gaming  
with say, Dalton, Monex,  
and possibly Wiks; and  
then face them out. PRT(c)  
could stay on the for  
however long you wished.

ABY  
13/11





S.H.

Pepper again.

I had a fairly hectic conversation not long after returning from the meeting. His points were

- (1) Rumours are circulating that M&A has been held down because of the PM's personal intervention [Rottell said so in today's FT].
- (2) He has heard a report at 3<sup>rd</sup> hand that <sup>at lunch with Bankers this week</sup> she has been lecturing them about the ineffectiveness of increasing interest rates, and blaming the banks for pushing short rates up. This rumour is causing great anxieties at several levels. The financial world are shocked that she will be the monetary outcast but will not appear to hear of the exchange rate means. And, as she has been held in such great esteem for the most part, the sense of disillusion is all the greater. And so on.
- (3) Gordon reiterates that there is not a great deal of liquidity around, hence not a buyers' strike in the sense that there are vast sums being deliberately withheld. Funds will, of course be flowing into the institutions all the time, so the impetus to get gold sales moving is not diminished by the fact that instant rate sales are out of the question.
- (4) The gilt market needs an event. Apart from the obvious trigger

of an MLR hike, he reckons what is needed is a new issue and a lender with a somewhat lower minimum price than would be normal (in view to the state of the market). It would not be appropriate to go for a completely unrestricted lender, as one might put the fear of the almighty into jobbers, brokers etc., whatever one said to reassure them about it e.g. being a one-off event.

(5) The corset should be continued - he agrees that to remove it would be quixotic at this juncture. But it must not be allowed to bite, & create more administrative difficulties.

(6) He is indeed slow to feel the Bank ought to be heavily criticised for not having got calls cut months, & those refusing requests to reopen the "tap" [i.e. at lower prices]. In his Bulletin on Thursday he may well criticise them, and press for publication of weekly money supply stats., on the ground that, armed with them, one can put monetary trends under a more searching & frequent scrutiny & avoid massive surprises such as were just had.

You may want the FSI or others to see this.

M. 8/11



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

PRIME MINISTER

MONETARY POLICY

..... I attach a very preliminary Treasury note on possible forms of direct control over bank lending (as distinct from Monetary Base Control, which I discuss later in this minute). We have not had time to discuss it with the Bank. You may find it useful if I set it in context.

2. I think that we are faced with three issues:-

- (i) How can we best develop the system of monetary control?
- (ii) What can we do immediately to regain control over the money supply, as quickly as possible; can we, in the short run, reduce bank lending or sell more gilts?
- (iii) How can (ii) be best presented as part of a coherent package including the roll forward of the target in the next week or so?

The system of monetary control

3. This is the most important issue in the longer term. It is not the most pressing, though we may need to make some reference to the development of our thinking on this - a point which I return to below. But I should stress one key point, which came out in the earlier discussions on monetary base control. In an economy and monetary system which are as sophisticated as ours, and ones which are now open with the relaxation of exchange control, the main methods available to the Government to affect





monetary conditions are what it does to public expenditure, taxation policy, and so the PSBR; what it does through interest rates and gilt sales; and how it intervenes in the foreign exchange markets. Any attempt at more direct control just stimulates evasion, either elsewhere in the uncontrolled sector of the domestic financial markets or through offshore routes. At present changes in interest rates are partly brought about by the markets, and partly by the discretionary actions of the authorities. A monetary base system, if it were found practicable, would generate changes in interest rates more automatically and with less direct political involvement on the part of the authorities. But most people would consider that it would induce wider swings in interest rates. If such a system had been operating in the last few months, it would almost certainly have led to higher interest rates than today's.

4. The attached note on alternative methods of controlling bank lending suggests that almost any method of direct controls open to us is likely to encounter a basic difficulty. It would further stimulate the channelling of credit through other routes outside the banking system, in ways analogous to those which have already brought the SSD scheme into disrepute; all the more so because there is now the obvious additional avenue of avoidance through the Euro-sterling markets. Moreover, forcing the credit into alternative routes is apparently unlikely to alter the present upward pressure on interest rates.

What should be done in the short run?

5. It is possible that something might be gained if one could change the present general impression that credit is fairly freely available. The Governor might ask the banks to be more severe in the granting or renewal of facilities. I would welcome the Governor's view on this, although particularly at the outset I would expect the effect mainly to be on the atmosphere in markets, rather than on the monetary statistics.







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6. It seems pretty clear that the only way we are going significantly to affect the money supply figures for banking November and December is through getting the gilts market moving again. One element in this has to be the Government reasserting its determination to control the money supply, and being seen to take the necessary action to achieve this, whatever it may cost in other respects. The other has to be the Bank following this through in its gilts market operations. On the first, if we rule out fiscal action, as I think we must, then it still seems difficult to avoid action on interest rates, at the very least moving MLR to confirm the move which has already taken place in market rates. I am strongly advised that anything less than a move to 16 per cent now would be seen as the action of Canute, and call in question our resolve to adhere to our monetary targets. The second is a matter for the Governor.

7. These are, of course, two of the key questions for discussion at our meeting later today.

The announcement next Thursday.

8. As I indicated in my minute last night, the other main elements in an announcement next Thursday ought to be the roll forward of the target, and the future of the SSD scheme.

/ The





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The decision on what the amount of the roll forward should be is, I think, separable from the decision on interest rates and the SSD scheme. I would therefore suggest that we should deal with it separately later. I will put something to you on it early next week.

9. But, I think that it would be useful if we discussed the SSD scheme today. There is a good case in logic for bringing it to an end. Ways round it have now become so developed that it is having little, if any, effect on either liquidity or credit. This is obvious to all informed commentators. Moreover, there is a distinct risk that if it is continued, it will encourage disintermediation into offshore banking - the Euro-sterling market. However, the Governor and I consider that there would be an adverse reaction, particularly abroad, if we were seen to take it off tout court. We therefore recommend announcing that it is intended to phase out the SSD scheme. We would justify that domestically by explaining that, while we accepted the scheme was no longer having a significant effect on liquidity of credit, its ending would lead to the inflation of a sterling M3 statistic, by as much as 3 per cent over a period, as some of the flows which had avoided the corset came back into the banking system. We were therefore retaining it to control the speed at which these flows returned.

10. The presentation would also be helped by including in the Thursday statement our intention to begin consultations shortly on possible forms of the Monetary Base control scheme. The cognoscenti would realize that the SSD scheme, and any monetary base scheme practicable in the absence of exchange control, were not really alternatives. The latter is less a system of direct control, and more a method of generating the necessary changes in interest rates.







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Conclusion

11. The conclusion to which one is driven by the best advice so far available is that controls on bank lending, or other changes in control systems, are not going to produce the immediate improvement in monetary conditions which we need. From this there follows the need to achieve substantial gilt sales, particularly before the end of banking November (21st), if at all possible, and to sustain them thereafter. This requires the Government to do what is necessary to maintain confidence in our determination to carry our policies through: that in turn means we must accept MLR of at least 16 per cent. It must then be followed by successful operations by the Bank in the gilts market to secure the maximum sales. Clearly these are the issues on which we both want to concentrate today.

12. I am sending a copy of this to the Governor.

A handwritten signature in cursive script, appearing to read 'G.H.', with a horizontal line underneath.

Approved by the Chancellor  
and signed in his absence

(G.H.)

9 November 1979



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ALTERNATIVE METHODS OF DIRECT CONTROL OVER BANK LENDING

In assessing ways of controlling bank lending one must separate the effect on the banks and their ability and willingness to control their advances to private sector customers, and the effects on the customers' demand for bank credit.

Banks' Ability to Control Lending

2. The ability of banks to control lending is circumscribed particularly in the short run. The first reason for this is the general practice of granting facilities, which are then used at the customer's discretion. The overdraft system is the classic example of this, where a bank normally agrees with a customer an overdraft ceiling, which is subject to review, usually annually: the customer then has a virtual contractual right to use that facility at his discretion until the time of the next review. The average utilisation of such facilities normally varies between 50% and 60%, and at present is at the top end of that range. Hence there is considerable scope for an uncheckable increase in bank lending due to increased utilisation of facilities, which the banks/<sup>can</sup> do nothing to prevent in the short term. In recent years, there has been a progressive switch from overdraft to term loans, but here again the normal practice is to negotiate facilities, which can then be drawn down at the customer's discretion.

3. The main opportunity for banks to vary the scale of their lending is therefore at the time when facilities are either requested from them or renewed. As a rule these reviews are, say, once a year, which means that the opportunities they offer for changing facilities are very limited, particularly over a period of a few weeks. The scope for change is further limited in practice, because a bank may not be able to reduce its overdraft facility to most industrial customers sharply without putting them out of business. The ability to cut back on lending is probably greater in the personal sector, where there are more personal loans for particular purposes which are being run off in accordance with a pre-determined schedule.

4. Banks can influence the use which is made of facilities already granted in only two ways, short of reneging on a contractual



obligation. The first is through the interest rate which it charges. The second is to offer an alternative source of finance, and to persuade the customer to use it rather than to draw on the facility: this may well have been happening to some extent in the recent past with the growth of acceptances, and could obviously happen in the future by offering a loan in the euro-sterling market from an overseas associate.

### The Demand for Credit

5. In the longer term, the authorities can affect the demand for bank credit by the whole range of their economic policies with their effects on the level of activity, prices, or on company profits and liquidity. For example the increase in VAT will have had a once-for-all effect on company liquidity, which should have reduced the demand for bank lending. More specifically, the authorities can affect the demand through interest rates, although it is clear that certain types of lending at least are not very sensitive, particularly in the short run. For example a company facing a turn down in demand for its products may have little alternative but to build up stocks in the short run, financing it from its bank facility, although its decision about whether to maintain those stocks thereafter or cut back on production may turn on the rate of interest. The effect of interest rates on company decisions may also be muted to the extent that interest payments are a charge against profits before tax.

6. The amount of credit which is taken by the borrower may be affected by the ease with which he can obtain facilities. But, given the sophistication of the British financial system, to the extent that some channels of credit are closed, it will usually be possible to find others - here again acceptances are a clear example at present, and euro-sterling loans could be in future. It may be harder for personal sector borrowers than for companies to find alternative sources of credit.





Methods of Control by the Authoritiesa. Existing

7. The present monetary methods for controlling bank lending, as one of the counterparts of the money supply, are interest rates, the Supplementary Special Deposits Scheme and directional guidance. Interest rates, which are essentially the price of credit, tend to have their effect after a substantial lag as already mentioned. The extent of the effect varies between types of customer, and with the financial situation in which the customer finds himself.

8. The Supplementary Special Deposits Scheme (the corset) may initially have had some effect on the willingness of banks to grant facilities. In those cases where it has bitten it has also had an effect on interest rates, because of provisions in some medium term loan agreements which enable banks to pass on part of any penalties which they incur under the SSD scheme. However, it would appear that the banks have now found sufficient ways round the SSD scheme, eg through acceptances, for it to be having little effect on their willingness to grant credit, although in some cases that credit has been channelled into acceptances. So it probably affects only individual interest rates rather than their general level.

9. The directional guidance requires the banks to exercise such restraint in their lending to low priority categories (persons, property companies and loans to finance purely financial transactions), as may be necessary to ensure that the banks have sufficient funds for priority lending, such as to meet the needs for working capital of manufacturing industry. The directional guidance seems to have restrained banks' lending to persons somewhat when the corset has been on on previous occasions. However, it would appear to have had less effect this time, presumably because the banks were confident that they could channel sufficient of the demand for credit from their other customers through the acceptances and other loopholes. The banks have recently been taking some measures to constrain personal lending. But the increase in personal lending in recent months since the post-Budget



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spending boom, has been significantly less than one tenth of the total increase in bank lending outstanding. The increases in personal credit in recent months have probably been more important in fostering a general impression that there is not a squeeze on credit, than in adding greatly to the figures.





b. Other Methods of Control

i. Controls on Banks

10. There are a range of methods of control which would seek to constrain more directly than the SSD scheme the growth of bank lending within banks' balance sheets. These include:

- a. ceilings on bank lending, as used in the 1960s;
- b. penalties on lending over a guideline - eg a tax on the excess: this would in effect be a switch of the SSD scheme from banks' liabilities to a block of their assets;
- c. a reserve or liquidity ratio system, which would require bank lending to be matched by the holding of a proportion of the amount lent in specified assets, the total of which could be controlled by the authorities.

The problem with them all is that they would cause the banks to channel business outside the control, without affecting underlying liquidity and credit conditions, in the same way that has already happened with the SSD scheme. If the scope of the control were widened to cover one loophole, for example acceptances, other channels would develop, notably the inter-company market and offshore banking. These by their very nature cannot be controlled and moreover they are potentially more dangerous than acceptances, both because their extent cannot be monitored and because of the distortions they create in the domestic financial system.

ii. Moral Suasion

11. It might be possible for the Governor to reinforce his directional guidance, by specifically asking all British banks to exercise restraint in granting or renewing facilities. The main banks would undoubtedly comply with the letter of the request. But it would not stop disintermediation: the demand for credit would not be affected and the supply would undoubtedly be forthcoming for most customers from other sources, eg the inter-company market and offshore.

iii. Hire Purchase and Other Terms Controls

12. At present hire purchase terms controls still apply to cars and certain electrical goods, and banks are asked to match those terms when giving personal loans or overdrafts for the purchase of such goods. The controls probably still have some effect in relation to



expensive goods. Finance houses prefer hire purchase contracts for them because their security is better, and since banks usually know when a facility is being used for that purpose. But, particularly since the Consumer Credit Act, the range of forms of credit for smaller purchases has become so great - overdrafts, personal loans, bank credit cards, departmental credit cards, charge accounts and retailers credit generally - that any attempt to reimpose hire purchase terms controls on smaller goods could be readily evaded. Moreover the Department of Trade no longer have enforcement staff.

13. The amount of consumer credit, other than bank lending, has been growing at about £100 million a month recently - much the same as last year. This is roughly 20% pa. However, given the extent to which the banks finance house subsidiaries have been financed by acceptances recently, it is doubtful whether the tightening or extension of terms controls would have much effect on the bank lending or money supply statistics.

iv. Credit Cards

14. The money advanced on bank credit cards is within the total of bank lending to persons. It would be possible to ask them again to tighten the repayment requirements - and to abstain from further increases in credit ceilings. But it would be difficult to justify singling out this one form of personal credit (which is already relatively expensive) for special treatment.

v. Tax

15. A theoretical option for making interest rates more effective as a means of regulating demand for credit would be to tax the borrower. This could take the form of either:

a. disallowing interest - presumably above some base level - as a charge against profit in computing corporation tax liability;

or b. levying a tax on financing charges (interest etc) for consumer credit.

But both would almost certainly be complex, if they were practicable at all. It is difficult to see either being introduced very quickly, if they were thought desirable.



SECRET

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cc Financial Secretary  
PS/Secretary (No.10) (2)  
Sir D Wass  
Mr Bridgeman  
Mr Middleton

CHANCELLOR

GRIFFITHS, BURNS, ROSE AND FLEMMING

I attach a series of notes on the conversations I was instructed to arrange. That with John Flemming was of necessity very short, but the others were fairly exhaustive. In each case I managed to cover most of the chief issues but not all, partly because to have raised too many questions on my side would have been indelicate.

2. There is a clear unanimity about almost all issues, apart from gauging what has happened to money supply and why and where it will go hereafter. These are matters about which people are understandably very cautious. But this caution does not diminish the firmness of views about the need for action or the general agreement about the form it should take.

*AR*

ADAM RIDLEY  
9 November 1979

SECRET





BRIAN GRIFFITHSThe determinants of and prospects for Bank lending

It is not surprising that money supply and bank lending should be so volatile in the short term, given the many factors which affect them. But one can expect stable relationships over periods of 6 months to a year.

2. Bank lending itself, or rather its trend, will reflect the recession and high interest rates. But one cannot know precisely when.

Interest rates

3. A sharp and substantial increase now a fundamental prerequisite of monetary policy, and possibly the only thing one can do. It is all the more necessary now that Euro-sterling has become, with the abolition of exchange controls, part of the de facto money supply, since interest rates are the only way one can control it. One must err on the side of caution by acting early and boldly. To do the opposite would threaten a crisis in monetary policy.

4. An MLR increase would probably set off the gilts market, and the rate could be brought down a bit before long. Once recession had set in firmly, rates could be expected to tumble very sharply over a short period - say roughly 6 months hence.

Financial Plan

5. To take an initiative over it before the short term anxieties over trends in and policies for money supply were resolved would be doubly dangerous. It would be deemed a foolish attempt to mask those short-term difficulties. And the plan itself would be thought to be worthless since the existence of unresolved short-term difficulties would make it appear unattainable.



Monetary Base Control

6. It is vital not to have a repetition of the Competition and Credit Control fiasco. C&C took 4 months between announcement and introduction, and that process was too hasty. MBC would require more. In particular, if one were considering introducing it now, one would need to consider very carefully the role of Euro-sterling, which might otherwise cause broadly analogous problems to the discount houses in 1972/73.

Conventional Controls

7. Special deposits, Reserve Ratios, Quantitative controls and the like would all be useless, since there is an easy foreign escape route from each. All a bank need do is discreetly ask its customers to steer transactions to an overseas branch.

Gilts

8. The present system is necessarily gilt-strike prone and spasmodic in operation. Since the Bank of England cannot in the short-run know a great deal about demand, they will periodically choose to sell stock at what turns out to be the wrong price.

9. The system is wrong. Tap prices are kept still far too long, and should be changed more quickly. There is a very strong case for an **open** rather than minimum price tender when selling long-dated stock.

10. At the short end of the money markets, more assets are needed; and interest rates should change more frequently and by smaller amounts, though not of course passively. They could still be used to lead the market. This is essential to keep fund managers on their toes, create a measure of uncertainty and thus a two way market. If one decided to do this, it would be vital to warn the market in advance.

Attitudes

11. No one has woken up to the nature of the authorities' monetary

policy till very recently if at all. Both the banking system and the company sector expect or at least feel that they will be "bailed out" if things get difficult.

Exchange rate

12. If Iran or other factors promote an inflow, this could be tricky and one should consider now how one would mop it up. To the extent one cannot do so, it would be far better to endure a temporary rise in the exchange rate than take in a lot of foreign money.



TERRY BURNSRecent trends in bank lending and money supply

1. On the prospects in the Summer, and assuming no unexpected surprises, the Government's policy had seemed a little risky but not unacceptably so. An £8.4 billion PSBR and 14% MLR should have been enough to bring down the money supply growth within the target range. Now, after the event, it is not difficult to see some reasons why things have gone wrong:

- output has, up till now, been more buoyant than expected; price inflation, and expectations of its future have, too. Both will have bolstered the demand for money and boosted bank lending.
- interest rates have risen unexpectedly high and quickly overseas, thus reducing the incentive to borrow overseas and, by the same token, increasing the incentive to borrow at home;
- exchange control abolition has probably meant that domestic interest rates have to be raised by more relative to overseas to achieve a given degree of monetary stringency.

Sentiment

2. There have recently been sudden but quite unambiguous signs of a gilts strike. In the short-run this is at least in part because an increase in MLR is seen as inevitable, and no one in his right mind would buy gilts till it has happened. But in part this is because there is a growing anxiety about the incompatibility between the PSBR and the monetary targets.

PSBR

3. Published data on the CGBR cause much anxiety, and imply a 79/80 PSBR well above the FSBR projection. Burns' own anxieties on this front are now very marked too, and he suspects action is needed.

Controls?

4. Direct intervention of any kind would be undesirable, since they would just hide the problem, and would be seen to. People know exchange controls have made a nonsense of them. If there is an imbalance between revenue/expenditure and money supply, it must be dealt with directly.

5. Furthermore, anxieties about the Government's possible willingness to intensify controls are already a serious problem, and have aggravated the authorities' problems. The stories indicating a desire to restrain mortgage interest are the chief problem. The PM's recent statement at Question Time (Thursday 6) ? accepting that interest rates might have to rise after all in the New Year had not been noted generally. People are saying that just as petrol prices were the Americans' Achilles heel, mortgages were the British Governments. A positive affirmation that the Building Societies would not be interfered with is urgently needed.

Monetary Base?

6. Not desirable in a hurry whatever its merits. Memories of Competition and Credit control have become obsessive. But the issue is more fundamental. Monetary control, gilt selling and so on are only operable effectively and reliably when monetary policy is right and create very high interest rates, rationing, and distortion when they are wrong.

7. This is not to say that it would be foolish to announce some moves or other on consultation over monetary base. But that, though sensible, is no substitute for the central measures needed, particularly an early increase in interest rates.

Gilts

8. It is not easy to be objective about selling methods when respected observers and commentators - most, however, with axes to grind - bend one's ear this way and that. However, it would

seem sensible to sell gilts by tender and ensure one mopped up one's target of liquidity, month by month. To hit targets for the quantity of money you must be able to control pretty directly the PSBR and gilt sales, its two principal determinants. The present system is one in which the authorities are often fighting with one hand tied behind their backs, and in which it is thus possible for some parts of the markets to make large and easy profits out of that disability.

### Interest rates

9. There is no avoiding a sharp increase. The longer one waits the bigger the gilts strike and the larger the jump needed. One should nip the crisis in the bud hard and as fast as possible.

### What is to be done?

10. The ideal response would be:

- a sharp and early MLR hike;
- action to reduce the PSBR, ie expenditure cuts or tax increases;
- new gilts sales tactics;
- on the negative front the avoidance of evasions, in particular an unfrank Bray forecast, and the continuation of anxieties about intervention in the mortgage interest levels.

### Reducing the PSBR

11. To achieve much this year would evidently be very difficult. To make firm suggestions about how would require a proper examine of the technical and political possibilities on both expenditure and revenue.

12. But in principal one can say something about the orders of magnitude one would be aiming at. One would wish at least to get

the PSBR back to £8.4 bn this year, and may be more to allow for the fact that, if one standardised the FSBR projection for deviations between projected and actual levels of output and prices, the £8.4 bn figure would be equivalent to less in today's conditions.

13. There is a very strong case for overkill now. Timing considerations are becoming very awkward. There is a risk, if one under-reacted now, that one would be driven to an excessively violent package in, say 6 months time, just when the economy is turning down anyway. The case for "quick and hard" is reinforced by the need to be influencing wage bargaining. The present deteriorating prospect on that front is only to be expected given the effective lack of awareness of the intended tightness of monetary policy.

#### Retrospect

14. Present problems stem from Healey's errors, from late 1977 onwards. But even if they are largely his fault, the need to err on the side of caution is none the less.

HAROLD ROSE

Money and lending trends since May

A slow-down in either never seemed probable before early 1980. The Bank of England read far too much optimism into the September money supply figures. The Banks have seen no clear signs of higher Vat payments in October, which strongly implies companies are short of money, only in limited measure because of funding income tax rebates, important though that is. Of course the tax position is of little comfort, as the more that is paid back, the lower the PSBR and Government created liquidity, but the higher is demand for Bank lending ceteris paribus.

2. Barclays - and other clearers - expect lending to remain strong for months and not to slacken before 1980 Q1 or possibly even QII.

3. The determinants of the money supply are not that easy to interpret. One factor leading to high demand for money may be that industry now operates with and wants high stock levels in relation to output, since to do so is very cheap with stock-relief plus tax deductible interest (if you have profits); and industrial disruption - now chronic - dictates higher levels for obvious reasons. The surveys suggest recession is only just beginning.

Policy

4. Interest rates must clearly go up immediately. On the one hand arbitraging is already happening and will get much worse if they don't. On the other, a feeling of gilts-striking is growing fast and that demands an increase. With short interest rates so high the authorities simply look silly if they delay.

5. The PSBR is looking too high. Direct controls are no use if there is unsatisfied demand for credit. It will go offshore immediately, and while it could leave the £M3 statistic looking better, people would not be fooled for long.

6 . The Bank of England should certainly take a tougher line in its guidance. No one has any feeling of monetary policy being tough. The Bank looked like being so only briefly in the Summer, when it failed to repay special deposits in August. But it soon changed its tune. One would have expected it to take a tougher line in a variety of ways, particularly over personal credit.

7. Barclays only issued a circular to branch managers about restricting the net total of personal credit last month. Since the branches always put up excellent "special case" pleas, this guidance will not be fearfully effective in all probability.

8. The increase in house prices is as telling a sign as any of the relative slackness of credit conditions.



JOHN FLEMMINGBank lending and money supply

The underlying determinants are very difficult to disentangle. The exchange control relaxation will, for various technical reasons, make it very attractive to borrow at home and run down overseas loans while dollar interest rates are so high<sup>relative of ours</sup>, all the more so since US inflation is less than here and their exchange rate is more competitive.

Role of interest rates

2. They will certainly have a dampening effect on credit expansion. But the lags and scale will vary a lot depending on a multitude of factors. Even Milton Friedman, who used to deny they restricted credit, has now recanted and admitted they do. They should be raised immediately.
3. Ruthless pursuit of monetary targets requires ruthlessness over interest rate policy.

Gilts strategy

4. This, too, demands higher interest rates.

SECRET

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THE BOARD ROOM  
INLAND REVENUE  
SOMERSET HOUSE

9 November 1979

PRINCIPAL PRIVATE SECRETARY

POSSIBLE MEASURES TO AFFECT BANK LENDING

1. You asked over the telephone for a note for the Chancellor's meeting with the Prime Minister at lunch today. This is attached.

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

Private Secretary  
Inland Revenue

---

cc Chief Secretary  
Financial Secretary  
MST(C)  
MST(L)  
Sir D Wass  
Sir L Airey  
Sir A Rawlinson  
Mr Littler  
Mr Bridgeman  
Mr Riley

Sir William Pile  
Mr Dalton  
Mr Isaac (origin)  
Mr Gracey  
Mr Ware

SECRET

Chancellor of the Exchequer

You asked us for a quick note, before you see the Prime Minister today, on 2 possible tax measures which could discourage the growth of bank lending:

- a. Deductibility of business interest.
- b. Leasing.

Either of these measures would require new legislation.

Interest

2. The present rules allow for interest to be deducted, in exactly the same way as any other expenditure incurred in earning profits. We see no scope for changing this. If a business borrows at (say) 12%, to finance an investment which yields a net 14%, we cannot argue that the business profit exceeds 2%.
3. A highly sophisticated point arises in the context of accounting for inflation. A tax system is unduly generous, to the extent that it both gives relief for maintaining the real value of capital assets and gives full relief for interest (which, in such circumstances, commonly includes an element of capital repayment). This is /the rationale of the monetary working capital and gearing adjustments proposed by the accountants. However, this is by some distance the most difficult and contentious aspect of the whole inflation accounting debate. It is not something on which one could realistically expect legislation in the 1980 Finance Bill.

Leasing

4. We hope to submit next week the report of the working party (Revenue, Treasury, Bank of England) which has been reviewing the tax treatment of leasing.
5. It will be recommending some significant changes in the present tax rules. These will not affect leasing, to the (very important) extent to which it is currently financing industrial and commercial investment. However, it will affect other business, which is thought to be attracting tax relief of some £m250-£m500 per annum; and the recommendations will affect new business on contracts entered into after Budget Day 1980.

6. It is not easy to be sure exactly how far these recommendations would affect bank lending. The loss of tax relief would add to the cost of the present business. One could expect to see therefore some reduction in present demands for lending. In other cases people would simply switch from leasing to direct borrowing.

SIR DOUGLAS WASS

cc Chancellor ✓  
 Chief Secretary  
 Financial Secretary  
 Mr Lovell  
 Mr Ridley  
 Mr Phelps (C&E)

THE REGULATOR POWERS

You asked for an immediate note on the use of the Regulator powers. This note has been prepared with the help of Customs and Excise. If the Chancellor wishes to take this further, Customs can let him have a fuller note very quickly setting out the considerations he would need to bear in mind in respect of the various duties and the timing constraints.

2. For completeness, the note covers the use of the VAT regulator as well as the regulators applying to the excise duties. But the use of the VAT regulator would of course conflict with the undertaking the Chancellor has given not to increase the VAT rate further in the lifetime of the present Government.

Timing Constraints

3. The main timing constraint applies to the use of the VAT regulator where Customs and Excise normally require seven days' notice for advance preparation. Customs would also prefer seven days' notice if the excise duty regulators are to be used, but could undertake a special exercise at less than 48 hours' notice, though such an increase would inevitably be rough at the edges and a slightly longer period of notice would be preferable. It is desirable that a VAT change should come into effect on a Monday so as to give traders a weekend in which to re-price.

4. A possible timetable might be: -

Wednesday 21 November	:	Final decision
Wednesday 28 November	:	Announcement and implementation of oil and drink package

.../

Monday 3 December : Implementation of tobacco  
and VAT increases

The short notice given of the VAT change in the last Budget gave rise to strong criticism, however, and a slightly longer period of notice might be preferable.

#### Scope of the powers

5. There are three regulators: one applying to the duties on drink, petrol, derv and rebated oil; one to the duty on tobacco; and one to VAT. The regulators may be activated separately or together and some selectivity is possible within each of them. Full use of the excise duties regulators would permit the immediate raising of the duties on tobacco, drink and oil by 10 per cent. Full use of the VAT regulator would permit the immediate raising of the rate by 25 per cent, ie. from 15 per cent to  $18\frac{3}{4}$  per cent. There are, however, two points to be noted. First, the TPD regulator, if applied to the full extent, would have an effect substantially larger than 10 per cent, because of the interaction between the specific and ad valorem elements. Secondly, if the VAT regulator were used in addition to the other regulators, there would again be a cumulative effect.

#### Procedure

6. Orders under the Economic Regulator powers can have immediate effect but all three regulators are subject, in the case of an increase, to affirmative resolution procedure. The VAT and tobacco regulators require Commons approval within 28 sitting days while an order under the main Economic Regulator (covering drink and oil) requires approval within 21 calendar days.

7. The powers covered by the Economic Regulator have to be renewed annually and would otherwise expire on 31 August. When it has been used, it has been standing practice to consolidate any surcharge (or rebate) into substantive rates in the next Budget and to renew the Regulator power so as to "free" it for



further use. The Regulator was last used for the alcoholic drinks duties (but not for oil) in December 1976 and the consequent increases in duty were consolidated in the Finance Act 1977. Unlike the Economic Regulator, the VAT and tobacco Regulator powers are not subject to annual renewal but Orders made under them remain in force for only one year unless further Orders are made. The tobacco products duty Regulator was used along with the Economic Regulator in December 1976, with consolidation of the increases in duty again in the Finance Act 1977. The VAT Regulator powers were last used in July 1974, to achieve a reduction in the standard rate of VAT from 10 per cent to 8 per cent. This was consolidated in the autumn Finance Bill, subsequently enacted as the Finance Act 1975.

#### Economic Effects

8. The full-year revenue, 1979/80 PSBR and RPI effects of the use of the regulators<sup>from 1 December 1979</sup> are summarised in the table below.

	Full Year Revenue Yield	PSBR (1979/80)	RPI
Tobacco (full regulator)	225	-50	0.4
Drink (+10%)	150	-40	0.2
Oil (+10%)	300	-95	0.2
	—	—	—
Total Duties	675	-185	0.8
	—	—	—
VAT (+3.75% points)*	2250	-70	1.9

\*Including consequential receipts from increased ad valorem duty on tobacco.

9. There is a time-lag in the collection of VAT revenue so that there would be little effect on the PSBR in the financial year 1979/80. On the other hand company liquidity improves temporarily in the first three months after the increase as companies build up their VAT receipts and this could lead to some reduction in bank borrowing.

Price Increases

10. The effects of the full use of the excise duty regulators would be to put about 6p on the price of a packet of 20 cigarettes, almost 1p on a pint of beer, an average of 6p on a bottle of EEC wine, 36½p on a bottle of spirits and 4.2p on a gallon of road fuel. An increase in the rate of VAT from 15 to 18¾ per cent would add nearly £100 to the price of a £3000 car.



H M GRIFFITHS  
FP2  
9 November 1979

VLS  
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PRIME MINISTER

As you suggested, Adam Ridley has seen Brian Griffiths, Harold Rose, Terry Burns and John Flemming. Their views are very much one of a kind. Briefly:

- (1) It is essential to move fast and increase MLR to at least 16%. M3 for November must be "good", and the only way of being certain of achieving this is to sell a large quantity of gilts. There is a general feeling that there is a "gilts strike" at present. No one will buy unless MLR goes up. ✓
- (2) It is almost impossible to control Bank lending to the private sector and the supply side - i.e. direct controls such as tightening reserve asset ratios, the SSD scheme and "moral suasion" won't work. Bank lending will only be certain to come down when activity weakens and we have high interest rates - though interest rates will not have an immediate effect. ~~AD~~
- (3) Nonetheless, the Governor should call the clearers in and try to get them to reduce lending. This could reduce the published figures for lending, though other ways of getting finance (e.g. acceptances and borrowing from branches abroad or from American banks) are likely to take its place. ←
- (4) There is no point in having a medium-term financial plan when the Markets are dubious about our ability to stay within the existing target. ✓
- (5) If we were to change to monetary based control, there should be plenty of time for consultation. Only four months consultation was allowed for Competition and Credit, and this was not enough. ←

CHANCELLOR

cc Sir D Wass

THE MEETING

I suggest the overwhelming priority is to avoid bad MS figures next month. To that end you might want to pursue:

1. MLR up.
2. Achieve gilt sales. Case for new tactics, if only exceptionally  
*for commission*
3. Avoid a harmful Bray forecast. Dilemma here, as to publish PSBR forecasts for this year and next which are bad would be harmful in one way, not to publish at all might be equally harmful in another.
4. For consideration: action to reduce PSBR; who to consider what when? Prudent to initiate contingency planning now?  
*← PA7  
← CASH flow*
5. Announcement of MBC desirable; but it must strike "juste milieu", and avoid appearing panicky, or involving too quick a timetable.  
*+ SSD  
+ ROLL-FORWARD*
6. Attitudes to money supply control need to be toughened - implying a vigorous approach by Bank to clearers, and by them to the system.
7. Possibly consider presentation over next week or so. Anything to note over and above Thursday's statement? [NB. There is a speech engagement on Friday night, set aside for oration on monetary policy.] eg include remarks about mortgages?

INCC M.I. NEXT MONTH  
- 1 -



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8. Possibly consider contingency planning for an inflow of foreign currency induced by IRAN etc.
2. Decisions on almost anything else are likely to be either undesirable or irrelevant.
3. The key points made by my interviewees are summarised in the attachment.

ADAM RIDLEY  
9th November 1979

(6) To be sure of selling sufficient gilts over the next month, there should be a tender - i.e. no minimum price.

(7) More generally, the credibility of the Government for years is at risk if adequate action is not taken now. There is a feeling that we are dithering, and unwilling to take unpleasant consequences of sticking to tight monetary targets. (Apparently this stems partly from the feeling that we were prepared to interfere with the mortgage rate: there needs to be a positive affirmation that we are not going to - though we virtually said this in the House the other day.) Terry Burns says that our fiscal stance is too lax, and in theory would like a fiscal package but he understands the political difficulties.

T. P. LANKESTER

9 November 1979



SUMMARY OF KEY POINTS FROM FOUR INTERVIEWS

Prospects: uncertain; but policy conclusions clear, indeed that very uncertainly makes the need for and desirable nature of action clearer.

General Policy: act early, and err on side of caution. Overkill later would coincide very damagingly with recessionary downturn.

MLR: up quickly to at least 16%, to break gilts strike.

Gilts: must be sold quickly and strike must be broken. Strong call seen for new tactics at this moment, in particular tendering long gilts without a minimum price.

Bank lending: difficult to control in short run and could well continue very strong for months more. But atmosphere of urgency needed quickly, both to infect banking system, its industrial customers and ordinary people. Is interest sensitive.

Forecasts: Bray must not be fudged, in particular perhaps PSBR for 79/80, 80/81.

Mortgages: positive affirmation needed that interest rate will not be interfered with.

Financial Plan: no use until short-term policy is under control.

Monetary Base: sensible to announce consultation. But vital that timescale is realistic, and announcement is not seen as a way of making short-term difficulties and evading the policy changes they demand.

PSBR: case for action to bring back in line, if possible in time to affect 79/80.

Controls: more or less unanimous feeling that corset, special deposits, reserve ratio changes and so on irrelevant at least, and probably damaging. Exchange control has undermined them all. The primary blame should not be put on the control system if PSBR and money supply are out of kilter.

Other ideas?: no enthusiasm revealed for other innovations, such as taxes. Clear feeling that if you want to control the quantity of money, then you have to be realistic about allowing the price to vary. [A difficult issue for ANR to explore really fully, however, as to push too hard implied panic.]

cc: Chief Secretary  
Financial Secretary  
Sir Lawrence Airey

1 Sir Douglas Wass

2 Chancellor of the Exchequer

Mr Bridgeman  
Mr Middleton  
Mr Unwin  
Mr Ridley

NATIONALISED INDUSTRY BORROWING & SALES OF ASSETS & PRT

Post Office

The Post Office is doing all it can to recover the lost revenue caused by the telephone billing dispute: the loss will be reduced to about £400 million by the end of the financial year compared with a peak of about £1 billion.

BNOC & Forward Oil Sales

2. It would be possible for BNOC to get an extra £100 million from forward sales this year. This would raise the total to £600 million, compared with the published figure of £400-500 million. It would add to the unwinding problem in later years and might be criticised by the Americans and others who are accusing the UK of leading oil prices up.

3. BNOC's finances will gain from the price increase this month but we cannot quantify this and there will be offsets in higher costs for other nationalised industries.

Asset Sales

4. BP would like to buy the Gas Corporation's interests in Wytch Farm (£100 million) and the BNOC interests in the North Sea. In both cases a reversal of the collective Ministerial decisions would be required and in the case of BNOC/reversal would be public. In both cases it is uncertain how soon negotiations and payments could be completed i.e. whether the money would help this year's PSBR. Wytch Farm is the best chance but Sir Denis Rooke's <sup>protests</sup> ~~process~~ would have to be beaten down.

Advancing PRT Receipts

5. Like forward oil sales, this might not help the banking figures. But the attached note by the Revenue says it might be possible to bring forward about £700 million into 1979/80. This would require legislation. The Revenue say the companies could thwart this by accepting the interest penalties for delaying interest payments by the one critical month which would bring them into 1980/81. But they do not think this very likely because the companies are likely to be embarrassed by their profits for 1979/80. The Revenue point out that advancing payments <sup>might</sup> ~~would be~~ at the expense of increasing the PRT rate in the 1980 Finance Bill. They cannot quantify the potential sacrifice now but should be able to do so in about 10 days' time on specified assumptions about the forthcoming OPEC decisions.

\* For BNOC assets it is virtually certain that it could not be done in time. There would ~~probably~~ also be <sup>large</sup> revenue losses to the PSBR in later years

*NM*  
N MONCK  
9 November 1979

MR JONES (HM TREASURY)

ADVANCING OF PRT RECEIPTS

1. You asked for a note on advancing PRT receipts from 1980/81 to 1979/80 on the assumption that legislation could be introduced in time.

How PRT receipts might be advanced

2. We have looked at a number of ways of advancing payments of PRT. (They are set out in the draft paper sent to Treasury PE Division and Department of Energy PP Division for comment yesterday.) The recommended method is to require the licensee to calculate and make a payment on account of his PRT liability, at the time he submits his return for the chargeable period, 2 months after the end of that chargeable period. Thus the payments on account would be due on March 1 and September 1 (whereas assessed PRT is due on May 1 and November 1). The payment would be based on the gross revenues, valuations and royalties shown in the return, expenditure claimed but not so far allowed, and allowances (such as oil allowance and safeguard) as provided by existing legislation. This is in fact closely analogous to the method adopted for royalties, which Department of Energy think works well (though expenditure reliefs are of less importance for royalties, there are detailed procedures for calculating such reliefs, and there are no other allowances involved).

Legislation in 1979/80

3. The drawback to the scheme is that we would have no effective sanction to enforce compliance. The companies could thwart the scheme simply by delaying their payment on account until the assessed PRT was due (in the new financial year). We could charge interest on the payment on account due and not paid (at 9 per cent per annum or a higher figure) - but for 6 to 8 weeks this might not be much of a penalty - certainly not an adequate recompense for not getting the money in 1979/80. Thus to some extent (and this applies to all the schemes we have examined) we would have to look to the companies for co-operation. This points to Ministers making an announcement, when legislation on advancing receipts was introduced, that certain concessions which the industry have been pressing for (in relation to gas) would be introduced in the 1980 Finance Bill.

Amount involved

4. We estimate that if the payments on account due on 1 March 1980 were made, about £700m would be brought forward into 1979/80. For future years there would be smaller amounts brought forward for as long as PRT receipts continue to increase.

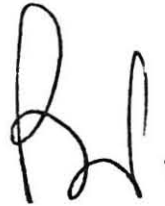
5. If we are to proceed with this the Bill should I think be

introduced before Christmas - after a reply to an arranged PQ that the Chancellor is not satisfied with the present collection arrangements for PRT.

General

6. Two final points. First, it should be borne in mind that going ahead will mean that if the PRT rate is going to be increased in the Finance Bill 1980 (and though we cannot yet be positive it does seem that there might be scope for this) we will have had three separate stabs at the oil companies in the space of 12 months (which the companies of course would say amounted to a Government vendetta against them). Proceeding with this proposal in 1979/80 therefore might be at the expense of having a PRT rate increase in the Finance Bill 1980. Second (and this is of course a matter for your judgement rather than ours) to introduce new PRT collection arrangements in 1979/80 by a special bill is so transparently a device to cut the 1979/80 PSBR as to look almost like a panic measure.

7. Mr Dalton has seen this note.



B POLLARD

9 November 1979



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NOTE OF A MEETING HELD IN THE TREASURY AT 4.30 P.M. ON  
WEDNESDAY, 7TH NOVEMBER, 1979

Present:

- |                               |                         |
|-------------------------------|-------------------------|
| Chancellor of the Exchequer ✓ | Governor of the Bank of |
| Chief Secretary               | England                 |
| Financial Secretary           | Mr. McMahon             |
| Sir Douglas Wass              | Mr. Page                |
| Sir Lawrence Airey            | Mr. Goodhart            |
| Sir Kenneth Couzens           |                         |
| Mr. Middleton                 |                         |
| Mr. Bridgeman                 |                         |
| Mr. Unwin                     |                         |

MONETARY SITUATION

The meeting resumed the discussion which had taken place at 10.45 a.m. on Monday, 5th November in a smaller group.

General Situation

2. The following main elements in the monetary situation were acknowledged in the course of a general discussion of the short-term outlook:

(a) PSBR This had deteriorated. The central forecast was now for a PSBR for 1979/80 around £9¼ billion compared with the £8.3 billion estimate at the time of the Budget. Although the best central estimate, some thought the risk of exceeding that figure greater than that of falling short. The latest NIF range was £9-9½ billion. The unadjusted CGBR for end of December could be as high as £9 billion, on the optimistic assumption that the current VAT shortfall is by then recouped.





(b) Bank lending could well not fall from its present high level until some time into the New Year, depending on the onset of the recession. The level of bank lending had dropped from the £1100/£1200 million a month in the summer to somewhere around £800 million currently; but this was still some way from the £600 million figure earlier forecast. With the present buoyancy of incomes bank lending might even increase slightly in the initial stages of the downturn.

(c) Money Supply. At more than 14 per cent the annualised rate was running well above the target range, and was not expected to come below 13 per cent on present policies by the end of January; allowing for disintermediation this latter figure might well represent a true underlying growth of 17 per cent. In forecasting the short-term outlook it was assumed that short and long interest rates would remain at about their present level, with MLR rising to validate the present market rate structure. With inflationary expectations, the outlook for 1980/81 was not encouraging, but would depend on the Budget.

(d) Causes of the deterioration. On the one hand, it was argued that underlying economic conditions had not changed greatly in recent weeks, and that current figures simply reflected better information. The PSBR deterioration reflected changes over a wide front: higher local authority and public corporation borrowing; slower accrual of revenues; and reduced expectation of public expenditure shortfall. On the other hand, internationally economic



activity was holding up longer than expected; inflationary pressures had increased; and overseas interest rates had risen sharply. Whatever the extent of changes in the underlying factors the risks in the present situation had increased.

#### Timing Considerations

3. The Chancellor asked how long decisions on the SSD scheme and the roll-over of monetary targets could be prudently delayed. The Chief Cashier thought that the clearers needed to know the future of the corset at latest by end November, since by the November makeup day they would need to be looking forward also to the January make-up. There was also an expectation that the Government would roll-forward the monetary targets within the same timescale, though this was theoretically the most detachable part of the package. A 15th November announcement, when the October money supply figures were published, was the obvious choice, though a further week's delay would not be serious.

4. The meeting noted that there were clear presentational advantages in associating an MLR change with a monetary package which included the roll-forward and an announcement about the future of the SSD scheme. Separation of the various elements risked loss of impact, and increased the risk of market uncertainty and the danger of further interest moves later. Against that, a week's delay was bound to involve its own risks. The Governor said that if action was taken this week, he would have to advise that MLR should move to 16 per cent. There was bound to be some risk that the figure would need to be higher in a week's time. This was not so much a direct consequence of not moving this week as the danger that some unforeseen piece of news might unsettle both the domestic and foreign exchange markets. Sterling was particularly vulnerable to some piece of unexpected news which



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could reverse the temporary renewed strength of the pound because of Middle East oil developments. Nevertheless, the strength of sterling helped to justify waiting another week, though Mr. McMahon thought it might shade a little if MLR was not increased the following day.

#### Funding

5. The Chancellor asked about the prospects for renewed funding once MLR had been increased. He and the Financial Secretary urged the Bank to examine all possibilities for getting gilts sales moving again. A policy of aggressive selling would be needed. The Governor said that funding prospects depended critically on reasserting market confidence in the Government's ability and determination to control the situation. The Chief Cashier said there was no way of selling gilts in present circumstances until some other decisive action was taken. However, even if MLR was delayed a further week, two weeks of banking November would still remain in which, if conditions were right, large amounts of gilts could be sold. The Bank had a fair amount of stock available. Very little long dated stock had been sold since September and the institutions were likely to be fairly liquid. The main counter-factor was the risk of growing market perception of the underlying PSBR situation. Publication of unseasonal CGBR figures on Friday could begin to spark such a perception.

#### Fiscal Action

6. A number of points were made:

(a) PRT. The Financial Secretary had gained the impression from BP that advancing payment of PRT might not be wholly out of the question in present circumstances; others, however, doubted the oil companies' readiness to accept further calls on their liquidity. BP might have been suggesting advancing PRT payment as a better alternative to forward sales of oil.

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(b) Forward Oil Sales. Sir Lawrence Airey mentioned that proposed BNOG forward oil sales were £100 million less than the oil theoretically available for such treatment - £600 million as against intended sales of £500 million. Knowledge of this difference had been obtained in strict confidence, and he would not wish it to be disclosed.

(c) The Regulator. Any decision to use the regulator would need to be taken quickly if it were to catch Christmas sales. But, since there was no question of applying the regulator to VAT, the maximum additional yield this year was unlikely to exceed £300 million, rather less in terms of PSBR effect. This was not an attractive option.

More generally, the Prime Minister's opposition to anything which approached a second Budget seemed to rule out the possibility of any early effective fiscal action.

#### The SSD Scheme

7. Discussion recognised that there were serious weaknesses to the present SSD scheme, exacerbated by the ending of exchange control. It did not stop leakages through offshore banking. The logical case for bringing the scheme to an end was strong. Nevertheless, there was equal recognition of the presentational difficulty of removing existing controls, in advance of considering the possibilities of an alternative monetary base system. Both the Governor and Sir Douglas Wass felt that it would be right to continue the present imperfect system for a further unspecified period. Removal of the corset so soon after ending exchange controls would put an unacceptably heavy weight of control on interest rates alone. Sir Kenneth Couzens thought it would be better to avoid bringing the corset to an end at a time when the Government was having to take action on MLR to correct an already difficult monetary situation.



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Conclusions

8. The Chief Secretary, who had to leave shortly before the end of the meeting, was inclined to favour increasing MLR the following day, unless the presentational advantages of a complete monetary package the following week were judged to be decisive.

9. The Chancellor, summing up, said that the choice of timing was an extremely difficult one. Nevertheless, on balance, the general view seemed to be in favour of waiting a week before increasing MLR. In present market conditions, the recommended increase would be to 16 per cent. He recognised the risks involved in deferring action a further 7 days, but they had concluded that it was not practicable to contemplate announcing a total package the following day. That being so, given the present breathing space provided by the strength of sterling, he judged that the presentational advantages of waiting a further week outweighed the additional risks involved. There was a presumption that the announcement on 15th November would also include continuation of the SSD scheme, together with the roll-forward of the monetary targets. Reluctantly, they had been forced to conclude that no appropriate fiscal action was available to be taken on a sufficient scale. Assuming that the Prime Minister agreed with this assessment, every effort should be made to try to find ways of influencing the monetary figures for banking-November, and of mounting a vigorous and effective funding programme over the coming weeks. A repeat of bad monetary figures in November would face the Government with a very serious situation. Lastly, the programme for considering a system of monetary base control should be accelerated with a view to starting the process of public consultation with the minimum of delay. A draft minute should be prepared so that he could inform the Prime Minister of their conclusions that evening.

*AW*  
(A.M.W. BATTISHILL)  
8th November, 1979



Circulation

Those present

Mr. Littler

Mr. Ridley





182  
a

Chancellor

put  
copy  
with  
PARSONS  
12/1  
20/11/1  
7/16

for approval before  
I commit press.

I have tried to pin up  
the press on

- (1) need for aggressive selling  
of gilts
- (2) need to improve November  
figures.

I don't think there is any  
chance for mentioning H.P. etc. which was  
not discussed: it will be on board  
now anyway.

As for intervention to keep  
it up and let it down - I think ✓

The answer is that we did  
interview himing last week  
when the  $k$  came under  
pressure, but we can't  
go on doing so when the  
 $k$  is rising of its own  
accord.

AM



10 DOWNING STREET

From the Private Secretary

(A9) 183

CHIEF SECRETARY  
NOV 1979  
PS/CST copy sent 8/11  
PS/FST  
SIR D. WASS  
SIR L. AIREY  
SIR K. COUZENS  
MR LITTLER  
8 November 1979  
MR BRIDGEMAN  
MR MIDDLETON  
MR UNWIN  
MR RIDLEY

Dear Tom,

When they met this morning, the Prime Minister and the Chancellor of the Exchequer discussed latest monetary developments. They had before them the Chancellor's minute of 7 November.

The Prime Minister said that she was not convinced that a further increase in MLR next week would bring the money supply under control. It would also, of course, create political problems. It seemed to her that existing policy levers were no longer working; in particular, an increase in interest rates of even several percentage points was unlikely to choke off lending to the private sector. Her own impression was that the demand for credit was continuing at a very high level, and that the banks were all too willing to provide it. There was the further difficulty that any increase in interest rates would tend to put upward pressure on the exchange rate; and with its worsening liquidity position, this could cause problems for industry.

The Prime Minister went on to say that alternative ways of bringing credit creation to the private sector under control should be examined with the utmost urgency. She understood that the work on monetary base control was still proceeding; this should be speeded up. Other possibilities, such as putting direct pressure on the banks, tightening their reserve asset ratios and even imposing higher taxes on their profits, should be examined. It was essential, in her view, to devise new measures of control - preferably as a substitute for a further rise in interest rates.

The Chancellor said that he too was most unhappy at the prospect of having to raise MLR. But he did not think there was any alternative. On the other hand, he shared the Prime Minister's concern about the inadequacy of the existing policy levers, and had asked that alternatives should be examined. If there were to be any changes on the existing set up, it was important that decisions should be reached in a considered manner; otherwise, there was the risk that we would move in the wrong direction. Logically, there was a case for abolishing the "corset" forthwith since it was now largely ineffective; but there were practical and political arguments for keeping it in place until an alternative system had been devised. The Chancellor went on to say that the major priority must be to make sure that next month's figures were much improved, and he agreed therefore that urgency was of the essence.

/ Turning

SECRET

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Turning to the borrowing requirement for this year, the Prime Minister said that renewed efforts must be made to reduce it. She agreed with the Chancellor that a new fiscal package should be ruled out; but there was a case for going harder on sales of assets, and also for reducing the borrowing of the nationalised industries. As regards the latter, she wondered whether new steps could not be taken to recover some of the lost revenue caused by the telephone billing dispute: could not subscribers be given a small discount on their bills if they paid early? The Chancellor commented that on practical grounds, he did not think assets sales could be pursued much further during the current financial year; and in any case, any further sales would not be all that helpful for the money supply because they would be - to some extent - substitutes for sales of gilts.

In conclusion, the Prime Minister re-emphasised that alternative options to a further increase in MLR should be examined very urgently. She would meet the Chancellor, the Chief Secretary, the Financial Secretary, the Secretary of State for Trade, the Governor and senior officials tomorrow to discuss the position further.

I am sending a copy of this letter to John Beverly (Bank of England). I will also be giving a copy of this letter personally to the Secretary of State for Trade.

*Law* *ev.*

*The Labour.*

A.M.W. Battishill, Esq.,  
H.M. Treasury.

SECRET



U R View

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11 DOWNING STREET  
WHITEHALL, S.W.1

A.B.

Some [further] thoughts which shed  
further (probably best) in note of last  
night's meeting with Gov.

- ① Did we discuss or refer enough note  
of the positive system (made at time of  
(+ some - but what!) → E.C. decision) in favour of intervention  
to keep £ up + £143 down?
- ② How Bank really sees a board one  
with (I say, + mins certainly) for actively  
selling bills, finding / making ways of  
doing so
- ③ Ditto ~~the~~ - & not just the bank - we  
need to look every way of improving  
next month's figures

(4) No body mentioned - but I have been  
thought just worthwhile to ask about -  
the possible role of changes in the  
regime of control for NP deficits,  
Wages etc. I know the  
arguments against, but are they - in these  
circumstances - less than desirable?

(5) Now the need to design - for  
delivery, when? on the weekend?  
Set a date, when I see the CPC  
conference is wanted - a better +  
more broadly detailed version of the  
Hansard report (including other  
than him: BU, M.B, P.M, D.W, K.C)

2/3 pages  
Pubs & printing  
Chosen

✓



chi 186



cc Mr. Ridley

A large, handwritten pink squiggle or mark on the right side of the page.

CHANCELLOR  
CHIEF SECRETARY  
FINANCIAL SECRETARY  
SIR DOUGLAS WASS  
MR. MIDDLETON  
MR. BRIDGEMAN  
PS/GOVERNOR

MONETARY POLICY

Tim Lankester reported this morning's meeting between the Prime Minister and the Chancellor. The decision to take no action today was not discussed, and the Prime Minister's agreement can be assumed.

2. The Prime Minister was, however, profoundly unhappy with developments. She thinks it is quite clear that the "old levers" (i.e. interest rates) are not working, and that new levers will have to be devised. The purpose of the lunch is to consider all the options. The Prime Minister would be grateful if work could be set in hand on this with the utmost urgency, so that the possibilities can be set out on paper in time for tomorrow's lunch, which will be followed by a working session (I am trying to find out how long this is likely to last). She has herself mentioned various possibilities, e.g. controlling credit and hire purchase; imposing a tax on the banks; introducing penalties for excessive lending; imposing liquidity ratios etc. etc.



But no sensible option should be regarded as out of court.

3. Finally, Tim Lankester warned me that it should be by no means taken for granted that the Prime Minister will go along with decisions proposed for next week.

4. The Governor is invited to suggest a maximum of 3 colleagues from the Bank of England to support him at lunch. *Mr. Nott has also been invited.*

*M.A.H.*

(M.A. HALL)

8th November, 1979



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PS/CHIEF SECRETARY

~~PS/Chancellor~~  
PS/Minister of State C  
PS/Minister of State L  
Sir D Wass  
COGPEC  
Miss Peirson  
Mr Ridley  
Mr Cardona

PUBLIC EXPENDITURE 1981-82 - 1983-84: C(79)54

The Financial Secretary has read Miss Peirson's minute of 7 November, briefing on this paper.

The Financial Secretary has not yet seen C(79)54; but paragraph 4 of this brief would, in his view, appear gravely inadequate in the light of Mr Bailey's minute of 6 November.

SAL

S A J LOCKE

8 November 1979

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FINANCIAL SECRETARY

cc Chancellor of Exchequer  
 Chief Secretary  
 Minister of State (C)  
 Minister of State (L)  
 Sir Douglas Wass  
 Sir Anthony Rawlinson  
 Sir Lawrence Airey  
 Sir Fred Atkinson  
 Mr Anson  
 Mr F Jones  
 Miss Brown  
 Mr F E R Butler  
 Mr Cassell  
 Mr Dixon  
 Miss Forsyth  
 Mr Hansford  
 Mrs Hedley-Miller  
 Mr Kemp  
 Mr Kitcatt  
 Mr Lavelle  
 Mr Monck  
 Mr Unwin  
 Mr Widdup  
 Miss Peirson  
 Mr Burr  
 GECS  
 Mr Ridley  
 Mr Cardona

PUBLIC EXPENDITURE - LATER YEARS

It may be helpful to offer some quick comments on your minute of yesterday to the Chief Secretary.

2. It was as you say made clear from the outset that any failure to achieve the original Treasury objective in C(79)11 (a phased return to the 1977-78 level of spending by 1982-83) would increase the risk that tax increases would be needed in the next two Budgets. The Chief Economic Adviser's minute covering the Medium-Term Assessment in June concluded that:

"It seems likely that the levels of public expenditure implied in C(79)11 would leave no room for tax cuts in the 1980 and 1981 Budgets. Indeed, even on what must be regarded as extremely favourable assumptions about sales of assets and savings in social security the implication is that taxes may have to rise in these years if the objective of bringing down the PSBR and money supply is to be met."

The first sentence of this was repeated in the Chancellor's July paper to Cabinet on the consequences of failing to achieve the full cuts (C(79)30).

3. It was also made clear that the prospects of securing all these cuts in full were not good, in the view of Treasury officials. You will recall that Mr Butler's minute of 2 August which submitted the proposals for the later years said:

"Cabinet are very unlikely to accept the reductions in full. They are put forward as realistic, but there is always some bargaining, and, where considered necessary, the figures allow for that. To the extent that the Cabinet are unwilling to adopt reductions on these lines, the outcome will fall short of the objective of getting the plans back to the 1977-78 level over the lifetime of the Parliament."

Sir Anthony Rawlinson's minute of 8 August to the Chancellor dealt explicitly with the dilemma we faced. I think that you might like to be reminded of his minute in full, and I attach a copy.

4. We do not recall any suggestion by officials that "the bilateral outcomes were wholly satisfactory" (the Treasury is seldom, if ever, wholly satisfied!). On the contrary: in the preparation and submission of the Chief Secretary's paper for Cabinet on 18 October, reporting the results so far of the bilaterals, we repeated the warning that the expenditure levels resulting were, at best, unlikely to allow any scope for further reduction in the total burden of taxation, and that there was a significant risk, particularly in the early years, that tax rates might need to be raised to contain the PSBR and interest rates. The handling of the bilaterals was discussed among Ministers in September, and in response to the Prime Minister's suggestion that there should have been "an element of bargaining" in the Treasury's approach, Sir Anthony Rawlinson's minute of 2 October explained how the target figures had been reached, by including all the cuts which looked as if they had some chance of proving politically and practically feasible. That minute concluded:

"The perennial trouble is that spending Ministers are almost always reluctant to accept cuts, or forego increases, in their own programmes even though they may endorse an overall expenditure objective."

5. It follows that we are not planning immediately "to undergo the joy of a second cuts exercise". Sir Douglas Wass' minute of 6 October spells out the prospects. On the public expenditure side we are bound to emphasise the difficulty, which must be very clear to Treasury Ministers, of re-opening decisions just taken

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on programme totals whether for 1980-81 (now published) or for later years. We respectfully agree with your conclusion that it will be right to concentrate immediately on not yielding further ground, even though we believe that it will in practice be impossible to avoid conceding some further ground on the extent to which Civil Service staff savings are additional to the cuts already agreed, and on agriculture.

AMB

A M BAILEY

8 November 1979



CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Sir Douglas Wass  
Sir Lawrence Airey  
Sir Kenneth Couzens  
Sir Fred Atkinson  
Mr Byatt  
Mr Anson  
Mr Bailey  
Mr Butler o.r.  
Mr Cassell o.r.  
Mr Shepherd  
Miss Brown  
Mr Unwin

PUBLIC EXPENDITURE PROPOSALS FOR 1981-82 TO 1982-83

I sent forward a few days ago Mr Butler's minute of 2 August to give you a first view of the proposals being put together in the Public Services Sector for the paper for Cabinet in September about public expenditure in the later years of the Survey. Following further discussion with Sir Fred Atkinson and others I should now like to add the following point, concerning the relationship of these proposals to the picture presented by the medium term assessment.

2. In broad terms the proposals in the paper go as far as, and indeed somewhat beyond, what we think likely to prove feasible in the direction of reducing public expenditure plans for the relevant years. And, on certain assumptions, they would meet the desired objective of bringing the total back to that of 1977-78 by 1982-83. How do they look in relation to what we can say about the economic prospects?

3. As you know, the next medium term assessment, which will be part of the source material for the big public expenditure White Paper now planned for December, cannot be completed for

some weeks after the next short-term forecast, that is, until November. But those concerned have been comparing the present expenditure proposals with what was assumed for public expenditure in the last MTA, especially "Case C", which was designed to reduce monetary growth by  $\frac{1}{2}$  a percentage point a year, and the PSBR as a per cent of GDP by  $\frac{1}{4}$  point a year. This MTA case showed a requirement for some increase in taxation in 1980-81 and 1981-82.

4. Further work is being done and more refined calculations are in progress; but the preliminary conclusion is that if the proposals on Mr Butler's minute were adopted in full the resulting path for public expenditure would be higher than assumed in Case C by about £1 billion in 1980-81 and in 1982-83. In 1981-82 it would be about the same as the MTA assumption. For the further year 1983-84 calculations have not been completed.

5. In relation to 1980-81 this is not a new point. It is familiar that the cuts agreed in Cabinet fell short of the original target by about £1.4 billion (at Survey prices). The present calculation exhibits that. But it also shows a similar difference between MTA Case C and the current proposals for 1982-83. One reason is the MTA had a larger figure for unemployment, increasing the amount of unemployment benefit and hence the amount of cuts needed to offset it.

6. In so far as the general structure of the MTA is to be believed and the comparisons are correct, this presents a problem both of substance and of presentation. In substance, it indicates that unless public expenditure can be cut further, the Government's objectives for tax reduction and interest rate reduction would be at risk. The presentational problem is that if the cuts proposals stand and even more if they are not fully achieved, the December White Paper may have difficulty in avoiding the implication that the proposed path for public expenditure is too high in relation to the economic calculations.

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7. Should one on this account propose larger cuts than in Mr Butler's paper? Our advice is not.

8. The figures produced by the MTA are extremely uncertain, especially for the later years. The results of the next MTA may be different, although not necessarily more favourable. The MTA represents a professional judgement of what may happen on the assumptions used, but the uncertainties are huge.

9. In any event, it is going to be difficult enough to secure Cabinet agreement to all our present proposals. Indeed, as Mr Butler's paper said, Cabinet are unlikely to accept them in full. We do not think it would help to make even more ambitious initial proposals. Rather, let us use the MTA calculation as part of the economic argument for going for the present proposals in full.

10. The time to think about a solution to the presentational problem is when we come to draft the December White Paper, knowing what the results of the next MTA actually are and what are the Cabinet decisions to which they have to be related.



A K RAWLINSON  
8 AUGUST 1979

S E C R E T

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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Sir D Wass  
Mr Littler  
Mr Middleton  
Mr Ridley  
Mr Riley

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Chief Cashier

MONETARY POLICY

I attach a first rapid draft of the paper for Friday's meeting at No 10, which is on the lines which you discussed earlier with Mr Ridley. It requires further work on it here, including the insertion of some figures. But, given the very tight timescale, we would find it very useful to have your reactions to it at this stage, so that they can be reflected in the next version later tonight.

J.M.B.

J M BRIDGEMAN  
8 November 1979

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PRIME MINISTER

MONETARY POLICY

I attach the note on possible forms of <sup>control over</sup> bank lending for which you asked. But you might find it useful if I set it in context.

2. I think that we are faced with three issues:-

i. what can we do immediately to regain control over the money supply, as quickly as possible;

ii. how can that be best presented as part of a coherent package with the roll forward of the target in the next week or so;

iii. how can we best develop the system of monetary controls.

3. The third is the most important issue in the longer term but it is not the most pressing. <sup>But</sup> ~~However, I think that it is important to remember~~ one key point, which came out in the earlier discussions on monetary base control, <sup>MBC</sup> ~~namely that it is not a method of avoiding interest rate changes, but one of generating some.~~ In an economy and monetary system which <sup>are</sup> ~~is~~ as sophisticated as ours, and one which <sup>are</sup> ~~is~~ now open with the relaxation of exchange control, the main methods <sup>(available open)</sup> of the

is relevant to the immediate discussion.

Government<sup>to</sup> ~~affecting~~ monetary conditions <sup>are</sup> ~~has to be~~ what it does in respect of public expenditure and taxation policy, and so the PSBR, <sup>what it does</sup> in respect of interest rates, including gilt sales, and <sup>has it</sup> ~~in~~ <sup>es</sup> ~~intervention~~ policy in the foreign exchange markets. Any attempt at more direct control just <sup>is it</sup> ~~leads to~~ ~~creating forms of~~ evasion either elsewhere in the uncontrolled sector of the domestic financial markets or through offshore routes. At present, changes in interest rates are partly brought about by the markets, and partly brought about by discretionary action by the authorities. A monetary base system, if it were found practicable, would generate changes in interest rates more automatically, although most people would consider that it would induce wider swings in interest rates. If <sup>such a system</sup> ~~one~~ had been operating in the last few months, it would almost certainly have led to <sup>the</sup> ~~them~~ being higher interest rates now, with even more unwelcome consequences ~~in relation to~~ <sup>for</sup> the cost of finance for industry and for the mortgage rate.

4. The attached note outlines the difficulties which would arise with most methods of trying to achieve a direct effect on bank lending. There would be a further stimulus to credit being channelled through other routes outside the banking system, in ways analogous to those which <sup>have</sup> ~~were~~ already brought the SSD scheme into disrepute. Moreover, <sup>also</sup> there is now ~~the~~ obvious avoidance route through the Euro-sterling markets. Moreover, forcing the credit into alternative routes would not alter the present upward pressure on interest rates. <sup>It is</sup> ~~It is~~

/possible



possible that something might be done to change the present general impression that credit is fairly freely available by the Governor intervening and asking the banks to be severe on <sup>the</sup> granting of renewal of a facility. I would welcome the Governor's view on this, although I would expect the effect mainly to be on the atmosphere in markets, rather than on the monetary statistics.

6. I think that the only way we are going to affect the money supply figures for banking ~~in~~ November and December significantly is through getting the gilts market moving again. One element ~~of~~ <sup>has</sup> this, ~~is~~ to be the Government reasserting its determination to control the money supply, and <sup>being seen to</sup> ~~to~~ take the necessary action to achieve this, whatever it may cost in other respects. If we rule out fiscal action, as I think we must, then we have to act on interest rates, at the very least moving MLR to confirm the move which has already taken place in market rates. I fear that anything less than a move to 16% now would be seen as the action of Canute, and call in question our resolve to adhere to our monetary targets.

7. The Governor will, I am sure, be ready to explain how the Bank would envisage that we should make the most effective use of the change in MLR to secure the necessary gilt sales over the next two months.

8. As I indicated in my minute last night, the other main elements in an announcement next Thursday ought to be the roll forward <sup>to</sup> target, and the future of the SSD scheme.

The decision on what the amount of the roll forward should be is, I think, separable from the decision on interest rates in the SSD scheme, and I would therefore suggest that we might deal with it separately later. I will put something to you on it early next week. <sup>//</sup> But, I think that it would be useful if we discussed the SSD scheme <sup>by day</sup> tomorrow. There is a good case in logic for bringing it to an end. ~~And~~ Ways round it have now become so developed that it is having little, if any, effect on either liquidity or credit. This is obvious to all informed commentators. Moreover, there is a distinct risk that if it is continued, it will encourage disintermediation into offshore banking - the Euro-sterling market. However, the Governor and I consider that there would be an adverse reaction, particularly abroad, if we were seen to take it off tout court. I therefore envisage that we should announce that it is intended to phase out the SSD scheme: we would justify that domestically by explaining that, while we accepted the scheme was no longer having a significant effect on liquidity of credit, its ending would lead to the inflation of a sterling M3 statistic as some of the flows which had avoided the corset came back to the banking system and we were retaining it to control that rate of return. The presentation would also be helped by the announcement that we were considering a monetary base scheme to come in after it, although the cognoscenti would realise that the two were not really alternatives, since the <sup>1</sup> matter is essentially a method of generating the required interest rate changes.

In assessing possible ways of controlling bank lending it is useful to separate the effect on the banks, and their ability and willingness to control their advances to private sector customers, and the effects on the customers' demand for bank credit.

### Banks' Ability to Control Advances

2. The ability of banks to control advances is circumscribed. The first reason for this is the general practice of granting facilities, which are then used at the customer's discretion. The overdraft system is the classic example of this, where a bank normally agrees with a customer an overdraft ceiling, which is subject to review usually annually: the customer then has a virtual contractual right to use that facility at his discretion until the time of the next review. The average utilisation of such facilities normally varies between 50% and 60%, and at present is at the top end of that range. Hence there is considerable scope for an increase in bank lending due to increased utilisation of facilities, which the banks cannot control in the short term. In recent years, there has been a progressive switch from overdraft to term loans, but here again the normal practice is to negotiate facilities, which can then be drawn down at the customer's discretion. The degree of utilisation is currently about [ % ].

3. The main opportunity for banks to vary the scale of their lending is therefore <sup>at</sup> the time when facilities are either

requested from them or renewed. Even this is limited in practice, because in the case of many industrial customers a bank may not be able to reduce its overdraft facility sharply without putting the customer out of business. The ability to cut back on lending is probably greater in the personal sector, where there are more personal loans for particular purposes which are being run off in accordance with a pre-determined schedule.

4. Banks can influence the use which is made of facilities already granted in only two ways, short of renegeing on a contractual obligation. The first is through the interest rate which it charges. The second is to offer an alternative source of finance, and to persuade the customer to use it rather than to draw on the facility: this may well have been happening to some extent in the recent past with the growth of acceptances, and could obviously happen in the future by offering a loan in the euro-sterling market from an overseas associate.

#### The Demand for Credit

5. In the long<sup>er</sup> term, the authorities can affect the demand for bank credit by ~~the~~ whole range of their economic policies, whether affecting the level of activity or prices, or causing particular pressures on company liquidity: eg the increase in VAT should have had a once-for-all effect on company liquidity, which should have reduced the demand for bank lending.

More specifically, the authorities can affect the demand through interest rates, although it is clear that certain types of lending at least are not very sensitive, <sup>particularly</sup> ~~at least~~ in the short run: for example a company facing a turn down in demand for its products may have little <sup>alternative</sup> ~~opportunity~~ but to build up stocks in the short run, financing it from its bank facility, although its decision about whether to maintain those stocks thereafter or cut back in production may turn on the rate of interest. The effect of interest rates on company decisions may <sup>also</sup> be muted by the fact that interest payments are a charge against profits before tax.

6. The amount of credit which is taken by the borrower may be affected by the ease with which <sup>it</sup> can obtain facilities. But, given the sophistication of the British financial system, to the extent that some channels of credit are closed, it will usually be possible to find others - here again acceptances are a clear example at present, and euro-sterling loans could be in future. It may be harder for personal sector borrowers <sup>than for companies</sup> to find alternative sources of credit.

#### Alternative Methods of Control

##### a. Existing

7. The present monetary methods for controlling bank lending, as one of the counterparts of the money supply, are interest rates, the Supplementary Special Deposits Scheme and directional guidance. Interest rates, which are essentially

the price of credit, tend to have their effect after a substantial lag. The extent of the effect varies between types of customer, and with the financial situation in which the customer finds himself - for example the case of involuntary stockbuilding referred to above.

8. The Supplementary Special Deposits Scheme may initially have <sup>had</sup> some effect on the willingness of banks to grant <sup>facilities</sup> credit. It has also had a potential effect on interest rates, because of provisions in some medium term loan agreements which enable banks to pass on part of any penalties which they incur under the SSD scheme. However, it would appear that the banks have now found sufficient ways round the SSD scheme, eg through acceptances, for it to be having little effect on their willingness to grant credit, although in some cases <sup>but credit-</sup> it has been channelled into acceptances.

9. The directional guidance requires the banks to <sup>exercise</sup> show sufficient restraint in their lending to low priority categories, notably persons and loans to finance purely financial transactions, as is necessary to ensure that they have sufficient funds for priority lending, such as to meet the needs for working capital of manufacturing industry. The directional guidance certainly has the effect of inhibiting banks' lending to persons, particularly <sup>since</sup> since the corset has been on on previous occasions. However, it would appear to have had less effect this time, presumably because they were



confident that they could channel sufficient of the demand for credit from their other customers through the acceptances and other loopholes. The banks have nevertheless recently been taking some measures to constrain personal lending. But the increase in personal lending in recent months since the post-Budget spending boom, has been significantly less than one tenth of the total increase in bank lending outstanding. The availability of personal credit in recent months has probably been more important in affecting the general attitude that there is not a squeeze on credit, than in the absolute amount involved.

<sup>Other</sup>  
b. Alternative Methods of Control

i. Controls on Banks

10. There are a range of methods of control which would seek to constrain more directly than the SSD scheme the growth of bank lending within banks' balance sheets. These include:-

- a. ceilings on bank lending, as used in the 1960s;
- b. penalties on lending over a guideline - eg a tax on the excess: this would in effect be a switch of the SSD scheme from banks' liabilities to a block of their assets;

- c. a reserve or liquidity ratio system, which would require bank lending to be matched by the holding of a proportion of the amount lent in specified assets, the total of which could be controlled by the authorities.

The problem with them all is that they would cause the banks to channel business outside the control, without affecting underlying liquidity and credit conditions, in the same way that has already happened with the SSD scheme eg through acceptances. If the scope of the control were widened to cover one loophole, for example acceptances, other channels would develop, notably the inter-company market and offshore banking, which by their very nature cannot be controlled - moreover they are potentially more dangerous than acceptances, both because their extent cannot be monitored and because of the damage to the domestic financial system.

ii. Moral Suasion

11. It would be possible for the Governor to reinforce his directional guidance, by specifically asking all British banks to exercise restraint in granting or renewing facilities. The main banks would undoubtedly comply with the letter of the request. But it would not stop disintermediation: the demand for credit would not be affected and the supply would undoubtedly be forthcoming for most customers from other sources, eg the inter-company market and offshore.

iii. Hire Purchase and Other Terms Controls

12. At present hire purchase terms controls still apply to cars and certain electrical goods, and banks are asked to match those terms when giving personal loans or overdrafts for the purchase of such goods. The controls probably still have some effect in relation to expensive goods, since finance houses prefer hire purchase contracts for them for reasons of security, and since banks usually know when a facility is being used for that purpose. But, particularly since the Consumer Credit Act, the range of forms of credit for smaller purchases has become so great - overdrafts, personal loans, bank credit cards, departmental credit cards, charge accounts and retailers credit generally - that any attempt to reimpose hire purchase terms controls on smaller goods could be readily evaded. Moreover the Department of Trade no longer have enforcement staff.

13. The amount of consumer credit other than bank lending has not been growing fast recently:

[Give figures]

Moreover, given the extent to which the banks finance house subsidiaries have been financed by acceptances recently, it is doubtful whether the tightening or extension of terms controls would have much effect on the bank lending or money supply statistics.

iv. Credit Cards

14. The money advanced on bank credit cards is within the total of bank lending to persons. It would be possible to ask them again to tighten the repayment requirements - and to abstain from further increases in credit ceilings. But it would be difficult to justify singling out this one form of personal credit (which is already relatively expensive) for special treatment.

v. Tax

15. A theoretical option for making interest rates more effective as a means of regulating demand for credit would be to tax the borrower. This could take the form of either:-

(i) disallowing interest - presumably above some base level - as a charge against profit in computing corporation tax liability;

or (ii) levying a tax on financing charges (interest etc) for consumer credit.

But both would almost certainly be complex, if they were practicable at all. It is difficult to see either being introduced very quickly, if they were thought desirable.

cc: CST  
FST  
Sir D Wass  
Sir L Airey  
Sir K Couzens  
Mr Littler  
Mr Bridgeman

SECRET



Mr Middleton  
Mr Unwin  
Mr Ridley

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Governor of the Bank of England  
Mr Mc Mahon  
Mr JB Page  
Mr C Goodhart

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

PRIME MINISTER

MONETARY DEVELOPMENTS

The monetary situation remains as bleak as when we talked on Monday. Indeed, there is now growing concern about the size of the PSBR for this year. Nevertheless, the Governor and I have considered the market situation this evening, and concluded that we should delay the change in MLR until next week. There would be difficulties in reaching a considered decision by 11 a.m. tomorrow, and there would also be a cost in terms of piecemeal presentation.

2. As expected the eligible liability figures depressed the domestic market - the 3 months inter-bank rate is now over 15½ per cent, the yields on short gilts are about 14½ per cent, and on long stocks a little under 14 per cent. However, developments elsewhere, notably in Iran and Arabia, have so far outweighed the effect on the exchange markets, and sterling has risen: the effective rate is now 67.2 per cent. While the market regards an increase in MLR as almost inevitable, it does not seem to be expecting it this week.

3. The Bank's assessment therefore is that postponement of the decision from this week would of itself be unlikely to represent a significant risk. But there is of course bound to be some risk of other unforeseen developments affecting markets adversely during the coming week, and therefore that the delay could mean

/that



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that the change in MLR had to be greater when it came. Because of this latter risk, if MLR were the only change which had to be announced, the Governor and I would have no hesitation in recommending a change to 16 per cent this week - the movement in market rates has been such that this would be the minimum necessary to reassert the authorities' position in the market.

4. However, there is a strong presentational case for delaying the change until next Thursday, 15th November, when the full money supply figures will be published. A change then could be explained as part of a general statement to the House on monetary policy. This would put the change in MLR and the October figures in context, reaffirm our determination to keep to the targets, and also include:-

(i) the announcement of the roll forward of the monetary target;

(ii) the announcement of the extension of the SSD scheme, or more probably its phasing out; and

(iii) the statement of the intention to have technical discussions on a monetary based scheme, so that, if it proved appropriate, it could be brought in as the SSD scheme was phased out.

The impact on markets of a comprehensive statement would be much greater than that of an announcement on MLR this week and an announcement on the other points a week or two later. This advantage to my mind outweighs the risk of needing a higher change in MLR: that risk is not substantial, since the movement in market interest rates

/has





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only just passed the point at which the move in MLR has to be to 16 per cent rather than 15 per cent, and there is therefore some leeway for a further move in market rates before the change would have to be one to 17 per cent.

5. If you agree that we should wait in this way, I will come back to you about the constituents of next week's package when I have had a further opportunity to discuss it with the Governor and others. I am sending a copy of this minute to the Governor.

(G.H.)

7 November, 1979

SECRET

FURTHER VIEWS.

PROBLEMS

Goodhart. Vital to make clear Govt. is willing to stand by its commitment to tough M.S. targets; to indicate its willingness, even desire, for recession; and need to recognize that monthly C&BR figures will continue to be bad until end Dec. even on our forecasts, which means that assurances about the M&R in the rest of this F year will count for little.

Gilt Dealer.  
(v. expert)

- Great anxiety because each control relaxation implied prior knowledge by authorities of good monetary trends, so shock from a sharp rise all the greater;
- with M.S. supply targets at 11% max. inflation at 19%. Something has to give in the <sup>fairly</sup> short-run - interest rates or the target;
- however in the very short-run (weeks), the institutions have too little money to invest, the banks will hold off because of previous bad experiences, and M&R hike will achieve little or nothing. Besides it is discouraged anyway
- in a month or so pain would be eased & gilts would have a ready market. but a second bad M.S. figure might have supervened.
- the only apparent solution - a new quantitative system of monetary control, a.s.p. but here, of course,

problems of time-scale, unfamiliarity, need for consultation, echoes of Comp. & Cr. Control.

- The prospect of monetary inflation seen as less pleasing than in my separate note on Iran. The rate would go up & cause consternation in industry. The standard response (of intervention) to hold the rate & accumulate reserves, matched by gilt sales to mop up the extra sterling thus liberated at home, would probably not work. The sellers of foreign currencies - mainly corporations involved in leading & lagging - would be unlikely to take the bait quickly or massively.
- Ergo a Catch 22 situation foreseen.

AR observations

Key policy priority: ensure M5 increase for next month is as low as possible. What can bank do? Jawbone Charter? What can Treasury or Dept do?

Questions: will MCR here really achieve much, even if it is right in itself

: would one activate gilt now? Are institutions dry?

: can M5 base contribution be got out quickly?

: What is latest overseas prospect given Iran & Saudi Arabia.

To be continued.

M. 7/11



F/E10

C  
2/12

CHANCELLOR

c Chief Secretary  
Financial SecretaryCONVERSATION WITH PEPPER

1. There are precedents, such as what happened in February/March this year, for this latest <sup>Bank</sup> mistake in misreading the ex-ante monetary prospect, mis-timing the gilts calls (part-paid) and (which is less widely known) refusing requests from the market to reactivate taps, which would also have reduced the MS this month.
2. The gilts market is, however, rather dry. The institutions do not seem to have much money to invest, so an MLR hike, (even quite a large one) might not greatly increase investment in government stock. The acuteness of the pressure of current monetary policy raises difficult questions when one looks at what the next target should be.
3. In appraising what happened last month and might happen next one must ask, inter alia, whether the Bank have reason to think that random factors make the standard "make-up" day statistics particularly unreliable. [For your private information, they also collect very confidential weekly statistics, which might show that a more stable pattern emerges if one measures monthly trends between other dates in the month than make-up day. These statistics are not themselves thought to be reliable on a week-to-week basis, so one could only examine what they reveal between eg successive third Thursdays or whatever. The week to week distortions arise from PAYE, salary payments, make-up day and so on.]
4. If next month's MS figures do not reveal that the latest figures were an aberration, then one is likely to face a massive outflow of sterling, and a financial crisis. This would demand Volcker-style action, both on interest rates and, possibly, on techniques of monetary management.





5. However a major mitigating action would be to announce and publish the consultative document on monetary control at the same time. That, combined with assurances (if possible) that the PSBR really will fall sharply in the last part of this financial year, would make a great difference.
6. In the meantime Bank Base rates will rise very soon - massive arbitraging will occur if not. And one has no alternative but to let MLR follow quickly.
7. In the background, but not far away, lurks the question of what monetary control techniques the Bank really want. One guess is, back to competition and credit control (ie interest rate levers), without active use of reserve asset ratios and management. They would achieve this goal by default if they can knock down all alternatives during a consultation period.

AR

ADAM RIDLEY  
7 November 1979



cc FST  
SIR D. WASS  
MR. LITTLER  
MR. MIDDLETON  
MR. RILEY  
MR. RIDLEY  
MR. BRIDGEMAN

f.w.p.  
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Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000

PRIME MINISTER

MONETARY PROSPECT

I am afraid that the October monetary figures are going to be worse than disappointing, and not encouraging as we had originally hoped.

2. The eligible liabilities figures, to be published tomorrow, Tuesday 6th, will show an increase of 2.4 per cent. The market will deduce from this that the money supply grew by about 2 per cent - correctly. The preliminary figures show that £M3 grew by 2.0 per cent and that Domestic Credit Expansion was £1.6 billion. (The components shown in the Annex, and the DCE figure, may change somewhat before they are published on Thursday 15th, but it is unlikely that there will be much change in £M3.)

3. The main change from expectation was in the Central Government's Borrowing Requirement which was nearly £1 billion rather than virtually nothing. This was due to the estimates of a number of components all going the wrong way. The largest single factor was that VAT receipts, which included the first significant payments at the higher rate, were £500 million less than expected: some of this was clearly a matter of timing (possibly due to the after effects of the computer strike) and has already been partly made good.

/4. Net





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4. Net debt sales were negligible, partly because the authorities were wrong-footed by the CGBR forecast: the calls on the part-paid stocks issued in banking September were timed for banking November, in expectation of a negligible borrowing requirement in banking October.

5. Perhaps more disturbing, the bank lending figure of £1.2 billion is a record. It is reasonable to look at this with last month's figure of £0.2 billion - bank lending, after allowing for acceptances taken up outside the banking system, still seems to be running at about £0.9 billion a month, as it has since the beginning of the year.

6. It is clear that monetary policy since June has not been as tight as we had intended. The rate of growth of the £M3 statistic has been about 14 per cent pa. If allowance is made for avoidance of the SSD scheme, for example through acceptances, the underlying growth is higher still.

7. While there are good grounds for thinking that the October figure was a "hump", and will be followed by lower figures, there are a number of further factors which have convinced the Governor and myself that we must consider whether we should act to tighten policy further. Market uncertainties have halted debt sales, which had been good until September. The borrowing requirement has been running at a level which is casting considerable doubt on whether it will be as low as the Budget estimate of £8½ billion for the year as a whole. Other countries' interest rates have moved higher - most notably in the United States, but more recently in Germany and Japan.

/8. The



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8. The market reactions to our policies, including exchange control relaxation, had generally been good, until the Public Expenditure White Paper last week.

9. Any immediate reaction to the monetary developments would have to be on MLR. Domestic market rates have already shifted upward in the last few weeks as a result of some of the factors I have just mentioned: the 3 month inter-bank rate is now over 14 $\frac{1}{4}$  per cent, leaving MLR out of line. Market rates are likely to move upward on the announcement of the eligible liability figures tomorrow, possibly with some further movement on Thursday week when the money supply figures confirm the worst. There could also be a further adjustment then, if we decide to announce the ending of the SSD scheme at the same time as the roll forward of the monetary target. It will certainly be necessary to move MLR by at least sufficient to validate these changes in market rates. The Governor and I will be considering whether a move may be needed to achieve our monetary targets.

10. We might discuss this briefly when we meet later this afternoon. But any decision should depend on the market reaction to Tuesday's figures, and on the further analysis by the Bank and Treasury of the implications of those figures. If there were a marked adverse reaction in the foreign exchange market, it might be necessary to decide at very short notice on Wednesday to move MLR this week. But I would hope that we could make the change the following week, when it could be presented in context with the roll forward of the target, and the full set of figures.

11. I have, of course, discussed these disagreeable developments with the Governor, who receives a copy of this minute.

A handwritten signature in dark ink, appearing to be 'G.H.'.

(G.H.)



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NOTE OF A MEETING HELD AT NO.11, DOWNING STREET, AT  
10.45 A.M. ON MONDAY, 5TH NOVEMBER, 1979

Present:

Chancellor of the Exchequer  
Chief Secretary  
Financial Secretary  
Sir Douglas Wass  
Governor of the Bank of England

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MONEY SUPPLY FIGURES

The meeting discussed the prospectively high money supply and bank lending figures emerging for banking October, and the range of available policy measures for dealing with them.

2. The Governor reported uncertain conditions in the domestic and foreign exchange markets, with gilt-edged trading between one-eighth and one-quarter down on the morning and sterling trading at around 66.0 effective, with the dollar rate 2.064 (compared with 2.0655 on opening and 2.0570 at its lowest point). The pound was tending to be sold rather than bought and trading on expectations of better money supply figures than now seemed likely. Markets could be expected to act adversely, therefore, when the eligible liabilities figures appeared on Tuesday. The forecast money supply and bank lending figures were virtually unchanged from those reported on Friday.
3. In discussion, Ministers noted that officials were still expecting the banking November figures to fall back considerably, perhaps even to be flat. However, the continued high level of bank lending and the CGBR was bound to cast doubt on the degree of confidence attaching to forward estimates. Only a month ago, most commentators agreed with the authorities in expecting good figures for banking October and Mr. Pepper had been prophesying that money supply would fall below the target range. As it was, bank lending



had not really moderated, and there could be no confidence that Government borrowing figures would not be exceeded. Money supply, annualised over the five months since June, was now running at 14.2 per cent and, with the leakage into acceptance credits, the Governor felt this could represent an underlying monetary growth approaching 19 per cent. At best, this could only be described as fairly accommodating in relation to the underlying growth in nominal incomes. There was no single explanation for the high money figures: large (plus £600 million) sight deposits might be awaiting investment in gilts; differences between an actual and expected CGBR could be just a matter of timing; companies might be borrowing to finance income tax repayments; and there was considerable uncertainty over the pattern of VAT payments. Involuntary stockbuilding might also be increasing.

4. The Financial Secretary warned against reading too much into erratic monthly movements. Bank lending had been very low in September, and now seemed very high in October. The difficulty was to decide whether later figures were themselves erratic or whether they demonstrated renewal of a trend upwards. Action by the authorities would certainly be interpreted by the media as an indication of the latter. The September and October figures would need to be presented together. Sir Douglas Wass said he agreed with the Financial Secretary that if time allowed it would be far preferable to see another month's figures before advising the Chancellor to take further action. But inaction could lead to a worrying situation in the financial markets. The Governor agreed. ~~The Chancellor needed to say something soon about rolling forward the monetary target, about the future of the corset and possibly also about a medium term financial plan.~~ Action to validate public faith in the Government's control of the money supply would pose a difficult choice between acting straight away or announcing the whole package in mid-November.



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5. The Chancellor said he was in no doubt that monetary growth was accelerating too fast, even though they might all remain confident of an eventual move downward. The Governor added that it was clear that the MLR increase in the Budget had not really deterred people from borrowing money at ruling interest rates.

6. The Financial Secretary asked how far ahead was the funding programme. The Governor replied that this depended on the level of borrowing to be funded. Because of redemptions, the contribution had been negative in October. Had only high October money figures been foreseen, the part-payments on the last tap could have been made to fall in October rather than in November.

7. The Chief Secretary agreed that the outlook was an uncertain one. He felt, however, that it was unwise to gamble on the next month's figures being better. Even at the risk of some over-kill it was better to act decisively now, either by moving MLR or by fiscal action. The other option was public expenditure which, even after the White Paper, would be taking a rising proportion of resources if GDP were to fall. The borrowing requirement was undoubtedly too high: the question was whether the Government could finance it. He was against anything which looked like a second Budget: for that reason he was not in favour of using the regulator, even though this would directly act on the PSBR. Further cuts in public expenditure, even if feasible, would not provide ready cash. An MLR increase could be justified by reference to international interest rates.

8. Reverting to the question of timing, the Financial Secretary agreed with the advice in Mr. Bridgeman's note in favour of deferring action until publication of the October money supply and bank lending figures on 15th November. Nothing done this week could possibly affect bank lending in the short term. He was confident it would soon turn down of its own accord. An MLR increase might have symbolic value and help to get debt sales moving.





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The question was whether markets still believed in the Government's resolve to keep the money supply in check, or whether this needed reaffirmation by another early gesture. The Governor agreed that an early move on MLR could unlock funding, perhaps even to excess.

9. Sir Douglas Wass commented on the shift in world and domestic interest rates. At home, MLR was no longer a penal rate. The Chancellor said there was a complex of factors at work. Reactions to the White Paper had somewhat reduced the market's assurance; he expected the response to Tuesday's figures to be bad. He thought the market might well be looking for some further demonstration of the Government's resolve. The Financial Secretary said that Ministers should not reject fiscal action. On the other hand, Sir Douglas Wass argued that tax increases might be thought to take the pressure too easily off the Chancellor's spending colleagues. The regulator suffered from three drawbacks: there were only four months of the year remaining: it would add to the RPI at a difficult time: and might hit confidence if seen as a reaction to insufficiently tough cuts in public expenditure.

10. The Financial Secretary was worried about damage to confidence and the Government's future credibility if the PSBR overshot. The only quick contribution from public expenditure could come from re-opening the BNOC/BGC sales. The Chancellor thought this route was exhausted this year.

11. The Financial Secretary suggested that the best course was to live with the eligible liability figures and stand ready to increase MLR on the 15th. The Governor did not dissent, but said he would want to keep open the option of increasing MLR this week if the reactions to the eligible liability figures justified it. As for size of increase, he thought this depended on the scale of reaction. He agreed that 15 per cent would just put MLR on the






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right side of the market - without forcing the building societies to re-open the mortgage rate (though, in this respect, 16 per cent might be different). On the other hand, Sir Douglas Wass noted that the building societies were now attracting funds on a fairly substantial scale.

12. The Chancellor asked what would be needed if the November banking figures were equally bad. The Governor said this could require MLR to rise to 18 per cent. The Chief Secretary thought it was sensible to look only a few weeks ahead, given the extent of uncertainties. He was firmly opposed to anything that smacked of a second Budget. He would bite on the bullet and put up MLR: decisive action now would be better than having to take action again in a month's time.

13. Summing up, the Chancellor said he would like to send a short minute to the Prime Minister arriving if possible before his appointment with her at 5.30. The present group might need to meet again on Tuesday evening or on Wednesday.

14. The Governor said that in the foreign exchange markets the Bank would want to spend fairly freely to counter downward pressure on the rate without defending a particular floor. The Chancellor agreed.

  
(A.M.W. BATTISHILL)  
7th November 1979

Circulation:

Those present  
Sir Kenneth Couzens  
Mr Bridgeman



222 CM

CHIEF SECRETARY



cc Chancellor of the Exchequer  
 Minister of State (C)  
 Minister of State (L)  
 Sir D Wass  
 Sir A Rawlinson  
 Sir L Airey  
 Sir F Atkinson  
 Mr Anson  
 Mr F Jones  
 Mr Bailey  
 Miss Brown  
 Mr Cassell  
 Mr Dixon  
 Miss Forsyth  
 Mr Hansford  
 Mrs Hedley-Miller  
 Mr Kemp  
 Mr Kitcatt  
 Mr Lavelle  
 Mr Monck  
 Mr Unwin  
 Mr Widdup  
 Miss Peirson  
 Mr Burr

PUBLIC EXPENDITURE - LATER YEARS

I am a little puzzled by one aspect of Mr Bailey's important minute of 6 November, which reaches the conclusion that the cuts achieved for the later years are inadequate and that unless further cuts are achieved there is a 'substantial risk' that we shall have to increase taxation in 1981-82. This was clear to me right at the start, as soon as the bilaterals began to result in major Treasury concessions and I minuted my concern at the time - only to be reassured by officials that everything was going according to plan and that the bilateral outcomes were wholly satisfactory.

There may be some subtle and compelling tactical reason for deliberately allowing ourselves to get into the position outlined so starkly in paragraph 7 of Mr Bailey's minute, in order to under-go the joy of a second cuts exercise in which we might snatch victory from the jaws

of defeat, but it is not immediately clear to me and perhaps might usefully be explained in any post mortem we may have on the present exercise. Meanwhile, I would suggest we concentrate on yielding nothing further over the (few) matters that are still to be decided.

A handwritten signature in black ink, consisting of a stylized 'N' followed by a 'L' and a period.

NIGEL LAWSON

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CONFIDENTIAL



CST  
FST  
NST (C)  
NST (L)  
SIR D WASS  
SIR A RALPHINSON  
MR ANSON  
MR FER BUTLER

Treasury Chambers, Parliament Street, SW1P 3AG  
01-233 3000  
7th November, 1979

*Dear Tim,*

PUBLIC EXPENDITURE: LATER YEARS

..... The Chancellor thought the Prime Minister might find the attached memorandum by Treasury officials useful as background to item 4 of tomorrow's Cabinet discussion.

*Yours ever,*

*MK*

(M.A. HALL)  
Private Secretary

T. Lankester, Esq.,  
Private Secretary,  
10, Downing Street

CONFIDENTIAL

PUBLIC EXPENDITURE: LATER YEARS

1. Treasury Ministers may wish to have a note on the overall picture for public expenditure in the light of recent decisions about later years.

2. The annexed table shows that, if the changes still under discussion (nationalised industries, agriculture, civil service) yield the savings hoped for, the total for 1981-82 will be slightly below the White Paper total for 1980-81, and the two later years rather lower than that. Hence the Government will have achieved its objective of a stable public expenditure programme starting from the 1978-79 level, with a small amount of leeway in 1982-83 and 1983-84.

3. But there are two important qualifications - will the programme be achieved in practice, and is it low enough?

A. Threats to Achievement

4. In the first place, there are the "changes still under discussion" already mentioned:

(i) On the nationalised industries the figures in line 5(ii) are £450 million worse than proposed earlier for 1981-82, but better in 1983-84. They assume that the phasing of gas pricing is resolved favourably (worth about £100 million in 1982-83 and £400 million in 1983-84); and that Mr. Nott's criticism of over-pricing for telecommunications does not prevail.

(ii) There is approaching £100 million a year at stake in the review of agriculture (line 5(i)), not now to be decided before December.

(iii) The assumed extra civil service staff savings (line 5(iii)) seemed optimistic to us even before last week's Cabinet, and in the light of Cabinet discussion

it now seems probable that they are over-estimated by at least £100 million a year. These savings too will probably not be settled until around the end of the month.

5. In addition, there are several variations in the figures which are already foreseeable:

(i) As C(79)56 points out, the nationalised industry figures are likely to be revised downwards in next year's Investment and Financing Review. They assume success on pricing and on the loss-making industries (e.g. nil borrowing by BSC from 1982-83 onwards), and are optimistic about economic growth.

(ii) Social security spending rests on the June assumptions for prices and unemployment which may need revision in either direction; in the economists' view the unemployment figure is more likely to be too low, and an extra 100,000 would add £100 million.

(iii) Local authorities may be unable or unwilling to make the full savings in current expenditure which have been counted into the totals, e.g. on school meals and transport. Instead they may choose a further increase in the rates, adding to public expenditure overall.

(iv) On the other hand, the figures included for EEC contributions take no credit for success in renegotiating the basis for contributions, so that there could be some gain on that front.

(v) In the industry programme, extra provision may be needed for Rolls Royce and British Leyland.



(vi) The employment programme makes no provision for continuing temporary employment measures, nor for any increase in redundancy rebates (which could add £100 million a year).

6. To meet these claims, and others not yet foreseeable, there is provision in the contingency reserve of £1,500 million, £2,000 million and £2,500 million in the three years. This is certainly not more than adequate, given that child benefit uprating, which is not provided for in the social security programme, will be virtually inescapable and could cost £500 million in 1981-82 rising to nearly £1,000 million in 1983-84.

B. Adequacy of Cuts

7. The annexed table shows that the cuts in Departments' programmes so far secured fall short of the original Treasury proposals by:

<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
888	1213	1304

As a result, even counting in the extra savings not yet agreed (paragraph 4 above), the totals achieve stability but make no significant progress towards the 1977-78 level which Treasury Ministers had earlier taken as a target - and which the Chancellor's paper C(79)30 said would still (according to current projections) leave no room for real tax cuts in the 1980 and 1981 Budgets.

£m at 1979 survey prices  
81-82      82-83      83-84

1. Total (projected outturn) before changes	75977	77220	77200
2. Changes proposed or assumed in C(79)35:			
(i) major spending Departments	-5658	-7269	-7117
(ii) nationalised industries	-750	-950	-1250
(iii) staff savings additional to (i)	-175	-250	-300
(iv) contingency reserve	-697	-750	-250
(v) sales of assets	-50	+50	+50
3. Resulting total (1 + 2)	68647	68051	68333
4. Changes agreed so far:			
(i) major spending Departments	-4770	-6056	-5813
(iv) contingency reserve	-697	-750	-250
(v) sales of assets	-200	-100	-100
5. Changes still under discussion			
(i) agriculture (UK)	-72	-96	-92
(ii) nationalised industries	-300	-1000	-1650
(iii) staff savings additional to 4(i) and 5(i) suggested by CSD	-175	-250	-275
6. Total (1 + 4 + 5)	69763	68968	69020
<u>Earlier years</u>	<u>77-78</u>	<u>78-79</u>	<u>79-80</u> <u>80-81</u>
7. Total (outturn) as in Cmnd 7746	65848	69767	69797      69829
8. Total for 1980-81 proposed in C(79)26			68000

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1. MR F E R BUTLER
2. CHIEF SECRETARY

cc Chancellor of the Exchequer  
 Financial Secretary  
 Minister of State (C)  
 Minister of State (L)  
 Sir D Wass  
 COGPEC  
 Mr Ridley  
 Mr Cardona  
 GECS

PUBLIC EXPENDITURE 1981-82 TO 1983-84 : BRIEF ON C(79)54

This is your paper, and you have invited Cabinet simply to take note. We understand that the Prime Minister's objective is to avoid any substantive discussion on this paper. In particular, she does not wish there to be any further discussion of defence.

2. In introducing the paper, there is no need for you to say more than <sup>that</sup> the paper reports on your bilateral discussions on housing and education, and on the figures for the later years as they emerge from the decisions so far taken. It is self-explanatory. The Cabinet will see from the penultimate line of Annex A that, subject to a few outstanding issues, the plans have been stabilised for the remainder of the period at the 1978-79 level but have not been reduced to the 1977-78 level. The intention is to round the figures for the later years in the White Paper, which will probably now be published in January.

Defensive points

3. In case specific points are raised the Chief Secretary may want to draw on these points -

(i) On agriculture, the inclusion of the figures proposed by the Treasury is, as the paper says, entirely without prejudice to the decisions to be taken on the agriculture review early next month. The Treasury's figures are about £70-90 million p.a. lower than the Minister has so far agreed.

(ii) On civil service savings, again the inclusion of the

figures proposed by CSD (though the Lord President has not been asked to endorse the CSD's estimates) is without prejudice to the Cabinet's further discussion (probably on 22 December). The amounts at stake are about £200-300 million p.a., and they are extremely vulnerable to "overlap", ie Departments' attempts to count staff savings towards savings already agreed.

- (iii) On nationalised industries, you have circulated another paper (C(79)56) about the savings here, for the Cabinet to note, though the phasing of the gas price increases [and therefore part of the public expenditure savings recorded in C(79)56] is to be decided in E Committee on 13 November.
- (iv) On housing, if the Environment Secretary's ability to deliver the cuts is questioned, given the absence of a particular policy on rents: - It is still intended to set a rent guideline for 1980-81; thereafter the Government will settle year by year how much pressure to put on rents. Public expenditure savings cannot however be guaranteed because the councils are free to increase local rates instead of rents (to control either directly would be a major reversal of agreed policy). The Environment Secretary argues that it could be counterproductive for the Government to commit itself publicly now to particular high rent increases for the later years. He has however committed himself to adjust his capital programme if necessary to deliver the agreed totals.
- (v) On the contingency reserve, which now stands at 1500,2000 and 2500 in the three years, this cannot safely be reduced further. [Child benefit uprating alone, if agreed, would absorb a third of the reserve.]

4. If you are asked whether the reductions are sufficient, you might say that they represent a substantial reduction on the previous Government's plans and that you have been most grateful for your

colleagues' cooperation. Whether the reductions will be sufficient to make possible the reductions in taxation and the money supply over the lifetime of the Parliament to which the Government is committed will have to be considered in the light of the economic prospects, which are not very rosy at present.

Background

5. You have also had Mr Bailey's note of yesterday about the present position and prospects for public expenditure in the later years.



MISS M E PEIRSON

7 November 1979



BRIDGEHEAD NOTE  
OF 7TH Nov.

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MR LITTLE

- cc Mr Barratt
- Mr Hancock
- Mr Middleton
- Mr Unwin
- Mrs Gilmore
- Mr Riley
- Mr Ridley

M/SUPPLY  
MAY? MON?

copies attached for:

- Chancellor Financial Secretary
- Chief Secretary
- Sir Douglas Wass
- Sir Lawrence Airey
- Sir Fred Atkinson
- Sir Ken Couzens

Cr. Gov.  
VAT int.

- Mr Fforde
- Chief Cashier
- Mr Goodhart

GILT-SALES?  
MLR  
Pou. over  
SSD.  
MON. BSE  
REGUL.  
SPENDING

PS/Governor

MONETARY POLICY

This submission is primarily directed to the two issues - the roll forward of the monetary target and the future of the SSD scheme - on which decisions might best be announced on 15 November. It also deals with some of the factors affecting a decision on MLR, although that decision will be affected significantly by what happens in the markets in response to yesterday's eligible liability figures, and this submission therefore does not reach any recommendation on that.

2. The submission has been discussed in draft with the Chief Cashier. But it is not agreed with the Bank and on one issue - the SSD scheme - we understand that the Governor takes a different view.

The Prospect

3. The submission should be read with Mr Middleton's parallel submission on the prospect as it has been reassessed following the October figures.

4. Events have meant that it is necessary to deal with the roll forward and the future of the SSD scheme at the same time as it has become clear that the monetary situation requires immediate corrective action. The problem with the present situation is that:-

- i. the PSBR this year is now much more likely to be in excess of £8½ billion than below it - the central estimate probably now lies between £9-9½ billion;



- ii. the CGBR figures already published, are already causing the City commentators concern: the cumulative figures will soon confirm this unease, even if a higher figure were not published in the Industry Act forecast;
  - iii. the rises in world interest rates, and in inflationary expectations here, have meant that UK domestic interest rates are not a severe deterrent to borrowing: it is difficult to argue that monetary and credit conditions are tight in present circumstances;
  - iv. bank lending is still high, and while there will almost certainly be a fall due to the recession, we may not yet have passed the peak - since Mr Middleton's note was prepared we have heard that the clearing bank economists variously expect the peak to be in Q4 1979 or Q1 1980;
  - v. these, and other factors - notably the prospect on pay and market fears about the PSBR and/or taxation next year following the Public Expenditure White Paper - have contributed first to hesitancy, and now to gloom in the gilts market which has meant that we have not achieved significant gilt sales since September, and there is little prospect of that situation changing of its own accord;
  - vi. the cumulative effect of these factors has been to leave the growth of £M3 at much the same level as was inherited, and to cause market rates to move up to a level at which MLR at 14% has been left behind.
5. The time lags are such that most of any immediate relief can only be achieved by creating conditions in the gilt edged market in which substantial sales can be resumed. The successful sale of two tap

stocks beyond those allowed for in the forecasts (say £1 billion long, £800 million short) could affect the growth of the money supply by 2% or more in the next few months. Such a turn round is partly a question of gilt tactics and pricing. But it also requires some action to deal with the underlying concerns in the market: this certainly means raising short term rates so that they are again a deterrent to borrowing and create tight conditions. The latest estimates on the PSBR may cause the Bank to re-open the question, which was touched on on Monday, of action on it through the regulator - although that raises issues which go much wider than this submission. The problem with the regulator from our side is that the effect of prices and inflationary expectations on interest rates will offset, largely if not even more, the effect of the lower PSBR on interest rates.

The Roll Forward System

6. The last Government adopted a system of rolling targets, similar to the then American practice, although not identical to it as the periods were longer in our case. A 6 monthly roll forward of a target set for 12 months forward was thought to have a number of advantages over a sequence of targets for each financial year, set in the Budget of that year, namely:-

- i. in the second half of the financial year it gave the market some reassurance about the Government's intentions for the beginning of the next year - there is always a target for at least 6 months ahead;
- ii. on the other hand, it meant that if there was a perturbation in the money supply in the second half of the financial year, the authorities had longer to get back on track - it is totally impracticable to reverse, before the end of the financial year, a significant change in trend which becomes apparent in January;

- iii. the authorities had the option as to whether to "base drift", or not, but had to give an explanation of their decision;
- iv. there was an occasion, between Budgets, for the Chancellor to reassess monetary policy, to decide on whether any corrective fiscal or monetary action was required, and to make a public exposition of his policies.

7. Some of these arguments will be affected if there is a medium term financial plan. It would be appropriate to look again at the form of the roll forward system at the same time as we look at the way in which the monetary objectives are specified in the medium term financial plan, if Ministers decided in principle to have one. But we would recommend that in the meantime the Chancellor should continue the roll forward system: given the October figures, a restatement and extension now of the Government's monetary targets would seem to be most desirable.

The Choice of Target Range

8. The existing target range is 7-11% pa for the 10 months, mid-June 1979 to mid-April 1980: the centre is equivalent, given the higher rate of growth in banking May and June, to 10.2% in the 12 months to mid-April 1980. The October figure brings the increase in £M3 in the first 4 months to 4.5% equivalent to 14.2% pa, rather than the 2.9% which would be equivalent to the centre of the target range.

9. The choice now is:-

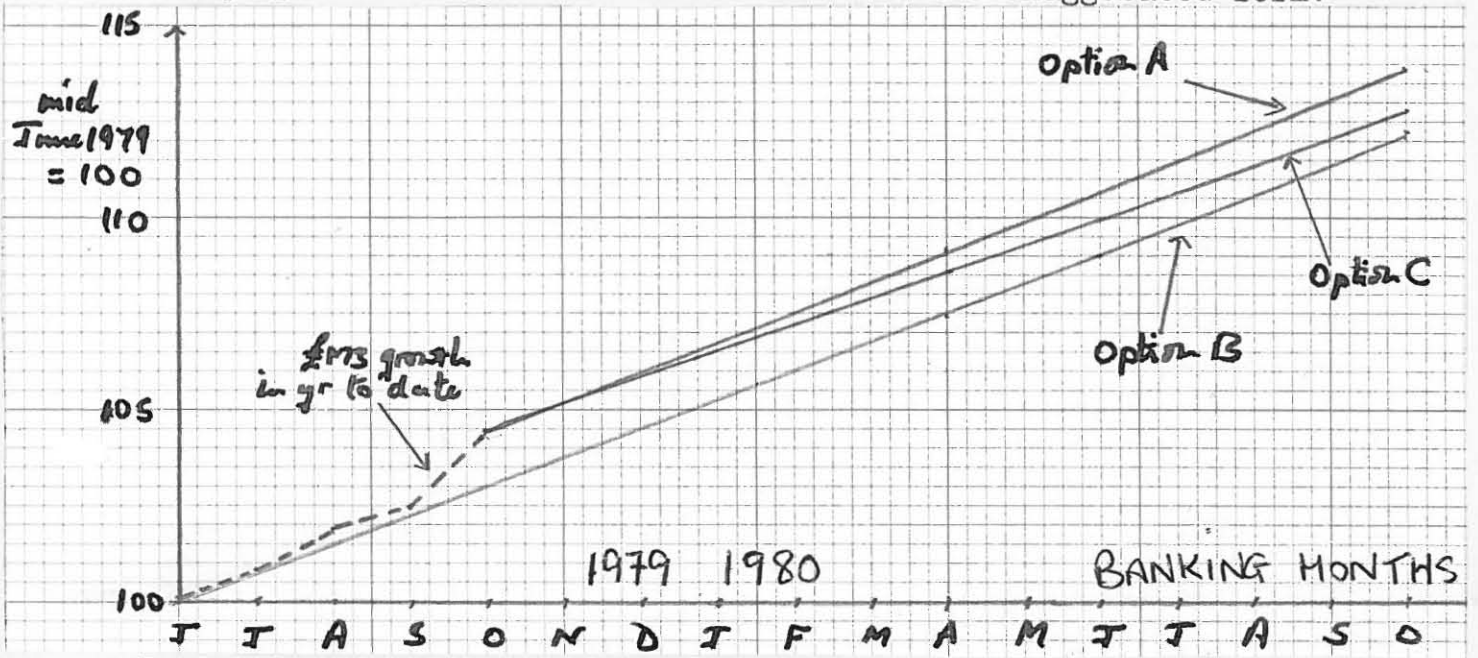
- i. whether the range should again be 7-11%, or something lower, say 6%-10%;
- ii. whether the period should run 12 months from mid-October (which would "base drift" by including

the high figures so far in the base) or for 16 months from the original date of mid-June, so avoiding base drift.

This gives the main options:-

- a. 7-11% to apply for 12 months from mid-October 1979;
- b. 7-11% to apply for 16 months from mid-June 1979;
- c. 6-10% (or 6½% to 10½%) to apply for 12 months from mid-October 1979.

The graph below shows the choice in somewhat exaggerated form:



In tabular form the options are:-

Option	Level of money supply if growth is in middle of range	
	(a) at mid-April 1980	(b) at mid-October 1980
A	109.1	113.9
B	107.4	112.2
C	108.6	112.9



10. The respective pros and cons (some of which tend to be two-edged) are:-

A Pro:

- i. probably requires lower interest rates than others;
- ii. even this could be presented as a significant tightening; if the SSD scheme were ended since, after allowing for reintermediation, a substantial fall in the underlying rate of growth would be required.

Con:

- i. the extent of base drift (some 1.7%) over 4 months would cast severe doubt on the Government's resolve - it could be interpreted as following an accommodating monetary policy.

B Pro:

- i. avoids accusations of base drift, by eliminating it;
- ii. although it keeps the same number for the range, can be seen as a tightening of policy - it only allows 7.3% growth over the remaining 12 months to mid-October 1980; (the converse effect would apply in a year's time).

Con:

- i. it is tight and will require a deceleration of growth to a rate below that which an MTFP might envisage for another year or more;
- ii. there must be a severe danger that it will not be met if there was doubt about it being achieved.

C Pro:

- i. can be seen as a progressive reduction in the figures for the ranges;
- ii. is not so tight as B in the coming year.

Con:

- i. will be criticised as "base drifting" and to some extent as a spurious tightening;
- ii. sets a precedent for downward shifts in the numerical range of each roll forward, a precedent which may not be sustainable;
- iii. in practice requires a lower rate of growth in 1980-81 than the other options, because it would be politically impracticable to raise the target range again.

11. The arguments against C are conclusive. But the choice between A and B is not an easy one at the present juncture given that monetary growth is still above the top of the existing target range, that some increase in interest rates now seems inevitable, and that subject to what is said below, room has to be found for the growth of the £M3 statistic as the SSD scheme is phased out or ended.

12. The most critical issue is which is most likely to sustain confidence in the Government's monetary policies. A clearly runs a risk in this respect because of its acceptance of base drift - that might be attributed to the "inheritance", but that excuse would run thin, given the earlier decision to start the previous target in June. B also runs a risk since the market could fairly soon come to the view that the sharp deceleration in underlying monetary growth could not be achieved without further fiscal action. (We could get a repetition of the situation after the 1978 Budget.) On the other hand, if it were achieved it might be at the cost of driving the economy further into



recession. (This depends in part on how far the recession already in train will of itself lead to a deceleration in monetary growth.)

13. This can only be a matter of judgement, and there are differing views among us in HF and FEU. On balance, mine is reluctantly in favour of B because I doubt whether the markets would accept A.

The SSD Scheme

14. The present guideline for the SSD scheme ends with the 3 month average for the make-up days in October, November and December. It is therefore necessary to announce soon whether it is to be extended or ended: this can be most logically done in the context of the roll forward of the target.

15. The paper "Direct Monetary Controls" attached to my submission of 1 October made the point that, with the ending of exchange controls, disintermediation through offshore banking would be added to the existing ways round the SSD control. This point has not unexpectedly been seized on by outside commentators. The SSD scheme has therefore now lost much of its remaining credibility (and so its ability to reassure the markets) in the eyes of most, but probably not quite all, commentators. But it may not yet have done so with the markets. It does seem to have lost its efficacy in exerting a squeeze on the banking system as the banks have discovered how easy it is to get round it eg through acceptances: from outside at least, it appears that on this, its third appearance, it has had less effect in causing the clearing banks to constrain low priority lending in accordance with the directional guidance - eg to persons.

16. Because of the risks of the ending of the SSD scheme being misinterpreted as a weakening of the authorities' stance - particularly by overseas exchange market operators, the Governor will probably propose continuation of the SSD scheme at its present guideline of 1% per month. This would be coupled with a request to banks not to facilitate offshore disintermediation. But in our view the arguments against this are very strong indeed:-

- i. given that domestic avoidance would continue, it would not affect underlying monetary conditions;
- ii. it is doubtful how far such an appeal to banks would stop disintermediation offshore, particularly by multinational companies, and we would not have the statistics monitor it;
- iii. it would cause the Government to be accused of having its head in the sand, believing that it was controlling monetary conditions when it controlled the £M3 statistic through the SSD scheme;
- iv. alternatively it would be accused of its monetary policy being merely a front, controlling a statistic rather than the reality;
- v. while there will be problems about the unwinding of disintermediation due to avoidance, referred to below, whenever the scheme is ended, and events of the last month make us less sanguine about dealing with them than we were at the time of the exchange control decision, the fact remains that the next 6 months appear likely to be as good as any for the foreseeable future for absorbing the effects as far as the PSBR is concerned: even after the increased estimate it is likely to be lower in the second half of 1979-80 than it has been so far, or is likely to be for some time to come. (The position on bank lending might on the other hand be somewhat easier later);
- vi. moreover the amount to be re-absorbed would probably grow over time if the SSD scheme were continued, even relatively loosely (eg 1% per month).

17. Some of the criticism might be met, if it were announced that this would definitely be the last 6 months of the scheme. The authorities



would not be accused of ignoring completely the defects of the SSD scheme. But even if the guideline were somewhat eased, it would lead to the continuance of much of the existing stock of disintermediation: as that stock was rolled forward it might take less desirable forms of disintermediation - notably offshore banking, notwithstanding the request to banks. The stock of outstanding disintermediation at the end of the 6 months, would then have to be reabsorbed into the statistic, at a time which would be even more difficult than the next 6 months.

18. It has to be accepted that there would be problems with an abrupt ending of the SSD scheme. It has been estimated that disintermediation amounts to about 3% of the money supply. If the SSD scheme were just abolished, that disintermediation might come back into banking channels, and so the £M3 statistic, over the coming months at a rate which is not predictable, but could be rapid. If monetary growth, after allowing for this, was allowed to be at the top end of the target range, it could be explained that this was merely the working into the statistic of an increase in "money" which had already taken place. This explanation would - or ought to - satisfy those critics of the SSD scheme who have pointed to the present distortions resulting from it. But it would not necessarily be apparent to observers further removed from the United Kingdom - such as foreign exchange dealers overseas. But even achieving growth at the top end of the range would require the underlying growth to be near or below the bottom end of the range - a tight stance on any of the options above, but especially so for option B.

19. Indeed, it might be possible to justify option A on the target on the grounds that it was not allowing "base drift", but including provision for reintermediation, and so bringing within the statistic monetary growth which had not been recorded as such. The SSD scheme has led to three main identifiable forms of avoidance which increase liquidity and credit without affecting the £M3 statistic:-

- i. bank acceptances held outside the banking system.  
(These increased by £290 million in the 6 months



to mid-June, and by a further £820 million in the 4 months since then);

- ii. Treasury Bills held outside the banking system (the respective changes were £360 million and minus £230 million);
- iii. local authority short term debt held outside the banking system. (These increased by £770 million in the 6 months to end-June: we do not have figures for a more recent period).

The main unquantified form hitherto has probably been sale and repurchase agreements in respect of other bank assets (eg short term gilts) over make-up day. We will be able to monitor i. and ii. and to comment on it when the £M3 statistics are announced month by month. But we can only obtain local authority statistics quarterly and 3 months in arrears. (Indeed, if it had not been for this last point it might have been worth adopting temporarily a £M3½ statistic incorporating those 3 forms of disintermediation and setting the target for it for the period mid-June 1979 to mid-October 1980.)

20. The balance of argument would seem to point to ending the SSD scheme now, recognising that it will allow reintermediation which will bring liquidity at present outside the £M3 statistic within it, explaining this in advance and monitoring it as it happens. It will probably require aiming for underlying growth at about the bottom of the target range in order to keep the growth of the statistic at the top. If it is felt that this is too restrictive, my preference would be to have option A on the target and ending the SSD scheme, rather than the tighter option on the target and retaining the SSD scheme.

Other Methods of Control

21. An alternative method of monetary control, such as one of the variants of monetary base, would not get over this problem of having to

allow this reintermediation following the end of the SSD scheme. It is common ground between those who have been working <sup>on</sup> possible schemes in the Bank and the Treasury and outside advocates, such as Pepper and Griffiths, that any continuing scheme should not impose a significant penalty on the UK banks in relation to their competitors, domestic or foreign - to do so would only cause similar disintermediation problems to the SSD scheme, with the added complications now of disintermediation through offshore banking.

22. The ending of the SSD scheme, without having a monetary base system to put in its place, would not represent a lacuna. Any monetary base system, which did not impose a penalty on the UK banking system, would work by generating changes in market interest rates generally and to at least some extent automatically, rather than leaving so much of the determination of the timing and amount of the changes in interest rates to the authorities. In other words, if a monetary base system had been in operation in recent months, the increase in interest rates discussed in the next section might already have taken place - it would not have provided any alternative to that change.

23. I should perhaps add that considerable work has been done in the Bank and the Treasury on alternative schemes and a submission should be ready shortly. We have severally had discussions on detailed points with Messrs Pepper and Griffiths. It is far from clear that there will at the end emerge a scheme which is workable, which will have the desired effects and will be acceptable to all concerned. But this will only be conclusively established when one or two of the schemes, which look most promising, have been put out for technical consultation, particularly with market operators, eg the discount market and the clearing banks. (Mr Pepper seems to have stolen our clothes on this.) Such consultations might be conveniently timed in relation to the papers on reserve asset ratios and on future prudential liquidity requirements which the Bank will probably want to issue about the turn of the year. If a particular monetary base scheme then proved justified, it would have to be refined and introduced over a period of 6 months or a year.

MLR

a. Timing

24. There would be considerable advantage in being able to announce a decision next week:-

- i. it would enable a more considered assessment to be made of the amount of the move necessary, and in particular give longer to observe the domestic market reaction to the eligible liability figures;
- ii. it would enable the change to be presented as part of a monetary policy package;
- iii. in particular it would enable the market to assess the implications of the MLR change and the ending of the SSD scheme together, and avoid the risk of an adverse reaction to the latter if it were announced separately a week after the MLR change;
- iv. it would avoid the change coinciding with a Building Societies Association council meeting, although this time there is probably little risk of a "snap" move.

25. There is one argument for acting this week rather than next, namely it would give an opportunity for greater gilt sales in banking November, and so produce an earlier improvement in the statistics. But I do not consider that this argument outweighs those above.

26. I understand that at present - thanks partly to good briefing by the Bank Press Office - neither domestic nor external markets are expecting a move this week. So, unless there is an unexpected change in the exchange market in the next few hours, it should be possible to



defer a decision until then without undue cost in terms of either intervention or the exchange rate. But clearly the Chancellor will want to consider the Governor's and OF's latest assessment of this at the meeting this afternoon.

b. Amount

27. A final decision on this should clearly wait until next week. But at present the signs are pointing to 16% rather than 15%:-

- i. a move to 15% would barely validate existing changes in market rates, and so would not have much effect on confidence;
- ii. indeed the prospect for reducing monetary growth in the next few months depends critically on achieving substantial gilt sales, and so on restoring confidence in the markets; there is therefore a need to establish the authorities' determination to deal with the continuing high growth;
- iii. the upward drift since the Budget in inflationary expectations means that the effective real rates of interest have fallen: the prime borrowing rate (base rate + 1% = 15% at present) is below the current inflation rate;
- iv. the ending of exchange control, and the resultant pressures on sterling, have meant that we have had to pay more attention to movements in international rates. These rates have been rising recently and, if allowance is made for differing rates of inflation, our short term rates may be lower than most others;
- v. it will be necessary to offset the ending, or phasing out, of the SSD scheme in two respects;

- a. fears by some that it represents a relaxation of control;
- b. reintermediation leading to an increase in the £M3 statistic.

(Even if it is accepted that £M3 should grow at the upper end of the target range, it will be necessary to have PSBR/interest rate such as to keep the "underlying rate" at near the bottom end of the range.)

28. The factors pointing to keeping to 15%, if market rates next week are not still above it, are:-

- i. there are good reasons for expecting a downturn in bank lending and the PSBR in due course;
- ii. any increase will probably need to be sustained for several months - an increase next week may not affect the outturn for banking November very much, so at best it would be early February before there could be two months good figures sufficient to justify any relaxation;
- iii. building society receipts have been bouyed up recently by investment of tax rebates: but their rates (other than term shares) are already badly uncompetitive, and they will be concerned about their inflows in the early months of 1980s. (This could be turned into an argument for a sharper increase now, as giving a better chance of rates being lower by February/March next year);
- iv. a further rise in interest rates could affect industrial confidence at this juncture to an extent which is disproportionate to the effect on companies' cash flow.

The Gilts Market

29. As mentioned above, one of the main aims of the monetary package must be to re-establish confidence in the gilts market: this is as much a question of dealing with the markets' fears, so far as possible at the present juncture, on the Government's resolve in relation to the other determinants of monetary conditions - the PSBR and bank lending - as bringing about a "Duke of York" style upward shift in the yield curve. But it will be necessary to consider with the Bank how any move in MLR can best be exploited in relation to:-

- a. repricing existing taps (we have just under £400 million of the medium tap left) and
- b. the timing and terms of new taps - we will probably need both a long tap and a short one.

30. We will face a familiar dilemma over long stocks. It is often argued that the downward sloping yield curve encourages institutions to hold funds short, and that we should therefore be ready to see long rates rise substantially. But stimulating a rise in long rates means that the real cost of borrowing becomes formidable, if inflation comes down on anything like the path hoped for by the Government. In present circumstances we can probably do little but accept that potential cost. (The option of borrowing more for medium term periods is not there - experience with the last taps suggests that that is a limited market.)

Conclusion

31. To sum up, I recommend that:-

- i. the new target range should be 7-11% for the 16 months to mid-October 1980;
- ii. the SSD scheme should be ended, rather than continued or phased out;

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iii. the MLR change should be deferred until next week, if exchange market conditions permit.

If the combined effect of i. and ii. is thought to require too tight a squeeze on the underlying rate of monetary growth, then I would opt for starting the target from the mid-October base, rather than for retaining the SSD scheme.

32. While it would be premature to reach a final decision on the size of an MLR change now, the balance of argument does at present seem to point to a change to 16%, rather than one to 15% which would merely validate the change that had already taken place in the market.

J. M. B.

J M BRIDGEMAN

7 November 1979



Mr Littler

copies attached for:

Chancellor of the Exchequer  
 Financial Secretary  
 Chief Secretary  
 Sir Douglas Wass  
 Sir Lawrence Airey  
 Sir Fred Atkinson  
 Sir Kenneth Couzens  
 PS/Governor (B/Eng)

cc Mr Barratt  
 Mr Hancock  
 Mr Bridgeman  
 Mr Unwin  
 Mrs Gilmore  
 Mr Riley  
 Mr Ridley  
 Mr Fforde  
 Chief Cashier ) B/Eng  
 Mr Goodhart )

## MONETARY POLICY

The attached note on the prospect, which has been agreed with the Bank, should be read alongside Mr Bridgeman's submission of today's date.

*E. A. Clarke*

*pp* P E MIDDLETON  
 7 November 1979

Enc



## THE MONETARY PROSPECT

1. The Chancellor is familiar with the factors which we take into account in assessing the financial prospect. The following is the latest assessment of these factors by the Treasury and the Bank.

The Present Target

2. The Government's announced target for the growth in the stock of £M3 is 7-11% from June to April with a centre point of 9%. This is equivalent to 10% for the full financial year 1979-80.
3. So far this financial year up to October:
- a. the money supply has increased by 15% at an annual rate. During the first 4 months of the target period the money stock has increased at a rate of 14% - well above the upper end of the range.
  - b. If we allow for the distortions caused by the SSD scheme, underlying monetary growth has been even higher. The effect is difficult to quantify but it seems that near-money substitutes of £1 billion or more have been created since April.
  - c. Some £7 bn of the forecast £8½ bn borrowing requirement has already taken place.
  - d. Bank lending has remained obstinately high - at an underlying rate of over £800 million a month. (See Table IV attached).
  - e. Externals have been negative by £240 million a month. Some of this has been the result of the outward movement from the private sector resulting from the relaxation of exchange controls. This has offset DCE of nearly £980 million a month.
  - f. Market sentiment has noticeably deteriorated recently. Markets, unsettled by the removal of exchange controls, were disappointed with the Public Expenditure White Paper. There is no longer any expectation of an early fall in interest rates.

Factors Affecting the Prospect for the Remainder of the Financial Year

4. In looking at the prospect for the remainder of the year the following factors have to be taken into account in addition to the currently very high rate of monetary growth:

a. The PSBR. When discussing the short term forecasts with Ministers we said that the PSBR for 1979-80 was being reconsidered in the light of recent information. The PSBR for the financial year is now expected to be around £9½ bn compared with the estimate of £8.3 bn at the time of the Budget. A good deal of uncertainty surrounds this figure: in particular, it assumes that all of the current shortfall in VAT receipts is recouped by the end of the year, which is at the optimistic end of the range of possibilities. The PSBR is however still likely to be much lower in the second half of the year than in the first.

There is likely to be an increasingly difficult problem in dealing with market expectations. The cumulative unadjusted Central Government Borrowing Requirement at the end of December could itself be as much as £9 bn, on the above conservative assumptions about the payment of VAT. This is likely to cause concern in the markets about the size of the PSBR for the year as a whole.

b. Bank Lending may be expected to abate in due course, not least because of the recession we forecast. But there are no signs of this yet and the timing of any reduction is very difficult to predict. Indeed, in the initial stages of the recession there could be upward pressure on lending.

c. Overseas Interest Rates. These have risen sharply recently as other countries have tightened their monetary policies in the wake of rising international inflation (see Chart II and III). The extent of the change can be gauged by the fact that looking at current interest rates and inflation rates, US real interest rates are now positive, and UK real rates negative: this is a significant reversal of the position earlier in the year. This puts some upward pressure on UK rates.

d. Exchange Control Relaxation. In the various submissions preceding the decision to relax exchange controls we pointed out that interest rates might need to rise to keep monetary growth within the target range. UK interest rates are no longer insulated as they were to some extent in the past from the movements in international rates referred to above.

e. The SSD Scheme. The artificial reduction in recorded £M3 since the imposition of the corset may now be around 3% though we have no way of knowing precisely. And the abolition of exchange controls opens up the potentially important new channels of offshore disintermediation; it has also concentrated attention on the disintermediation which has already taken place.

If the corset is removed, the recorded money stock could increase quite rapidly - by perhaps 3% as reintermediation takes place. The effect on market confidence if the corset is removed also has to take into account that it will appear to some as though we have relaxed a control. To others however retention of the corset, causing continuing large disintermediation - some of it overseas - might itself be seen as a sign of weakness and cast doubt on the strength of the Government's commitment to genuine monetary control.

5. Interest rates in the market have already moved upwards; they are currently over 13½% at the long end and over 15% at the short end. We would not attribute this solely to special factors; there seems to have been some deterioration in inflationary expectations, and growing concern about the coming wage round.

#### The Next Three Months

6. We have looked in detail at the prospects for the next three months on the assumption that changes in MLR do no more than accommodate recent movements in market rates. On this basis, as the table below shows, we expect monetary growth since mid-June to remain above the top end of the target range even if the corset remains in place. If, on the other hand, the corset were to be removed we would expect a substantial acceleration in recorded monetary growth as the figures increasingly start to

reflect the underlying monetary position.

Table I  
1979-80

Monthly  
Averages

£m

	OUTTURN	FORECAST	
		<u>Corset On</u>	<u>Corset Off</u>
	JUNE- OCT	NOV- JAN	NOV- JAN
CGBR	900	450	450
CG Debt Sales (-)	- 500	- 50	- 100
Other Public Sector	- 50	- 50	- 50
Bank Lending	650	650	1000
DCE	1000	1000	1300
Externals	- 350	- 400	- 400
Other	- 50	- 100	- 100
£M3	600	500	800
Percentage increase in £M3 since mid-June (at annual rate)	14%	13%	17%
£M3 adjusted roughly for disintermediation	19%	17%	17%

7. The main points are:

- a. The CGBR comes down, as VAT receipts increase. The assumption is that the current VAT shortfall is entirely recouped during this period - and this could be optimistic.
- b. With MLR doing no more than following market rates up, gilts and other public sector debt sales are low, against a background of continued weak domestic confidence.
- c. The underlying growth in bank lending remains strong. We expect some reduction to occur eventually but we are extremely unsure about the timing. So the most we feel able



to say is that there might be some slight deceleration compared with recent months.

d. Although there has been significant official intervention to support the exchange rate recently, a somewhat smaller presence in the market is assumed in future.

The direct effect of capital outflows is to reduce £M3 to some extent.

#### The Remainder of the Present Financial Year

8. The credibility of policy in the final quarter of the financial year depends critically on the behaviour of the PSBR. Though PSBR changes do not have a once for one effect on the money supply, confidence is bound to be adversely affected if it looks as though the PSBR is likely to substantially exceed the £8.3 bn set out by the Chancellor in his Budget. Figures of the order of £9-9½ bn are likely to be greeted with concern in both domestic and overseas markets.

9. It is of course still possible to imagine more favourable circumstances - especially if the PSBR does fall rapidly and tighten up monetary conditions or if bank lending falls sharply or if external markets remain buoyant because of fears of further changes in the world oil price - in which the current level of interest rates is satisfactory or even too high. But the balance of risks points in the other direction though it is impossible to be precise about the change in interest rates which might be necessary to bring monetary growth to the centre of the target range.

10. Interest rate changes do however operate after uncertain time lags. To give the best chance for the changes to affect monetary conditions in the rest of 1979-80 the sooner the authorities move the better.

#### The Prospect for 1980-81

11. The prospect for inflation in 1980-81 is relatively poor, unless the current pay round turns out to be much better than now seems likely and the exchange rate holds up extremely well. The PSBR prospect, even if it is held constant as a proportion of GDP, is for a substantially higher nominal figure than in



1979-80. With target monetary growth well below both the likely rate of accumulation of financial assets by the private sector and the growth of nominal incomes, it is difficult to see much change in interest rates from current levels. If rates are raised sharply in response to the deterioration in the immediate outlook some falling back may be possible but even this is far from certain.

12. There might indeed be some further upward movement in interest rates. This could happen, for example, if any of the PSBR increase which we now foresee for the present year has to be carried forward into next. And of course the interest rate outlook next year depends critically on the target for monetary growth which is adopted as well as the accompanying fiscal stance. Looking at it crudely the tighter the monetary target the higher interest rates will have to be unless there is an accompanying tightening of fiscal policy. Some forms of fiscal tightening - for example increases in indirect taxes - may not even help much. But the relation between the monetary target and the interest rate outlook is not quite as simple as this suggests. Much depends on how the markets interpret any change in the target. For example, to the extent that a reduction in monetary tightness is foreshadowed - say by allowing some degree of base drift - inflationary expectations are likely to be adversely affected and this itself would have some adverse impact on interest rates. This is not to say that a looser monetary stance would imply higher interest rates than a tighter one, but simply that the gain in terms of interest rates from a loosening may not be very great.

13. These judgements are all subject to large margins of error; in particular the recession may produce much lower bank lending than we have suggested. Some commentators have suggested this, though none of them are confident about the timing. On the other hand, if it becomes the view that the PSBR over the next 3 years was on a strongly rising trend, interest rates might be carried still higher.

P E MIDDLETON  
7 November 1979



THREE MONTH INTEREST RATES

(Source Morgan Guaranty & Bank of England)

% p.a.

15

10

5

UK

US (Eurodollars)

France

Germany

Japan

Switzerland

1979 April

May

June

July

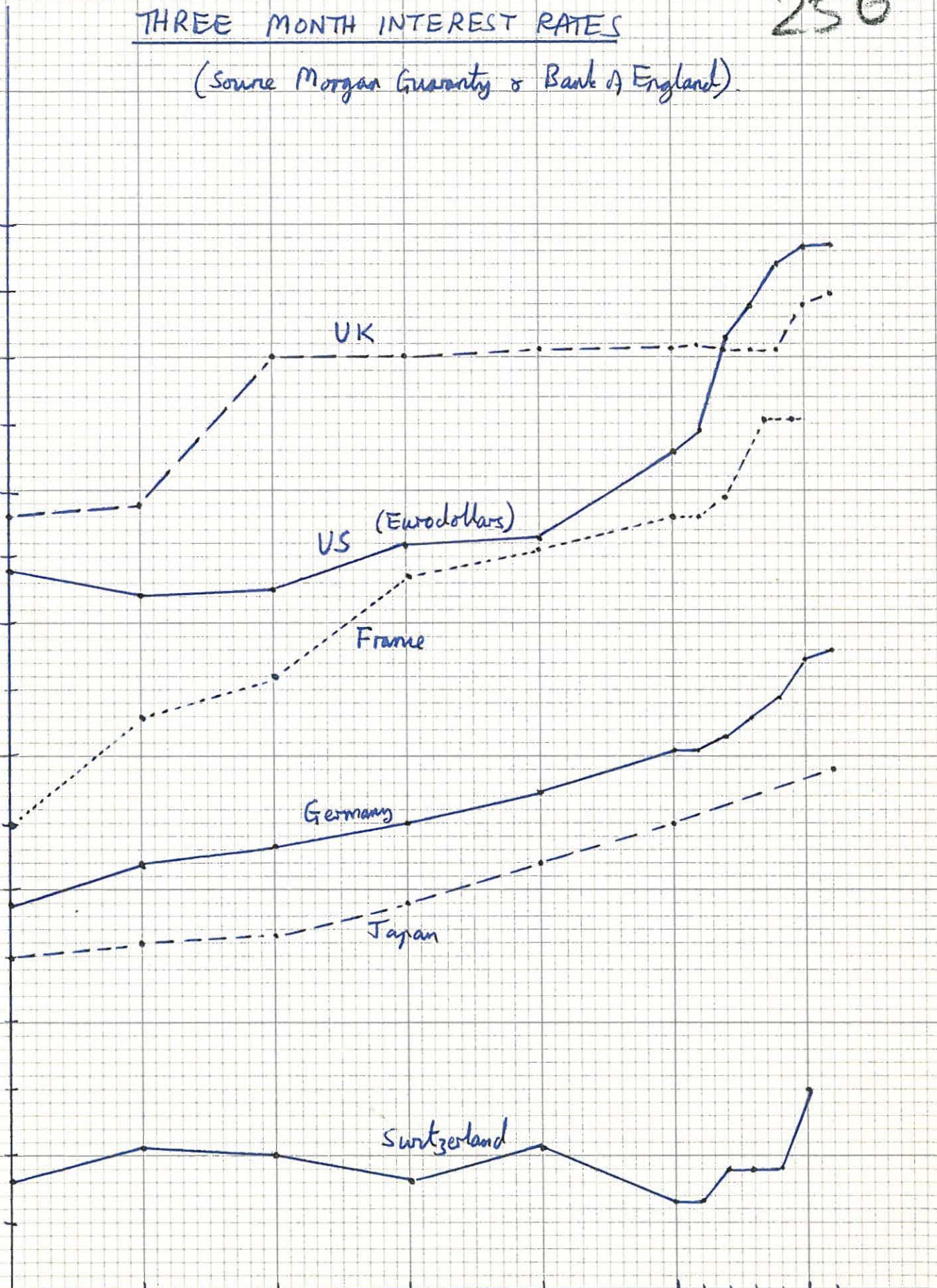
Aug

Sept

Oct

5 Nov

(end-period)





UNCOVERED 3 MONTH INTEREST DIFFERENTIALS

COMPARED WITH STERLING (+ in favour of sterling)

- against sterling

257

(Source Morgan Guaranty & Bank of England)

% p.a.



Table IV: Bank Lending: Recent History

monthly average increase (£m)  
months preceding October:

	1	3	6	12
Recorded increase in lending	1,237	699	720	676
Effect of:				
bill leak	174	223	178	95
special factors	- 535	- 98	- 19*	- 10*
Underlying increase in lending	876	824	879	761

\*special factors were not quantified in monthly forecasts prior to that for July

CONFIDENTIAL

PM 259

-CHIEF SECRETARY

cc Chancellor of the Exchequer  
Financial Secretary  
Minister of State (C)  
Minister of State (L)  
Sir Douglas Wass  
Sir Anthony Rawlinson  
Sir Lawrence Airey  
Sir Fred Atkinson  
Mr Anson o/r  
Mr F Jones  
Miss Brown *Mr FER Butler*  
Mr Cassell  
Mr Dixon  
Miss Forsyth  
Mr Hansford  
Mrs Hedley-Miller  
Mr Kemp  
Mr Kitcatt  
Mr Lavelle  
Mr Monck  
Mr Unwin  
Mr Widdup  
Miss Peirson  
Mr Burr  
GECS

PUBLIC EXPENDITURE - LATER YEARS

As a companion piece to your report to Cabinet, before Thursday's meeting, you and other Treasury Ministers may wish to see the attached note on the present position and prospects for the later years.

AMB

A M BAILEY

6 November 1979



PUBLIC EXPENDITURE : LATER YEARS

- 1. Treasury Ministers may wish to have a note on the overall picture for public expenditure in the light of recent decisions about later years.
- 2. The annexed table shows that, if the changes still under discussion (nationalised industries, agriculture, civil service) yield the savings hoped for, the total for 1981-82 will be slightly below the White Paper total for 1980-81, and the two later years rather lower than that. Hence the Government will have achieved its objective of a stable public expenditure programme starting from the 1978-79 level, with a small amount of leeway in 1982-83 and 1983-84.
- 3. But there are two important qualifications - will the programme be achieved in practice, and is it low enough?

A. Threats to Achievement

4. In the first place, there are the "changes still under discussion" already mentioned:

(i) On the nationalised industries the figures in line 5(ii) are £450 million worse than proposed earlier for 1981-82, but better in 1983-84. They assume that the phasing of gas pricing is resolved favourably (worth about £100 million in 1982-83 and £400 million in 1983-84); and that Mr Nott's criticism of over-pricing for telecommunications does not prevail. ~~It should be possible to agree to use these figures, but it may be necessary to postpone a substantive decision until after the White Paper has been settled.~~

(ii) There is approaching £100 million a year at stake in the review of agriculture (line 5(i)), not now to be decided before December. ~~(Mr Walker's recent additional bid for increased hill livestock allowances is being handled separately.)~~

(iii) The assumed extra civil service staff savings (line 5(iii)) seemed optimistic to us even before last week's Cabinet, and in the light of Cabinet discussion it now seems probable that they are over-estimated by at least £100 million a year. These savings too will probably not be settled until around the end of the month.

5. In addition, there are several variations in the figures which are already foreseeable:

- (i) ~~On defence, a contingent liability for certain additional costs could add up to £300 million to the agreed figures.~~ <sup>(over the budget)</sup>
- (i) (ii) ~~As C(79)56 points out, the nationalised industry figures are optimistic. They assume full success for policies on pricing and on the loss-making industries (e.g. nil borrowing by BSC from 1982-83 onwards),~~ <sup>are likely to be revised</sup> ~~Moreover some of the industries have been optimistic about economic growth, and next year's Investment and Financing Review will probably produce a net deterioration in the figures.~~ <sup>and are</sup>
- (ii) (iii) Social security spending rests on the June assumptions for prices and unemployment ~~— on the latter, a level of 1.65 million through the period.~~ <sup>which</sup> ~~These arbitrary assumptions could be falsified in either direction; in the economists' view the unemployment figure is more likely to be too low, and an extra 100,000 would add £100 million. If Treasury Ministers decide to change the economic assumptions before the second White Paper, this would affect the totals.~~ <sup>may need revision</sup>
- (iii) (iv) Local authorities may be unable or unwilling to make the full savings in current expenditure which have been counted into the totals, e.g. on school meals and transport. Instead they may choose a further increase in the rates, adding to public expenditure overall.
- (iv) (v) On the other hand, the figures included for EEC contributions take no credit for success in renegotiating the basis for contributions, so that there could be some gain on that front.
- (v) (vi) In the industry programme, extra provision may be needed for Rolls Royce and British Leyland.
- (v) (vii) The employment programme makes no provision for continuing temporary employment measures, nor for any increase in redundancy rebates (which could add £100 million a year).

6. To meet these claims, and others not yet foreseeable, there is provision in the contingency reserve of £1,500 million, £2,000 million and £2,500 million in the three years. This is certainly not more than adequate, given that child benefit uprating, which is not provided for in the social security programme, will be virtually inescapable and could cost £500 million in 1981-82 rising to nearly £1,000 million in 1983-84.

B. Adequacy of Cuts

7. The annexed table shows that the cuts in Departments' programmes so far secured fall short of the original Treasury proposals by:

<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
888	1213	1304

As a result, even counting in the extra savings not yet agreed (paragraph 4 above), the totals ~~barely decline at all, and are nowhere near down to the 1977-78 level~~ <sup>achieve stability but make no significant progress towards</sup> which Treasury Ministers had earlier taken as a target. ~~The economic projections~~ <sup>indicate that</sup> suggest that with these expenditure totals, it must be very doubtful whether the Government can achieve its financial objectives and a declining real burden of taxation. Indeed, there is a substantial risk that unless there are further cuts, taxes will have to be raised in 1981-82 if the PSBR is to be contained and the ~~growth of money supply reduced.~~

— and which the Chancellor's paper (71) 30 said would still (according to ~~the~~ <sup>current</sup> ~~July~~ projections) leave no room for real tax cuts in the 1980 and 1981 Budgets.



PPS ✓  
 PS/FST  
 PS/MST (C)  
 PS/MST (L)

Sir Douglas Wass  
 Sir Lawrence Airey  
 Sir Anthony Rawlinson  
 COGPEC  
 Mr Bridgeman  
 Mr F E R Butler  
 Mr Middleton



Treasury Chambers, Parliament Street, SW1P 3AG

T P Lankester Esq  
 Private Secretary to the  
 Prime Minister  
 10 Downing Street  
 London SW1

6 November 1979

*Dear Tim,*

THE PUBLIC EXPENDITURE WHITE PAPER COVERING THE YEARS  
 AFTER 1980-81

... I attach a note setting out proposals on the degree of detail to be given for the later years, in response to the Prime Minister's request conveyed in Martin Vile's letter of 5 November.

I should perhaps mention that, now that the main decisions on the 1979 public expenditure Survey have been taken, the Treasury has launched a review, with the spending Departments, of the way in which the Survey is conducted and the material is presented to Ministers. This will include the possibility of looking at programmes for the later years in less detail, and with more grouping, in future.

I am copying this letter to Tony Battishill and Martin Vile,

*Yours sincerely,  
 A C Pirie*

A C PIRIE  
 (Private Secretary)

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PRESENTATION OF PUBLIC EXPENDITURE FIGURES  
FOR THE YEARS AFTER 1980-81

1. This note concerns the form in which the public expenditure decisions for the later years should be published. The Cabinet decided on 13th September that the White Paper covering the later years should contain totals for expenditure on the main programmes and an appropriate amount of detail for certain programmes such as education and law and order, but that the detail for other local authority services should be kept to a minimum. They considered that the tentative nature of the figures for the later years should be emphasised.
2. Discussions between the Treasury and Departments at official level have indicated that the spending Departments feel themselves faced with a dilemma. They accept that the tentative nature of the later figures should be stressed. They recognise the spuriousness of publishing plans up to four years ahead in great detail. But given the importance of influencing expectations, they want to give enough detail about the later years to convince outside observers that the Government's plans for stabilising expenditure are well-founded and will be achieved. They know that their Ministers will come under close questioning in Parliament and in the new departmental Select Committees. They will in any case be giving some details to spending authorities as the basis for forward planning.
3. Treasury officials have envisaged that the White Paper would give figures for the years up to and including 1980-81 in the usual detail, and that the figures for the later years would be given in a rounded form and in much less detail. For some programmes, where spending authorities will need to know their allocations for 1981-82 before next year's White Paper is published, there will be advantage in including detail for 1981-82 also, and rounding the figures for the last two years. An example of what is envisaged is the attached illustrative table for Programme 2 (on which we have not yet consulted the FCO). For other programmes, such as housing, the Ministers concerned will probably not want to give a detailed breakdown even for 1981-82. For yet others, such as the examples of education and law and order mentioned at Cabinet, it



may be desired to give more details for the later years. It is not essential to treat all programmes identically.

4. Apart from the reduction in detail about programmes in the later years, we have envisaged that the spread of information given by the White Paper would be much the same as in previous years. That is to say, the programme chapters would contain comment on spending in the last complete year, and on what has been achieved by the programme and is planned to be achieved, plus a bibliography of other sources of information. The rest of the White Paper would contain the normal analyses and statistical breakdowns, including changes from the previous plans, public expenditure in cost terms and by economic category: but the analysis in cost terms and by economic category will probably not extend beyond 1980-81, because some of the programme chapters will not provide the detail on which to base the analysis. For local authority expenditure, the agreement that the Secretary of State for the Environment should keep his options open on ways of achieving the agreed reductions in housing means that it will not be possible to include figures of this major component of local authority expenditure after 1980-81.

5. It would theoretically be possible to have a still more summary presentation, but we do not recommend it. If, for example, the Government were to publish for the later years no more than what is in the short White Paper on 1980-81, i.e. figures for the volume of expenditure on the main programmes and a paragraph or two on each programme, this would (in the Parliamentary context) put the clock back to the very early years of these White Papers. The new Select Committees have been set up to achieve a more effective scrutiny of Departments than the previous Expenditure Committee. To tell them that the Government would provide a good deal less information even about the years up to 1980-81 than the previous Committee was given would provoke strong criticism in Parliament. Even the reduced detail we propose in paragraph 3 above may encounter some unfavourable comment of this kind. Where information is omitted, Select Committees and individual MPs can be expected to press Departments for the missing information.

Recommendation

6. Our recommendation is that the White Paper should contain the

OVERSEAS AID AND OTHER OVERSEAS SERVICES

	'1974-75	1975-76	1976-77	1977-78	1978-79	1979-80	1980-81	1981-82	1982-83	1983-84
Overseas aid	628	699	671	718	786	790	782	738	700	700
Overseas aid administration	10	13	12	12	11	13	13	14	} - 380	} 380
Overseas representation	212	216	202	183	187	187	192	192		
Overseas information	70	72	72	68	68	70	70	69		
Other external relations	100	109	106	114	130	146	130	120		
Military aid	5	2	2	3	3	10	3	2		
<b>Total</b>	<b>1025</b>	<b>1110</b>	<b>1064</b>	<b>1097</b>	<b>1186</b>	<b>1216</b>	<b>1192</b>	<b>1134</b>	<b>1080</b>	<b>1080</b>
Contribution to the European Communities (net) and to the European Investment Bank	-13	16	281	632	774	919	1000	1100	1300	1550
Sterling area guarantees	140	-	-	-	-	-	-	-	-	-
Special assistance to the Crown Agents	162	-	-	107	-	-	-	-	-	-
<b>Total</b>	<b>1314</b>	<b>1127</b>	<b>1345</b>	<b>1836</b>	<b>1960</b>	<b>2135</b>	<b>2191</b>	<b>2234</b>	<b>2380</b>	<b>2630</b>

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same spread of information for the years up to 1980-81 as in previous White Papers. The amount of detail to be given for the later years should be considered programme by programme, but in general only summary and rounded figures of planned expenditure should be given at least for 1982-83 and 1983-84, and in some cases for 1981-82 also. Accordingly, most of the special analyses and statistical breakdowns of the expenditure plans would not extend beyond 1980-81. If this is agreed, the Treasury will discuss with each Department on this basis the information which they would want to give, and submit an outline draft of the White Paper later this month.



A.B. Ok  
268  
for below  
M.

Chancellor

If you can approve this  
and return it to us, we will  
have it typed for delivery to  
the PM - if possible - before  
you meet.

But since she will  
be as continuously occupied  
as you were 5.30 (at the  
same meetings) I doubt  
whether we can realistically  
expect her to focus on  
it before 5.30.

A.B.  
5/11  
I agree  
but it  
can go  
through.  
(It can be  
arranged so  
won't it?)





~~DRAFT~~ MINUTE TO THE PRIME MINISTER

MONETARY PROSPECT

worse  
than

I am afraid that the October monetary figures are going to be disappointing, <sup>and not</sup> ~~instead of~~ encouraging as we had originally hoped.

2. The eligible liabilities figures, to be published tomorrow, Tuesday 6th, will show an increase of 2.4%. The market will deduce from this that the money supply grew by about 2% - correctly. The preliminary figures show that £M3 grew by 2.0% and that Domestic Credit Expansion was £1.6 billion. (The components shown in the Annex, and the DCE figure, may change somewhat before they are published on Thursday 15th, but it is unlikely that there will be much change in £M3.)

3. The main change from expectation was in the Central Government's Borrowing Requirement which was nearly £1 billion, rather than virtually nothing. This was due to the estimates of a number of components all going the wrong way. The largest single factor was that VAT receipts, which included the first significant payments at the higher rate, were £500 million less than expected: some of this was clearly a matter of timing (possibly due to the after effects of the computer strike) and has been made good (partly) already.

4. Net debt sales were negligible, partly because the authorities were wrong-footed by the CGBR forecast: the calls on the part-paid stocks issued in banking September were timed for banking November, <sup>in expectation</sup> ~~anticipating~~ a negligible borrowing requirement in banking October.

5. Perhaps more disturbing, the bank lending figure of £1.2 billion is a record. It is reasonable to look at this with last month's figure of £0.2 billion - bank lending, after allowing for acceptances taken up outside the banking system, still seems to be running at about £0.9 billion a month, as it has since the beginning of the year.

6. It is clear that monetary policy since June has not been as tight as we had intended. The rate of growth of the £M3 statistic has been about 14% pa. If allowance is made for avoidance of the SSD scheme, for example through acceptances, the underlying growth is higher still.

7. While there are good grounds for thinking that the October figure was a "hump", and will be followed by lower figures, there are a number of further factors which have convinced the Governor and myself that we must consider whether we should act to tighten policy further. Market uncertainties have halted debt sales, which had been good until September. The borrowing requirement has been running at a level which is casting considerable doubt on whether it will be as low as the



Budget estimate of £8 $\frac{1}{4}$  billion for the year as a whole. Other countries' interest rates have moved higher - most notably in the United States, but more recently in Germany and Japan.

8. The market reactions to our policies, including exchange control relaxation, had generally been good, until the Public Expenditure White Paper last week.

*to the monetary developments*  
9. Any immediate reaction would have to be on MLR. Domestic market rates have already shifted upward in the last few weeks as a result of some of the factors I have just mentioned: the 3 month inter-bank rate is now over 14 $\frac{3}{4}$ %, leaving MLR out of line. Market rates are likely to move upward on the announcement of the eligible liability figures tomorrow, possibly with some further movement on Thursday week when the money supply figures confirm the worst. There could also be a further adjustment then, if we decide to announce the ending of the SSD scheme at the same time as the roll forward of the monetary target. It will certainly be necessary to move MLR by at least sufficient to validate these changes in market rates. The Governor and I will be considering whether a move may be needed to achieve our monetary targets.

10. We might discuss this briefly when we meet later this afternoon. But any decision should depend on the market

reaction to Tuesday's figures, and on the further analysis by the Bank and Treasury of the implications of those figures. If there were a marked adverse reaction in the foreign exchange market, it might be necessary to decide at very short notice on Wednesday to move MLR this week. But I would hope that we could make the change the following week, when it could be presented in context with the roll forward of the target, and the full set of figures.

11. ~~I am sending a copy of this minute to the Governor.~~

~~with whom~~

I have, of course, discussed these developments with the Governor, who receives a copy of this minute.

£ billion  
Banking Months

	<u>Average of 3 months July-Sept</u>	<u>Banking October</u>
CGBR	0.90	0.94
less sales of cg debt outside banking system		
Gilts	- 0.77	+ 0.28
Other	+ 0.07	- 0.13
Bank and overseas lending to rest of the public sector	+ 0.15	- 0.57
Bank lending to private sector	0.41	+ 1.24
Overseas	<u>+ 0.03</u>	<u>- 0.03</u>
DCE	+ 0.79	<u>1.60</u>
External (net)	- 0.29	- 0.43
Other	<u>- 0.07</u>	<u>- 0.09</u>
	+ 0.43	1.08
	(0.8%)	(2.0%)



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CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
Financial Secretary  
Sir Lawrence Airey  
Sir Kenneth Couzens  
Mr Littler  
Mr Bridgeman  
Mr Unwin

MONEY SUPPLY FIGURES ETC : PRESENTATION

I expect you will have seen Mr Bridgeman's minute of today's date to the Financial Secretary.

This is all rather disturbing. And the situation has not been made any brighter by the performance of the gilts market today. There is a serious presentational problem. But there may be a need to look at MLR in the near future.

I had a word with the Governor this afternoon. He is worried too. Indeed he does not rule out the need for a move on Thursday next, 7 November, if the foreign exchange market should turn sour after the publication of the eligible liabilities. I told him that I thought that this timing would be very awkward. Besides the problem of the payment of the first subscription for the BP stock on Friday, we have to reckon on the Prime Minister's needing some persuading.

The situation merits an early discussion between yourself and the Governor and I recommend that you invite him over for a talk on Monday. Thereafter I would be inclined to minute the Prime Minister, alerting her to the problem. It is most important that she should not learn of the eligible liabilities - and of the market's reaction to them - from the press and radio. Moreover we ought, given past experience, to give her as much time as we can to come to terms with an unpalatable policy decision if such a decision proves to be necessary.

I discussed  
with the  
Governor:  
(I have fixed  
for 10.45  
+ Wass, and  
of course (St.)  
AW

J.W.

DOUGLAS WASS  
2 November 1979

Ch  
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FINANCIAL SECRETARY

- cc Chancellor  
Chief Secretary  
Sir Douglas Wass  
Sir Lawrence Airey  
Sir Ken Couzens  
Mr Barratt  
Mr Littler  
Mr Middleton (OR)  
Mr Hancock Mr Unwin  
Mr Bottrill  
Mr P Davies  
Mr Riley  
  
Mr Ridley  
Mr Cropper  
Mr Cardona
- 
- Chief Cashier  
Mr Quinn

MONEY SUPPLY FIGURES ETC: PRESENTATION

This minute is in response to your request for a note on how the October money supply figures might be presented: it relates this to the policy announcements - already made (notably exchange control) and to come (roll forward of monetary target, SSD scheme etc). It follows discussion with the Chief Cashier, Mr Hancock and Mr Middleton.

The Figures

2. We now have some idea of what may be in store for banking October money supply and bank lending - although we should have better figures on Monday\*. The main elements are expected to be:-

- £M3 - growth of 2% or just over making a cumulative rate of about 14% pa for the first 4 months of the year.
- ML - a sharp increase of nearly £900 million.
- CGBR - nearly £1 billion, much higher than expected for the reasons already described.

\* or possibly later today.



Debt Sales - virtually flat, partly because, anticipating a lower CGBR we had not timed calls on part-paid gilts for this month.

Bank Lending - well over £1 billion, plus a further increase in acceptances held outside the banking system of over £100 million.

DCE - nearly £1½ billion.

These full figures will be published on Thursday 15 November.

3. The market will get its first indication of what is to come this Tuesday when the total eligible liability figures are published by the Bank and the CLCB publishes figures for the clearers only. We will not know until Monday what the eligible liabilities figures themselves will show. However, the practice of the Bank Press Office is, if the eligible liability figures for some reason point towards a figure for the money supply significantly different from what we expect to give a steer towards the true figure by indicating any factors which may have caused an unusual difference between the two - this avoids the market trading on a false basis for 9 days, and the problems which then arise when expectations are confounded. If this is done (if it is necessary) this time - and we think that it should be done - then we ought to work on the basis that from Tuesday next the market will be assuming that the <sup>money supply and</sup> October/bank lending figures will be high and that this will be confirmed on the 15th.

#### The Prospect

4. Mr Middleton's team and the Bank forecasters are looking again at both the month by month forward look, and the prospect for the next 12 months or so in the light of the October figures. They will be completing this as soon as they can after the fuller analysis of these

figures becomes available on Friday, so that Mr Middleton can put forward a note on this early next week in parallel with the policy submissions which will need to relate to them.

5. The present assessment for the immediate future, on the basis that a substantial proportion of the change in the CGBR in banking October was due to timing differences, is that the banking November growth will be substantially less than that 14% pa rate - it could even be flat. The growth in banking December will depend, inter alia, on what is done about the SSD scheme.

The Roll Forward of the Target and other Impending Decisions

6. It will be necessary to announce during November:-

- a. the roll forward of the monetary target by 6 months;
- b. the future of the SSD scheme.

It will also be necessary to decide whether to take any action on interest rates, given the movement in market rates that has already taken place and the possible effects on market confidence of the ending or relaxing of the SSD scheme (if either is decided) and of the October figures. We will put submissions forward on this complex of issues, as soon as we have the revised prospect and as soon as we see the market reaction to the eligible liability figures - probably on Wednesday or Thursday of next week.

7. Unless the unexpected happens, the arguments on the choice of target range, and on the alternatives of ending the SSD scheme forthwith or phasing it out, should be fairly clear cut. The difficult decision will be on the interest rates - and the judgement on this may be affected by external and domestic market movements virtually up to the time of announcement.



8. There are strong arguments for announcing decisions on all three - more especially if there is any action on interest rates - on Thursday 15th so that the market can assess and react to the package of decisions and statistics as a whole, and not to one at a time. I realise that this is a tight timetable for decisions, but it is essentially dictated by the short lead time between information being available and being published. It might be possible to defer announcing the roll forward, but that is not the most difficult of the issues, so there seems little to be gained by it.

9. The roll forward of the monetary target and the ending of the SSD scheme, or even the latter alone, would require a statement by the Chancellor to the House: presumably after the business statement on the 15th. If it had been decided in principle by then whether there should be a medium term financial plan at the time of the second Public Expenditure White Paper, that also could be announced - that would help with the justification for excluding the 1980-81 PSBR from the Industry Act forecast to be published the following week. But this is very much an optional extra and a decision in principle on this may not be practicable in the limited time available.

Ministerial Speeches

10. We would see advantage in both sets of October figures and those policy decisions being put in context by a series of Ministerial speeches or statements. We would suggest:-

- i. Wednesday 7 November: Chancellor's speech to the Small Firms Bureau to give an extended treatment of exchange control and the domestic market consequences, making it clear that the Government had recognised the implications of its decisions, and referring as necessary to the eligible liability figures. That part of the speech at least would be released in full to the Press. (Drafting of this is in hand.) (We had also thought of the possibility of a statement to the NEDC that morning, but



I understand that the Chancellor and Sir Douglas Wass agreed this morning that that would merely invite a strong attack from the TUC representatives on the Government's domestic and external monetary policies to no good purpose.)

- ii. Thursday 8 November: Treasury 1st Order for PQs: it will be possible to refer back to the previous days speech.
- iii. Wednesday 14 November: Chief Secretary's speech to Financial Times conference. The timing is unfortunate and it will need to be somewhat guarded about what it says on monetary control.
- iv. Thursday 15 November: Chancellor's statement to the House on the roll forward of the target, future of the SSD scheme etc.
- v. Friday 16 November: Chancellor's speech to the Institute of Bankers at Chester. This could be a more philosophical speech about the role of monetary policy, putting Thursday's announcements into a wider context. (Mr Ridley has suggested that this should be issued on Thursday, embargoed until Friday: this should secure better coverage in the Sunday papers and might inhibit some of the wilder comments in the Friday morning's treatment of the Thursday statement.)
- vi. Tuesday 20 November: Speech to City Merchants. This would repeat the main theme of the Chester speech, but also react to any comment in the meantime.

Guidance to the Press on the Figures

11. It will also be possible to do something to dampen the market reaction to the October figures by Press briefing: but both domestic

and external markets will inevitably find these figures disappointing. Points which will need to be made - although the exact way in which it is done will depend on the final pattern of the figures - include:-

- a. this month's figures contain a number of surprises, demonstrating the erratic nature of the monthly figures;
- b. the CGBR was higher than expected - partly because of the slower receipt of the higher rate payments of VAT;
- c. debt sales were low, because we had been expecting a lower CGBR, and so timed part payments on gilts to avoid the temporary pressures on the banking system. (But we will need to avoid giving the impression that we time gilts to get a smooth money supply from month to month - we manifestly cannot do so);
- d. the PSBR and CGBR should be lower from now on ~~(although there will be fluctuations from month to month)~~ because inter alia, the benefits of higher indirect taxes and disposals will now be coming through - in contrast to the direct tax side where the PAYE rebates mean that by mid-November we will have had the effect on the PSBR of 6 months income tax reliefs;
- e. the bank lending figure was similarly erratically high after an erratically low month - the two need to be looked at together (the last three months average about £600-700 million a month);
- f. these lending figures may have been swelled by the effect of companies funding the payments of tax relief immediately after 5 October. (This effect will have been offset, at least in part, by the slower VAT payments.)

Conclusion

12. We should be grateful to know whether the Chancellor and you are content with this suggested approach. If so we will put it in hand. (Mr Hancock has already in preparation the first draft of Wednesday's statement.)

J. M. B.

J M BRIDGEMAN

2 November 1979

# Monetary mumbo-jumbo

ECONOMIST

British ministers are thinking of setting, and publishing, monetary targets for several years ahead. They should stop

Should Britain's Tory government wear its monetarist heart on its sleeve? Ministers are thinking of publishing a medium-term monetary plan, which would set money supply targets for several years ahead, not just for 12 months as is now the case. For a government critical of short-term policymaking and set on a five-year programme, that may seem sensible enough. Nor is there anything exclusively monetarist about monetary targets per se, whether for one year or five.

At which point, doubts start creeping in. If it takes its cue from this week's public spending white paper (see page 16), the proposed plan would steadily and irreversibly reduce the rate of monetary growth—which might seem to make sense if you share the monetarist belief that this would in time steadily and irreversibly reduce the rate of inflation. But even that belief does not rest on the existence of a published plan.

Supporters argue that the promise of monetary restraint will reduce the transitional costs of getting inflation down, by dampening inflationary expectations. But whose expectations, and how will it do so? The City is probably already satisfied that the government will not let the money supply rip, and would be unmoved by a plan outlining further monetary restraint in general terms. And if the targets were very specific, sterling holders and gilt buyers would get as irrationally jumpy about decimal-point deviations as they already do with so unreliable a number as the PSBR forecast.

### Pint of sterling $M_3$ seasonally adjusted, love

The real purpose of a published plan would be to lower inflationary expectations in the labour market and wage rises with them. If earnings, by some miracle, were to rise by 5% this winter instead of the 15%-plus that now looks likely, the threat of major bankruptcies and 2m unemployed would seem scare-mongering nonsense a year from now.

But would a monetary plan help to achieve such a miracle? Governments have preached the virtues of moderate wage settlements often enough. They have enforced them directly by incomes policy, offered the

carrot of tax cuts and the stick of higher unemployment. And, even when they have been relying on monetary restraint, they have always used arguments (eg, high wage settlements mean faster inflation) which are comprehensible to management and unions. Try the details of sterling  $M_3$  on the public bar of the Brickmaker's Arms—or the nineteenth hole at Wilmslow, for that matter.

Doubts about the persuasiveness of a long-run monetary plan are reinforced by practical considerations. The end of exchange controls has added a new twist to the two related issues of (a) which measure of the money supply should be used for setting targets; and (b) how it can best be controlled. On both there is now widespread disagreement. Since it is City analysts who would be recommending how the markets should react to a monetary plan, it would be stupid to found the plan on a system that most of them now dispute.

Finally, a credible monetary plan would need to have a fiscal face as well. The past two years have shown that monetary targets take on real meaning only when fiscal policy is also known—and the price of mutual inconsistency is very high. But it is not possible, let alone sensible, to offer firm predictions about the PSBR several years ahead. To do so would mean publishing a full medium-term economic forecast, which would necessarily have large margins of error. It is easy to envisage a hapless Sir Geoffrey Howe telling a suspicious City in 1981 not to worry that the PSBR was going to be £3 billion higher than planned two years earlier, because, eg, commodity prices and the savings ratio were 20% higher than expected.

A sufficiently flexible (ie, honest) plan would spare Sir Geoffrey's blushes—but risk the charge that his monetary resolve was weakening. If that is a risk he is not prepared to take, then he must choose either to put nothing on paper, but keep talking tough; or pluck some numbers for the PSBR and the money supply out of the air, publish them, and then use them against big-spending departments and inflationary wage claims. They wouldn't be honest—or believed.

# Public-spending swap shop

The Thatcher government has not axed public spending. It has robbed one budget to boost another

So much for the blood on Downing Street carpets, and the protests against spending cuts up and down Britain. Take a look at the Thatcher government's first public expenditure white paper and, lo, the volume of public spending is still, actually, rising between the last year of Labour government (1978-79) and the first fully Tory-planned year (1980-81). "Volume" means measured at one constant set of prices, so that a rise reflects real increases in the number of teachers, form-fillers, kidney machines and parking meters. Only by knocking off the proceeds from public-sector asset sales—still put at £1 billion for this year, and with a new target of £500m for next—can you achieve the result shown by the treasury on its bottom line: no change in the volume of spending either this year or next.

That flat profile is what the government has all along said it wanted to achieve. Even so, it looks positively lavish compared with the last round of public spending "cuts". Between 1975-76 and 1977-78, Mrs Thatcher's predecessors lopped a cool 8½% off the volume of public spending (only to put 6% back the following year). So why the cries of universal woe? Has the government been loudmouthing itself into unnecessary unpopularity? Or has it been wilfully misunderstood?

## Taking stick

A little of both is the natural lot of government. But the protest is not all either political or hysterical. The totals conceal some sharp wielding of the axe, because:

● All the public services were nurturing plans for much bigger increases in spending. The cuts made last June knocked £3½ billion off the planned total for a year that had already begun. Plans for 1980-81 were about £6 billion higher (in 1978 prices) than those in this white paper.

● More important, all programmes have not stood still together. Defence rises 3%, still in volume terms, both this year and next. Since the defence budget is more

than one tenth of total spending, that means one heck of a lot of money has had to be carved out of other programmes. Social security goes up a huge £1 billion, in real terms, between 1978-79 and 1980-81, largely because of the overgenerous uprating of pensions and other benefits announced in the first flush of government. Even so, the figures do not allow for even a nominal increase in child benefit, which will earn the government plenty of brickbats next spring. Nor has the treasury come clean about its unemployment assumptions: crucial when the economy is expected to nosedive into recession.

Spending on law and order inches up; spending on the health service rises by rather more than suggested by the white paper's net figures—which are reduced by the extra revenue from prescription charges, to be raised to 70p next April. On the agriculture budget, spending on EEC-financed market support policies explains some of the modest increase. But Britain's rising bill for EEC membership figures prominently in this white paper: between last year and next, it is roughly equal to the £240m the government plans to save on school meals, transport and milk. Sensible cuts, so far as they go; these non-educational services have become a top-heavy burden on the schools budget. But what British voter wants to see his kids' fish fingers disappear down the EEC commission's maw?

On central government, the axe has been wielded with some finesse. It falls heaviest on trade, employment and industrial support. So much for good intention, anyway; British Leyland could soon send that bill right up again. Education suffers no more than its due, given the declining school rolls; but tighter budgets will mean painfully quick decisions on closing schools with an uneconomic number of children in them, which will bear harshly on the Tories' rural heartlands. And here, and still more in the social services (cut sharply to allow for more spending on health), there is a real reason for



cries of grief:

● The cuts fall heaviest on local authorities. Because both defence and social security rise, the volume of central government spending goes up 4% this year, and marks time next. But the local authorities are suffering a cut of 3% next year, compared with the 1978-79 yardstick, and the figures for a modest rise this year are a bit odd: they assume English and Welsh local authorities turn a blind eye to the government's request this summer to cut 3% off spending (Scottish authorities were simply asked to do what they could). Some have been saying loudly that they will refuse to cut; but since the government has tightened cash limits, they can do so only by emptying their reserves or borrowing on the strength of big rate increases next year.

Health apart, local authority services (education, transport, old people's homes, for example) are those which most directly affect people. It is a common mistake of central government to try to squeeze too much out of local authority spending, earning unpopularity twice over as rates soar and services shrivel. The government cannot carve much more money for defence out of local authority services.

● Capital expenditure. Unusually, this white paper does not contain a breakdown between capital and current spending for the whole of the government sector; but there are gloomy hints in the text, and in the local authority figures. Some £200m is to come off the central and local roads and transport programme next year; £300m off housebuilding.

What ultimately happens to services does not, of course, depend solely on these "volume" spending

plans. They will not mean a lot to local authorities until the government clothes them in cash figures, as it must do later this month when it sets the cash limits for the rate support grant. If it sets the cash limits "realistically" (ie, allowing for pay increases of 15-18%) then ratepayers should breathe easy; local authority workers are not spoiling for a fight after last year's increases, and, if local authorities obediently cut the volume of services, rates should rise by less than the expected rate of wage inflation. On the other hand, the government will have done nothing to ease the plight of private-sector employers fighting double-figure pay claims against the background of a single-figure monetary policy; nothing to help the rate of inflation back down to single figures; and nothing to provide room for a cut in direct taxes next budget. But if it sets the cash limits tight (say, 10%), then local authorities are likely to grab the extra from ratepayers.

There is still a risk that the government will want to take a further bite at public spending when it comes to do its final budget arithmetic for 1980-81. *The Economist's* use of the treasury model suggests that this volume of spending would, if public-sector wages are not let rip, leave room for a tax cut next April without sending the public sector borrowing requirement high enough to threaten the government's monetary policy (see page 58). But it would send the PSBR above the magic £8½ billion mark. How wedded is the government to this target? This spending white paper speaks only of "controlling" the PSBR, because it is "a" (not "the") main determinant of monetary growth. Treasury mandarines, or a faint change of heart?

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14.30 HOURS 15 NOV 1979

Money and Banking Figures: 17th October 1979

1. During the four weeks ended 17th October, sterling  $M_3$  rose by £1,080 million (2.0%) after seasonal adjustment (Table 11.2); in the four months from mid-June there has been an increase of  $4\frac{1}{2}\%$ , or  $14\frac{1}{4}\%$  at an annual rate.  $M_1$  (seasonally adjusted) rose by £940 million (3.4%) during the month. There was a very sharp rise of £570 million in interest-bearing sight deposits which accounted for the major part of the rise in  $M_1$ , whilst the non-interest-bearing component grew by £370 million (1.5%).
2. Domestic credit expanded this month by £1,570 million after seasonal adjustment (Table 11.3). The main component was the exceptionally large rise of £1,240 million in bank lending in sterling to the private sector. In addition, bank acceptances held outside the banking sector grew by a further £170 million. The high demand for credit this month follows a very small rise in the previous month (£330 million, including acceptances), with special factors affecting September operating in the reverse direction in October.
3. The public sector contribution to DCE amounted to £360 million. Within this the central government borrowing requirement was large at £940 million, almost all of which represented funds borrowed for on-lending to the rest of the public sector. Much of the CGBR was offset by the repayment of market borrowing by local authorities and public corporations, whose direct contribution to DCE was therefore -£620 million. Transactions in central government debt were an expansionary factor in DCE. There were sizeable redemptions of gilt-edged stocks and official buying-in of next maturities during the month. Largely as a result of these transactions holdings of gilt-edged stocks by the non-bank private sector fell by £250 million, but there were modest net purchases of other forms of central government debt.
4. External and foreign currency finance (-£400 million) continued to be an important contractionary influence on money.
5. Figures for the banks' total eligible liabilities at 17th October were published on 6th November; they rose by £1,220 million

during the month. Reserve assets grew by £105 million, but the large rise in eligible liabilities led to a fall in the combined reserve ratio of 0.1% to 13.2%. Tables 2 and 3 give further details of the banks' and discount market's assets and liabilities. The main component of eligible liabilities - sight and time deposits from outside the banking system - rose by £1,160 million, of which £930 million came from the UK private sector. UK residents' deposits with the discount market rose unusually sharply by £270 million (all of it at call and therefore included in  $M_1$ ). The market's undefined assets multiple fell by 0.6 to 18.9.

6. There were further very large increases in foreign currency lending to and deposits of overseas residents. A substantial part of these increases is thought to reflect increased holdings by oil exporting countries owing to the oil price rise in June and the subsequent reduction in the credit period from 60 to 30 days. The figures this month were little affected by changes in the exchange rate.

Estimated seasonal movements - month ending 21st November

7. The provisional seasonal movements for the month ending 21st November 1979 are as follows -

	£ million
Notes and coin	+ 20
Private sector sterling sight deposits	<u>-220</u>
$M_1$	-200
Other sterling deposits (including CDs) held by UK residents	<u>+ 50</u>
Sterling $M_3$	<u>-150</u>
	<u>=====</u>
Bank lending to the private sector in sterling	- 20

The seasonally adjusted change in the money stock is obtained by subtracting (with due regard to sign) the seasonal movement from the unadjusted change.



Banking statistics

17 October 1979

[Table 2 in the Quarterly Bulletin]

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Discount market

£ millions

	Liabilities: borrowed funds										
	Sterling							Other currencies			
	Total	of which		Bank of England	Other UK banking sector	Other United Kingdom	Overseas	Total	UK banking sector	Other United Kingdom	Overseas
Call and overnight		Other									
1978 Sept. 20	4,053	3,593	460	-	3,585	435	33	74	38	11	25
Oct. 18	3,880	3,681	199	-	3,473	366	41	61	16	19	26
Nov. 15	3,619	3,225	394	-	3,141	444	34	72	27	22	23
Dec. 13	4,022	3,557	465	-	3,425	560	37	89	41	17	31
1979 Jan. 17	3,784	3,594	190	-	3,245	488	51	120	74	9	37
Feb. 21	4,299	3,829	470	-	3,781	481	37	91	62	13	16
Mar. 21	4,478	4,059	419	414	3,691	346	27	81	50	17	14
Apr. 18	4,491	4,079	412	60	3,876	512	43	95	54	21	20
May 16	4,171	3,786	385	-	3,676	449	46	101	66	20	15
June 20	4,054	3,743	311	-	3,597	417	40	197	146	26	25
July 18	4,390	3,986	404	-	3,881	464	45	61	30	22	9
Aug. 15	4,444	3,998	446	-	4,018	378	48	50	23	18	9
Sept. 19	4,639	4,045	594	-	4,287	305	47	78	42	19	17
Oct. 17	4,753	4,184	569	-	4,123	575	55	90	55	14	21

	Sterling assets												
	Total	UK and Northern Ireland Treasury bills	Other bills			Funds lent					Investments		
			Local authority	Other public sector	Other bills	UK banking sector	Certificates of deposit	UK local authorities	Other United Kingdom	Overseas	Up to 1 year	1-5 years	Over 5 years
1978 Sept. 20	4,231	707	174	46	1,773	7	521	113	63	-	-	492	-
Oct. 18	4,054	673	104	62	1,792	98	447	112	65	4	-	367	-
Nov. 15	3,798	536	35	52	1,829	84	358	110	61	-	-	387	23
Dec. 13	4,214	845	48	81	1,909	36	333	102	96	-	-	444	10
1979 Jan. 17	3,977	611	104	74	1,820	154	327	113	65	-	-	374	19
Feb. 21	4,499	691	76	61	2,029	35	528	136	50	-	-	565	40
Mar. 21	4,692	643	230	63	2,065	29	568	120	52	-	2	593	31
Apr. 18	4,688	622	124	75	2,095	14	489	136	44	-	-	766	8
May 16	4,358	387	49	63	1,844	100	635	123	58	-	3	770	5
June 20	4,249	507	140	42	1,753	178	417	143	63	-	-	643	33
July 18	4,608	662	148	55	2,041	34	321	158	65	-	-	650	149
Aug. 15	4,649	393	54	76	2,352	25	324	138	50	-	-	753	145
Sept. 19	4,841	442	140	81	2,378	16	319	171	49	-	-	751	122
Oct. 17	4,951	444	104	89	2,388	25	328	157	53	-	-	974	8

	Sterling assets continued			Other currency assets				Undefined assets	
	Investments continued		Other sterling assets	Total	Certificates of deposit	Bills	Other	Total undefined assets	Undefined assets multiple [a]
	Local authorities	Other							
1978 Sept. 20	303	20	12	78	56	17	5	2,613	17.8
Oct. 18	301	18	11	66	46	11	9	2,623	17.9
Nov. 15	299	12	12	77	51	16	10	2,578	17.6
Dec. 13	282	15	13	94	75	16	3	2,624	17.9
1979 Jan. 17	290	14	12	125	105	12	8	2,668	16.3
Feb. 21	263	12	13	94	77	14	3	2,955	18.1
Mar. 21	271	13	12	85	72	12	1	2,991	18.3
Apr. 18	292	11	12	98	86	9	3	2,928	17.9
May 16	296	12	13	105	87	14	4	2,912	17.8
June 20	309	10	11	200	178	15	7	2,823	17.3
July 18	303	11	11	64	48	13	3	2,872	17.6
Aug. 15	317	11	11	53	42	10	1	3,132	19.2
Sept. 19	349	11	12	81	68	11	2	3,185	19.5
Oct. 17	358	11	12	94	79	12	3	3,096	18.9

[a] The undefined assets multiple has been calculated with a capital and resources base of 147 in 1978 and 164 in 1979.

# Banks in the United Kingdom: summary

£ millions

	Notes out-standing	Total deposits	Sterling liabilities									Certificates of deposit	Items in suspense and transmission	Capital and other funds
			Sight deposits				Time deposits							
			UK banking sector	UK public sector	UK private sector	Overseas	UK banking sector	UK public sector	UK private sector	Overseas				
1978 Sept. 20	436	61,059	2,042	558	16,961	2,285	10,715	292	21,407	2,660	4,139	2,829	10,195	
	439	62,504	2,201		17,924	2,296	11,400		21,843	2,769	4,071	2,791	10,208	
Oct. 18[a]	439	62,827	2,207	690	17,543	2,300	11,400	251	21,597	2,769	4,071	2,820	10,251	
Nov. 15	442	63,495	2,224	666	17,543	2,236	12,050	294	21,759	2,803	3,921	2,710	10,187	
Dec. 13	460	62,755	1,987	625	17,907	2,116	11,437	286	21,773	2,814	3,809	2,840	10,158	
1979 Jan. 17	443	63,803	2,234	678	17,752	2,271	11,524	319	22,603	2,870	3,552	2,785	10,643	
Feb. 21	456	64,496	2,577	795	17,655	2,216	11,847	288	22,499	2,943	3,675	3,000	10,588	
Mar. 21	464	64,884	2,386	769	17,918	2,411	11,913	190	22,200	3,064	4,034	3,084	10,683	
Apr. 18	475	67,159	2,426	746	19,267	2,474	12,283	232	22,232	3,301	4,198	3,661	10,959	
May 16	471	67,373	2,455	701	18,987	2,560	11,955	217	23,064	3,375	4,059	3,222	10,922	
June 20	467	69,579	2,937	719	18,802	2,481	12,956	251	23,895	3,609	3,929	3,356	11,517	
July 18	479	70,780	3,557	651	18,979	2,633	12,894	204	24,144	3,713	4,005	3,351	11,492	
Aug. 15	463	71,657	3,613	607	18,994	2,691	13,171	195	24,542	3,889	3,954	3,357	11,515	
Sept. 19	467	72,028	3,609	573	19,115	2,664	13,195	195	24,793	3,994	3,890	3,212	11,564	
Oct. 17	475	73,682	3,675	676	19,914	2,641	13,754	170	24,924	4,172	3,756	3,317	11,828	

	Notes and coin	Sterling assets									Special and supplementary deposits	
		Total	Balances with Bank of England	Money at call		Reserve assets			Other bills			British government stocks 0-1 year
				Discount market	Other	UK and N.Ireland Treasury bills	Local authority	Commercial				
1978 Sept. 20	1,248	5,827	363	2,997	222	944	133	782	387	634		
	1,250	5,903	291	3,178	221	929	168	784	332	1,051		
Oct. 18[a]	1,251	5,988	294	3,232	241	932	168	790	332	1,051		
Nov. 15	1,289	6,033	413	2,668	205	1,041	183	798	726	1,094		
Dec. 13	1,423	6,132	420	3,002	220	838	148	804	700	1,087		
1979 Jan. 17	1,318	6,138	395	3,008	209	846	161	836	683	1,101		
Feb. 21	1,245	6,200	388	3,245	252	756	166	821	571	251		
Mar. 21	1,276	6,248	412	3,315	242	826	87	812	554	2		
Apr. 18	1,494	6,454	352	3,348	240	1,092	140	845	437	1		
May 16	1,346	6,533	554	3,231	208	934	131	868	607	712		
June 20	1,380	6,511	479	3,211	217	1,022	169	862	551	733		
July 18	1,481	6,542	453	3,324	194	1,019	127	870	555	90		
Aug. 15	1,382	6,609	480	3,383	238	933	144	899	532	514		
Sept. 19	1,327	6,645	490	3,641	226	858	172	915	344	764		
Oct. 17	1,394	6,750	401	3,508	233	1,124	214	941	329	771		

	Sterling assets concluded						Other currency assets				
	Investments			Miscellaneous assets			Miscellaneous assets				
	British government stocks			Other			Miscellaneous assets				
	Over 1 year to 1½ years	Over 1½ years to 5 years	Over 5 years and undated	Public sector	Other	Items in suspense and collections	Assets leased	Other	Items in suspense and collections	Assets leased	Other
1978 Sept. 20	542	1,832	186	256	1,817	4,458	237	2,366	164	17	533
	560	1,813	179	244	1,803	4,465	236	2,392	212	17	606
Oct. 18 [a]	562	1,830	181	262	1,803	4,502	236	2,399	213	17	606
Nov. 15	366	1,670	204	260	1,817	4,516	237	2,389	217	17	496
Dec. 13	388	1,706	187	318	1,857	4,436	253	2,399	196	17	438
1979 Jan. 17	393	1,701	166	308	1,922	4,468	284	2,375	215	16	383
Feb. 21	372	1,743	207	325	1,920	4,966	301	2,367	216	16	574
Mar. 21	190	1,698	264	342	1,944	5,127	298	2,378	182	15	624
Apr. 18	206	1,734	357	366	1,967	5,932	313	2,404	225	15	531
May 16	43	1,814	433	367	1,955	5,273	323	2,469	197	15	615
June 20	226	1,671	517	376	1,979	5,535	337	2,461	246	14	659
July 18	264	1,488	563	380	1,959	5,399	321	2,455	232	13	773
Aug. 15	325	1,413	571	391	1,965	5,220	325	2,471	207	13	575
Sept. 19	306	1,442	580	388	1,984	5,104	333	2,499	230	14	643
Oct. 17	366	1,425	540	377	1,950	5,383	329	2,541	255	14	550

[a] National Girobank became a contributor to this series in October 1978; the first line of figures excludes this bank, whilst the second line includes it.



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Total deposits	Other currency liabilities						Total liabilities/assets	of which sterling		
	Sight and time deposits			Certificates of deposit	Items in suspense and transmission	Capital and other funds		liabilities	assets	
	UK banking sector	Other UK	Overseas							
129,510	26,189	4,286	87,943	11,092	209	1,259	205,497	74,519	73,518	1978 Sept. 20
133,117	26,792	4,417	90,147	11,761	249	1,243	210,551	75,942	75,052	Oct. 18(a)
133,117	26,792	4,417	90,147	11,761	250	1,243	210,947	76,337	75,447	Nov. 15
139,803	28,375	4,658	93,908	12,861	202	1,212	218,051	76,834	75,936	
141,192	27,977	4,538	94,546	14,132	241	1,283	218,929	76,213	75,453	Dec. 13
140,108	28,063	4,386	93,981	13,678	247	1,206	219,234	77,674	76,806	1979 Jan. 17
141,444	29,152	4,559	93,509	14,224	242	1,224	221,449	78,539	77,833	Feb. 21
140,109	28,982	4,320	93,361	13,446	202	1,260	220,687	79,115	78,711	Mar. 21
139,362	28,297	4,319	93,207	13,540	207	1,204	223,027	82,254	81,997	Apr. 18
143,557	29,483	4,467	95,093	14,513	243	1,245	227,033	81,988	81,635	May 16
144,142	29,935	4,731	95,155	14,321	254	1,256	230,570	84,919	84,656	June 20
139,181	27,946	4,349	92,744	14,142	233	1,285	226,802	86,102	86,080	July 18
143,041	28,893	4,257	94,314	15,577	211	1,301	231,545	86,992	87,127	Aug. 15
157,983	32,121	4,274	103,746	17,843	263	1,365	246,882	87,271	87,310	Sept. 19
164,969	33,544	4,582	107,519	19,324	253	1,343	255,868	89,302	89,453	Oct. 17

**Sterling assets continued**

Total	Market loans (other than reserve assets)								Bills (other than reserve assets)	Advances				
	Banks in UK	Discount market	Certificates of deposit	UK local authorities	UK public corporations	UK private sector	Overseas	Total		UK public sector	UK private sector	Overseas		
													19,352	
19,798	13,197	244	2,485	2,605	107	510	649	362	34,995	860	30,337	3,798	Oct. 18(a)	
20,010	13,198	244	2,510	2,749	149	510	649	365	35,007	860	30,349	3,798	Nov. 15	
20,590	13,814	442	2,414	2,691	92	526	612	359	35,112	823	30,522	3,767		
19,702	13,093	422	2,344	2,699	104	528	513	361	35,203	845	30,509	3,849	Dec. 13	
19,615	13,307	238	2,129	2,834	89	466	552	378	36,639	893	31,833	3,913	1979 Jan. 17	
20,649	14,003	538	2,079	2,881	111	548	490	299	36,990	898	32,214	3,898	Feb. 21	
20,828	13,935	380	2,373	3,016	124	526	473	377	37,739	1,057	32,742	3,941	Mar. 21	
22,076	14,496	484	2,602	3,286	148	519	540	429	38,265	1,043	33,269	3,953	Apr. 18	
21,266	14,027	419	2,433	3,124	83	604	577	357	38,743	1,000	33,768	3,976	May 16	
22,592	15,536	316	2,531	2,916	84	686	523	389	39,950	1,103	34,862	3,984	June 20	
23,883	16,267	497	2,725	3,065	103	684	543	387	40,870	1,099	35,804	3,967	July 18	
24,219	16,656	531	2,698	3,043	112	599	580	423	41,298	1,224	36,041	4,033	Aug. 15	
24,326	16,626	645	2,607	3,023	175	661	589	432	41,181	1,211	35,956	4,014	Sept. 19	
24,824	17,241	624	2,549	2,947	215	692	556	502	42,302	1,219	37,057	4,025	Oct. 17	

**Other currency assets continued**

Total	Market loans and advances							Bills	Investments			Acceptances		
	of which advances	Banks in UK and discount market	Certificates of deposit	UK public sector	UK private sector	Overseas	Total		UK	Overseas	Sterling	Other currencies		
													129,176	
132,564	36,495	26,695	1,864	3,118	7,932	92,955	437	1,662	107	1,555	3,270	395	Oct. 18(a)	
132,565	36,495	26,695	1,864	3,118	7,932	92,956	437	1,662	107	1,555	3,270	395	Nov. 15	
139,162	37,437	28,314	2,005	3,273	8,165	97,407	429	1,792	108	1,685	3,283	412		
140,618	37,692	27,989	2,043	3,255	8,302	99,029	440	1,768	105	1,662	3,426	413	Dec. 13	
139,658	37,644	27,755	1,649	3,150	8,145	98,958	424	1,733	105	1,629	3,417	389	1979 Jan. 17	
140,596	37,937	28,451	1,583	3,144	8,145	99,274	431	1,783	115	1,669	3,657	378	Feb. 21	
138,865	37,658	28,212	1,589	3,027	8,156	97,881	451	1,838	118	1,720	3,713	393	Mar. 21	
137,751	36,893	27,748	1,621	2,860	7,986	97,536	398	2,111	107	2,003	3,760	379	Apr. 18	
142,242	38,047	28,674	1,732	2,872	8,406	100,559	388	1,942	109	1,833	3,857	459	May 16	
142,494	37,368	29,198	1,767	2,787	8,106	100,636	394	2,107	99	2,008	3,965	520	June 20	
137,159	35,590	27,240	1,622	2,453	7,781	98,064	377	2,167	102	2,065	4,455	544	July 18	
140,916	36,462	28,340	1,867	2,461	7,902	100,346	391	2,315	110	2,205	4,814	521	Aug. 15	
155,914	38,510	31,451	1,939	2,518	8,143	111,863	409	2,363	116	2,247	5,092	543	Sept. 19	
162,847	39,789	32,799	2,211	2,520	8,316	117,002	406	2,344	118	2,226	5,406	546	Oct. 17	

## Banks in the United Kingdom: detail

£ millions

				Liabilities						Other currency deposits					
				Sterling deposits											
				Total	of which sight deposits	UK banking sector	UK public sector	UK private sector	Overseas	Certificates of deposit	Total	UK banking sector	Other UK	Overseas	Certificates of deposit
Notes out-standing															
<b>British banks:</b>															
London clearing banks	1979	Sept. 19	—	35,247	16,766	2,459	357	28,944	2,072	1,416	7,304	1,699	652	4,678	275
		Oct. 17	—	36,237	17,425	2,598	419	29,713	2,159	1,348	7,826	1,663	685	5,176	301
Scottish clearing banks	1979	Sept. 19	419	3,685	1,600	121	80	3,251	79	155	1,032	483	96	348	106
		Oct. 17	427	3,860	1,710	165	78	3,393	81	144	1,060	482	107	350	121
Northern Ireland banks	1979	Sept. 19	47	1,202	437	480	42	619	61	—	18	8	5	4	—
		Oct. 17	48	1,208	448	476	33	635	64	—	24	10	9	5	—
Accepting houses	1979	Sept. 19	—	3,742	844	1,099	22	2,186	321	114	5,109	1,425	337	3,214	134
		Oct. 17	—	3,889	926	1,125	19	2,284	361	100	5,319	1,586	353	3,240	140
Other	1979	Sept. 19	—	14,044	3,579	6,241	249	5,238	1,606	709	17,765	4,497	503	11,640	1,125
		Oct. 17	—	14,382	3,765	6,440	292	5,349	1,639	662	18,815	4,855	638	12,179	1,143
<b>Overseas banks:</b>															
American banks	1979	Sept. 19	—	7,100	1,243	3,140	9	2,088	805	1,058	49,567	6,005	1,517	31,577	10,467
		Oct. 17	—	6,959	1,218	3,110	4	2,015	770	1,060	52,552	6,270	1,645	33,007	11,630
Japanese banks	1979	Sept. 19	—	543	78	338	—	142	60	3	26,657	6,612	163	16,702	3,180
		Oct. 17	—	548	58	369	—	129	47	3	27,116	6,841	166	16,741	3,367
Other	1979	Sept. 19 [a]	—	5,728	1,259	2,454	11	1,326	1,532	406	41,801	8,019	915	30,450	2,417
		Oct. 17	—	5,832	1,173	2,666	1	1,215	1,538	412	43,406	8,512	878	31,534	2,482
<b>Consortium banks</b>	1979	Sept. 19 [a]	—	736	156	471	—	113	122	29	8,731	3,375	86	5,132	139
		Oct. 17	—	767	183	480	—	106	154	27	8,850	3,324	100	5,286	140
<b>Total</b>	1979	Sept. 19	467	72,028	25,961	16,804	768	43,908	6,658	3,890	157,983	32,121	4,274	103,746	17,843
		Oct. 17	475	73,682	26,906	17,429	846	44,838	6,813	3,756	164,969	33,544	4,582	107,519	19,324

				Sterling and other currency		Sterling assets						Special and supplementary deposits	
				Liabilities: items in suspense and transmission; capital and other funds	Total liabilities/assets	Notes and coin	Reserve assets						
							Total	Balances with Bank of England	Money at call	UK and N. Ireland Treasury bills	Other bills		British government stocks up to 1 year
<b>British banks:</b>													
London clearing banks	1979	Sept. 19	8,320	50,871	828	3,674	472	1,821	468	702	210	381	
		Oct. 17	8,559	52,622	868	3,723	387	1,881	517	730	208	382	
Scottish clearing banks	1979	Sept. 19	865	6,002	433	402	1	183	95	73	50	46	
		Oct. 17	884	6,231	454	415	—	141	141	87	45	46	
Northern Ireland banks	1979	Sept. 19	169	1,437	27	144	—	63	50	19	11	—	
		Oct. 17	178	1,459	27	149	—	62	57	21	8	—	
Accepting houses	1979	Sept. 19	1,077	9,928	1	300	1	244	9	46	—	43	
		Oct. 17	1,083	10,290	1	309	1	231	21	55	—	43	
Other	1979	Sept. 19	3,852	35,661	27	947	13	637	127	135	34	130	
		Oct. 17	3,857	37,054	31	952	9	591	173	146	32	133	
<b>Overseas banks:</b>													
American banks	1979	Sept. 19	463	57,131	2	605	1	453	50	77	24	89	
		Oct. 17	433	59,944	2	606	1	347	154	78	25	89	
Japanese banks	1979	Sept. 19	150	27,350	—	49	—	39	8	1	—	7	
		Oct. 17	173	27,837	—	52	—	44	8	1	—	7	
Other	1979	Sept. 19 [a]	735	48,264	9	475	2	390	43	29	11	61	
		Oct. 17	804	50,042	9	494	2	407	45	32	8	64	
<b>Consortium banks</b>	1979	Sept. 19 [a]	772	10,239	1	50	—	37	7	3	3	6	
		Oct. 17	771	10,388	1	52	—	37	8	4	3	6	
<b>Total</b>	1979	Sept. 19	16,403	246,882	1,327	6,645	490	3,867	858	1,086	344	764	
		Oct. 17	16,741	255,868	1,394	6,750	401	3,741	1,124	1,155	329	771	

[a] One contributor was transferred from 'Consortium banks' to 'Overseas banks: other' in September 1979.

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## Sterling assets continued

			Market loans (other than reserve assets)					Bills (other than reserve assets)	Advances			Investments	
			Banks in UK and discount market	Certifi- cates of deposit	UK local authorities	Other UK	Overseas		UK public sector	UK private sector	Overseas	British government stocks over 1 year and undated	Other
<b>British banks:</b> London clearing banks	1979	Sept. 19	5,386	259	367	7	70	67	237	19,904	3,106	1,408	1,461
		Oct. 17	5,838	250	374	9	60	105	191	20,510	3,082	1,410	1,420
Scottish clearing banks	1979	Sept. 19	408	112	23	7	1	8	76	2,442	195	86	44
		Oct. 17	420	120	22	6	1	7	81	2,547	200	99	44
Northern Ireland banks	1979	Sept. 19	129	19	53	12	49	3	16	739	14	39	17
		Oct. 17	117	18	51	13	48	2	16	744	12	42	11
Accepting houses	1979	Sept. 19	1,211	401	503	127	26	86	112	1,222	78	163	251
		Oct. 17	1,244	408	474	165	25	109	124	1,304	84	132	239
Other	1979	Sept. 19	5,769	1,006	1,139	410	164	108	72	5,887	171	421	412
		Oct. 17	5,918	1,009	1,083	444	144	128	80	6,027	175	440	416
<b>Overseas banks:</b> American banks	1979	Sept. 19	1,704	466	374	58	148	46	218	3,256	317	99	51
		Oct. 17	1,656	424	368	55	121	49	195	3,336	333	90	63
Japanese banks	1979	Sept. 19	169	—	7	—	4	—	102	249	11	—	3
		Oct. 17	152	—	7	—	4	—	102	279	12	—	3
Other	1979	Sept. 19 [a]	2,202	193	427	179	122	85	261	1,977	110	76	106
		Oct. 17	2,219	168	437	175	147	75	293	2,018	114	82	104
<b>Consortium banks</b>	1979	Sept. 19 [a]	293	152	130	37	6	30	116	281	12	36	28
		Oct. 17	301	153	131	41	6	28	137	292	14	36	26
<b>Total</b>	1979	Sept. 19	17,271	2,607	3,023	836	589	432	1,211	35,956	4,014	2,328	2,372
		Oct. 17	17,865	2,549	2,947	907	556	502	1,219	37,057	4,025	2,331	2,327

## Other currency assets

			Market loans and advances						Bills	Invest- ments	Sterling and other currencies	Accept- ances	
			Total	of which advances	Banks in UK and discount market	Certifi- cates of deposit	UK public sector	UK private sector					Overseas
<b>British banks:</b> London clearing banks	1979	Sept. 19	7,346	2,571	2,147	50	523	923	3,704	19	413	5,938	627
		Oct. 17	7,794	2,604	2,428	58	521	871	3,916	17	427	6,163	669
Scottish clearing banks	1979	Sept. 19	1,071	614	207	4	68	212	580	2	10	635	126
		Oct. 17	1,102	617	230	4	68	200	599	3	10	656	166
Northern Ireland banks	1979	Sept. 19	19	1	7	—	—	1	11	—	8	151	6
		Oct. 17	25	3	7	—	—	1	17	—	20	165	6
Accepting houses	1979	Sept. 19	4,666	1,706	1,216	122	24	472	2,833	19	202	518	1,833
		Oct. 17	5,003	1,853	1,223	147	27	516	3,089	23	203	401	1,878
Other	1979	Sept. 19	17,225	5,731	3,148	177	390	1,576	11,924	18	791	965	470
		Oct. 17	18,218	5,967	3,266	179	389	1,595	12,789	16	785	1,055	478
<b>Overseas banks:</b> American banks	1979	Sept. 19	49,186	9,864	7,500	407	432	2,354	38,493	36	230	245	1,148
		Oct. 17	52,054	10,036	8,142	519	410	2,402	40,581	34	213	256	1,200
Japanese banks	1979	Sept. 19	26,353	5,523	4,979	108	411	729	20,125	50	293	53	247
		Oct. 17	26,798	5,844	5,037	110	414	765	20,471	59	297	63	284
Other	1979	Sept. 19 [a]	41,205	8,582	11,096	966	576	1,694	26,873	233	281	262	1,077
		Oct. 17	42,914	8,822	11,312	1,082	596	1,781	28,142	225	243	260	1,174
<b>Consortium banks</b>	1979	Sept. 19 [a]	8,842	3,916	1,150	106	94	182	7,310	31	134	54	101
		Oct. 17	8,940	4,044	1,153	111	94	186	7,397	29	144	54	99
<b>Total</b>	1979	Sept. 19	155,914	38,510	31,451	1,939	2,518	8,143	111,863	409	2,363	8,823	5,635
		Oct. 17	162,847	39,789	32,799	2,211	2,520	8,316	117,002	406	2,344	9,072	5,952

## UK banking sector: transactions in liabilities and assets [a]

£ millions

Month ended	Liabilities												
	Total	Domestic deposits								Overseas deposits		Non-deposit liabilities (net)	
		Total		Public sector				Private sector		Sterling	Other currencies		
		Un-adjusted	Seasonally adjusted	Sterling		Other currencies	Sterling		Other currencies				
		Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted	Un-adjusted	Seasonally adjusted						
1978 Oct. 18	+ 3,306	+ 642	+ 391	- 116	- 53	+ 12	+ 628	+ 314	+ 118	+ 9	+ 2,721	- 66	
Nov. 15	+ 4,403	+ 434	+ 484	+ 32	+ 49	- 8	+ 147	+ 180	+ 263	+ 10	+ 3,892	+ 67	
Dec. 13	+ 2,781	+ 546	+ 553	- 38	+ 8	- 4	+ 564	+ 630	+ 24	+ 84	+ 2,182	- 31	
1979 Jan. 17	+ 2,010	+ 440	+ 755	+ 85	- 86	+ 27	+ 547	+ 928	- 219	+ 187	+ 1,171	+ 212	
Feb. 21	+ 645	- 70	+ 484	+ 353	+ 265	- 4	- 598	+ 44	+ 179	- 11	+ 675	+ 51	
Mar. 21	+ 121	- 660	- 702	- 324	- 265	+ 38	- 115	- 216	- 259	+ 339	+ 465	- 23	
Apr. 18	+ 4,124	+ 1,514	+ 786	+ 42	+ 107	- 34	+ 1,393	+ 600	+ 113	+ 353	+ 2,144	+ 113	
May 16	+ 3,212	+ 710	+ 916	- 151	- 146	+ 12	+ 600	+ 801	+ 249	+ 115	+ 2,392	- 5	
June 20	+ 4,703	+ 1,023	+ 1,065	+ 187	+ 34	- 11	+ 451	+ 646	+ 396	+ 151	+ 2,965	+ 564	
July 18	+ 4,771	+ 255	+ 137	- 210	- 147	+ 18	+ 561	+ 380	- 114	+ 207	+ 4,235	+ 74	
Aug. 15	+ 1,066	+ 208	+ 347	- 103	+ 63	- 12	+ 472	+ 445	- 149	+ 275	+ 561	+ 22	
Sept. 19	+ 6,969	+ 206	+ 76	- 35	- 58	+ 35	+ 374	+ 267	- 168	+ 70	+ 6,743	- 50	
Oct. 17	+ 6,952	+ 1,477	+ 1,276	+ 66	+ 93	- 6	+ 1,013	+ 785	+ 404	+ 163	+ 5,075	+ 237	

Month ended	Assets											
	Total	Lending to public sector					Lending to private sector				Lending to overseas sector	
		Total	Sterling		Other currencies	Total	Sterling		Other currencies	Sterling	Other currencies	
			Un-adjusted	Seasonally adjusted			Central government	Other				Un-adjusted
1978 Oct. 18	+ 3,306	+ 223	+ 63	+ 29	+ 194	+ 20	+ 413	+ 395	- 12	- 14	+ 2,676	
Nov. 15	+ 4,403	+ 65	- 17	+ 267	- 202	+ 121	+ 254	+ 428	+ 145	- 117	+ 3,935	
Dec. 13	+ 2,781	+ 432	+ 127	+ 370	+ 62	- 12	+ 36	+ 505	+ 159	+ 137	+ 2,029	
1979 Jan. 17	+ 2,010	- 238	+ 525	- 475	+ 237	- 53	+ 1,218	+ 485	- 45	+ 62	+ 1,066	
Feb. 21	+ 645	- 742	- 67	- 768	+ 26	- 7	+ 826	+ 830	+ 19	- 147	+ 696	
Mar. 21	+ 121	- 518	- 703	- 891	+ 373	- 72	+ 635	+ 938	+ 113	+ 8	- 45	
Apr. 18	+ 4,124	+ 1,382	+ 637	+ 1,098	+ 284	- 99	+ 637	+ 629	- 4	+ 29	+ 2,179	
May 16	+ 3,212	+ 187	+ 367	+ 551	- 364	- 18	+ 177	+ 378	+ 378	+ 61	+ 2,427	
June 20	+ 4,703	+ 115	- 25	+ 69	+ 46	+ 8	+ 1,382	+ 1,312	- 50	- 73	+ 3,321	
July 18	+ 4,771	- 286	+ 138	- 480	+ 194	- 153	+ 1,094	+ 347	+ 191	- 6	+ 3,931	
Aug. 15	+ 1,066	+ 360	- 92	+ 281	+ 79	- 42	+ 339	+ 894	- 45	+ 109	+ 345	
Sept. 19	+ 6,969	+ 190	+ 173	- 95	+ 285	- 42	+ 111	+ 163	- 87	- 20	+ 6,817	
Oct. 17	+ 6,952	+ 266	+ 103	+ 296	- 30	- 1	+ 1,364	+ 1,236	+ 185	- 33	+ 5,171	

[a] The banking sector comprises all banks included in Table 3 together with the discount market and the Banking Department of the Bank of England. The National Girobank is included in the banking sector throughout, even though prior to October 1978 it was excluded from Table 3. Inter-bank items are excluded and adjustments made to allow for transit items (see additional notes to Table 6 in the *Quarterly Bulletin*).

## Money stock: amounts outstanding

[Table 11.1 in the Quarterly Bulletin]

£ millions

	Notes and coin in circulation with public 1	UK private sector sterling sight deposits		Money stock M <sub>1</sub> (b)		UK private sector sterling time deposits (c) 5	UK public sector sterling deposits 6	Money stock Sterling M <sub>3</sub> (b)		UK residents' deposits in other currencies (c) 8	Money stock M <sub>3</sub> (b)	
		Non-interest-bearing (a) 2	Interest-bearing 3	Unadjusted 4	Seasonally adjusted 5			Unadjusted 7	Seasonally adjusted 8		Unadjusted 9	Seasonally adjusted 10
Month ended												
1978 Oct. 18	8,160	13,184	3,237	24,581	24,620	22,462	1,190	48,233	48,140	4,522	52,755	52,670
	8,184	13,557	3,319	25,060	24,860	22,635	1,074	48,769	48,490	4,637	53,406	53,130
Nov. 15	8,258	13,583	3,258	25,099	24,900	22,817	1,106	49,022	48,800	4,946	53,968	53,750
Dec. 13	8,682	13,906	3,500	26,088	25,490	22,816	1,068	49,972	49,520	4,953	54,925	54,370
1979 Jan. 17	8,382	13,497	3,661	25,540	25,730	23,611	1,153	50,304	50,570	4,685	54,989	55,260
Feb. 21	8,594	13,012	3,713	25,319	25,930	23,446	1,506	50,271	51,080	4,855	55,126	55,940
Mar. 21	8,689	13,446	3,488	25,623	25,960	23,122	1,182	49,927	50,640	4,577	54,504	55,220
Apr. 18	8,862	14,484	3,792	27,138	26,750	23,173	1,224	51,535	51,360	4,552	56,087	55,920
May 16	8,833	14,262	3,857	26,952	26,790	23,930	1,073	51,955	52,090	4,839	56,794	56,930
June 20	8,804	14,026	3,718	26,548	26,570	24,756	1,260	52,564	52,690	5,065	57,629	57,760
July 18	9,230	14,335	3,755	27,320	27,210	24,971	1,050	53,341	53,110	4,654	57,995	57,770
Aug. 15	9,143	14,532	3,632	27,307	27,190	25,369	947	53,623	53,640	4,585	58,208	58,220
Sept. 19	9,121	14,750	3,470	27,341	27,300	25,687	912	53,940	53,950	4,642	58,582	58,590
Oct. 17	9,268	15,154	4,038	28,460	28,220	25,728	978	55,166	55,010	5,038	60,204	60,050

[a] After deducting 60% of transit items (see additional notes to Table 6 of the Quarterly Bulletin).

[b] M<sub>1</sub> equals columns 1 + 2 + 3. Sterling M<sub>3</sub> equals M<sub>1</sub> + columns 5 + 6. M<sub>3</sub> equals sterling M<sub>3</sub> + column 8.

[c] Including UK residents' holdings of certificates of deposit.

## Money stock: changes(a)

[Table 11.2 in the Quarterly Bulletin]

£ millions: percentages in *italics*

	Notes and coin in circulation with public 1	UK private sector sterling sight deposits		Money stock M <sub>1</sub> (c) 4	UK private sector sterling time deposits (d) 5	UK public sector sterling deposits 6	Money stock Sterling M <sub>3</sub> (c) 7	UK residents' deposits in other currencies (d)		Money stock M <sub>3</sub> (c) 10
		Non-interest-bearing (b) 2	Interest-bearing 3					Transactions 8	Valuation changes (e) 9	
Month ended (unadjusted)										
1978 Oct. 18	+ 24	+ 373	+ 82	+ 479	+ 173	- 116	+ 536	+ 130	- 15	+ 651
Nov. 15	+ 74	+ 26	- 61	+ 39	+ 182	+ 32	+ 253	+ 255	+ 54	+ 562
Dec. 13	+ 424	+ 323	+ 242	+ 989	- 1	- 38	+ 950	+ 20	- 13	+ 957
1979 Jan. 17	- 300	- 409	+ 161	- 548	+ 795	+ 85	+ 332	- 192	- 76	+ 64
Feb. 21	+ 212	- 485	+ 52	- 221	- 165	+ 353	- 33	+ 175	- 5	+ 137
Mar. 21	+ 95	+ 434	- 225	+ 304	- 324	- 324	- 344	- 221	- 57	- 622
Apr. 18	+ 173	+ 1,038	+ 304	+ 1,515	+ 51	+ 42	+ 1,608	+ 79	- 104	+ 1,583
May 16	- 29	- 222	+ 65	- 186	+ 757	- 151	+ 420	+ 261	+ 26	+ 707
June 20	- 29	- 236	- 139	- 404	+ 826	+ 187	+ 609	+ 385	- 159	+ 835
July 18	+ 426	+ 309	+ 37	+ 772	+ 215	- 210	+ 777	- 96	- 315	+ 366
Aug. 15	- 87	+ 197	- 123	- 13	+ 398	- 103	+ 282	- 161	+ 92	+ 213
Sept. 19	- 22	+ 218	- 162	+ 34	+ 318	- 35	+ 317	- 133	+ 190	+ 374
Oct. 17	+ 147	+ 404	+ 568	+ 1,119	+ 41	+ 66	+ 1,226	+ 398	- 2	+ 1,622
Month ended (seasonally adjusted)										
1978 Oct. 18	+ 73	+ 81	+ 82	+ 236	+ 151	- 53	+ 334 +0.7	+ 130	- 15	+ 449 +0.9
Nov. 15	+ 77	+ 27	- 61	+ 43	+ 214	+ 49	+ 306 +0.6	+ 255	+ 54	+ 615 +1.2
Dec. 13	+ 72	+ 271	+ 242	+ 585	+ 117	+ 8	+ 710 +1.5	- 85	- 13	+ 612 +1.1
1979 Jan. 17	+ 154	- 102	+ 161	+ 213	+ 869	- 86	+ 996 +2.0	- 87	- 76	+ 833 +1.5
Feb. 21	+ 198	- 55	+ 52	+ 195	+ 47	+ 265	+ 507 +1.0	+ 175	- 5	+ 677 +1.2
Mar. 21	+ 38	+ 222	- 225	+ 35	- 213	- 265	- 443 -0.9	- 221	- 57	- 721 -1.3
Apr. 18	+ 14	+ 467	+ 304	+ 785	- 171	+ 107	+ 721 +1.4	+ 79	- 104	+ 696 +1.3
May 16	+ 74	- 100	+ 65	+ 39	+ 836	- 146	+ 729 +1.4	+ 261	+ 26	+ 1,016 +1.8
June 20	- 79	+ 5	- 139	- 213	+ 780	+ 34	+ 601 +1.2	+ 385	- 159	+ 827 +1.5
July 18	+ 194	+ 411	+ 37	+ 642	- 68	- 147	+ 427 +0.8	- 96	- 315	+ 16
Aug. 15	+ 41	+ 77	- 123	- 5	+ 491	+ 63	+ 549 +1.0	- 161	+ 92	+ 480 +0.8
Sept. 19	+ 125	+ 155	- 162	+ 118	+ 274	- 58	+ 334 +0.6	- 133	+ 190	+ 391 +0.7
Oct. 17	+ 202	+ 166	+ 568	+ 936	+ 51	+ 93	+ 1,080 +2.0	+ 398	- 2	+ 1,476 +2.5

[a] Changes in the money stock may differ from those which can be calculated by reference to amounts outstanding (see additional notes to Table 11 of the Quarterly Bulletin).

[b] After deducting 60% of transit items (see additional notes to Table 6 of the Quarterly Bulletin).

[c] M<sub>1</sub> equals columns 1 + 2 + 3. Sterling M<sub>3</sub> equals M<sub>1</sub> + columns 5 + 6. M<sub>3</sub> equals sterling M<sub>3</sub> + columns 8 + 9.

[d] Including certificates of deposit.

[e] See additional notes to Tables 6 and 11 of the Quarterly Bulletin.



## Public sector borrowing requirement, domestic credit expansion and changes in money stock

£ millions

	Public sector borrowing requirement (surplus -)		Purchases (-) of public sector debt by UK private sector (other than banks)		Sterling lending to UK private sector [b]	Bank lending in sterling to overseas [c]	Domestic credit expansion [d]	External and foreign currency finance (increase -)			Non-deposit liabilities (net) (increase -) [c]	M <sup>s</sup> M <sub>3</sub> [f]	
	Central government borrowing requirement	Other public sector contribution	Other public sector debt	Central government debt [a]				Public sector	Overseas sterling deposits [c]	Banks' foreign currency deposits (net) [e]			
													1
Month ended (unadjusted)													
1978 Oct. 18	+ 293	+ 107	- 215	+ 415	- 14	+ 586	+ 60	- 9	- 167	+ 66	+ 536		
Nov. 15	+ 983	- 222	- 763	+ 269	- 117	+ 150	+ 126	- 10	+ 54	- 67	+ 253		
Dec. 13	+ 1,424	+ 328	- 653	+ 5	+ 137	+ 1,241	- 212	- 84	- 26	+ 31	+ 950		
1979 Jan. 17	- 547	+ 125	- 511	+ 1,216	+ 62	+ 345	+ 397	- 187	- 11	- 212	+ 332		
Feb. 21	- 31	+ 375	- 944	+ 1,125	- 147	+ 378	- 229	+ 11	- 142	- 51	- 33		
Mar. 21	+ 272	+ 279	- 1,371	+ 426	+ 8	- 386	+ 606	- 339	- 248	+ 23	- 344		
Apr. 18	+ 2,335	+ 234	- 1,381	+ 543	+ 29	+ 1,760	+ 461	- 353	- 147	- 113	+ 1,608		
May 16	+ 695	- 341	- 526	+ 618	+ 61	+ 507	- 111	- 115	+ 134	+ 5	+ 420		
June 20	+ 1,507	+ 35	- 1,426	+ 1,096	- 73	+ 1,139	+ 256	- 151	- 71	- 564	+ 609		
July 18	+ 601	+ 82	- 817	+ 1,128	- 6	+ 988	+ 240	- 207	- 170	- 74	+ 777		
Aug. 15	+ 571	+ 216	- 224	+ 143	+ 109	+ 815	- 94	- 275	- 142	- 22	+ 282		
Sept. 19	+ 1,456	+ 184	- 993	+ 108	- 20	+ 735	- 476	- 70	+ 78	+ 50	+ 317		
Oct. 17	+ 849	- 442	+ 57	+ 1,365	- 33	+ 1,796	- 52	- 163	- 118	- 237	+ 1,226		
Month ended (seasonally adjusted)													
1978 Oct. 18	+ 368	- 60	- 228	+ 397	- 14	+ 463		- 179		+ 50	+ 334		
Nov. 15	+ 890	- 186	- 779	+ 443	- 117	+ 251	+ 165		- 110	+ 306			
Dec. 13	+ 756	+ 401	- 709	+ 474	+ 137	+ 1,059	- 289		- 60	+ 710			
1979 Jan. 17	+ 593	+ 151	- 494	+ 483	+ 62	+ 795	+ 186		+ 15	+ 996			
Feb. 21	+ 648	+ 338	- 920	+ 1,129	- 147	+ 1,048	- 313		- 228	+ 507			
Mar. 21	- 30	+ 294	- 1,320	+ 729	+ 8	- 319	- 87		- 37	- 443			
Apr. 18	+ 1,464	+ 134	- 1,339	+ 535	+ 29	+ 823	- 95		- 7	+ 721			
May 16	+ 853	- 215	- 521	+ 819	+ 61	+ 997	- 132		- 136	+ 729			
June 20	+ 1,250	+ 133	- 1,451	+ 1,026	- 73	+ 885	- 6		- 278	+ 601			
July 18	+ 786	+ 119	- 841	+ 381	- 6	+ 439	- 13		+ 1	+ 427			
Aug. 15	+ 281	+ 202	- 238	+ 698	+ 109	+ 1,052	- 359		- 144	+ 549			
Sept. 19	+ 1,647	+ 118	- 982	+ 160	- 20	+ 923	- 512		- 77	+ 334			
Oct. 17	+ 937	- 617	+ 42	+ 1,237	- 33	+ 1,566	- 400		- 86	+ 1,080			

[a] Net purchases (-) of central government debt by the UK private sector (other than banks) can be analysed by instrument as follows:

	Marketable debt		National savings		Tax instruments	Other	Total (column 4 above)	
	Stocks	Treasury bills	Unadjusted	Seasonally adjusted			Unadjusted	Seasonally adjusted
Month ended								
1978 Oct. 18	+ 37	+ 62	- 166	- 179	- 152	+ 4	- 215	- 228
Nov. 15	- 832	- 35	- 135	- 151	+ 250	- 11	- 763	- 779
Dec. 13	- 366	+ 87	- 23	- 79	- 334	- 17	- 653	- 709
1979 Jan. 17	- 411	- 88	- 66	- 49	+ 71	- 17	- 511	- 494
Feb. 21	- 924	+ 95	- 266	- 242	+ 148	+ 3	- 944	- 920
Mar. 21	- 511	- 80	- 131	- 80	- 653	+ 4	- 1,371	- 1,320
Apr. 18	- 990	- 113	- 145	- 103	- 124	- 9	- 1,381	- 1,339
May 16	- 578	+ 5	- 54	- 49	+ 109	- 8	- 526	- 521
June 20	- 1,118	- 175	- 24	- 49	- 79	- 30	- 1,426	- 1,451
July 18	- 887	+ 178	- 80	- 104	- 18	- 10	- 817	- 841
Aug. 15	- 434	+ 145	- 43	- 57	+ 101	+ 7	- 224	- 238
Sept. 19	- 951	- 10	- 38	- 27	- 10	+ 16	- 993	- 982
Oct. 17	+ 251	- 79	- 43	- 58	- 74	+ 2	+ 57	+ 42

[b] Bank lending in sterling to the UK private sector (see page 6) plus Issue Department's holdings of commercial bills.

[c] See page 6.

[d] Domestic credit expansion equals the sum of columns 1 to 6.

[e] Banks' foreign currency deposits from, less foreign currency lending to, UK and overseas residents (see page 6).

[f] Sterling M<sub>3</sub> equals domestic credit expansion plus columns 8 + 9 + 10 + 11 (see also page 7).

## Symbols and conventions

.. not available.

- nil or less than £½ million.

Owing to rounding of figures, the sum of the separate items will sometimes differ from the total shown.

Further notes and definitions on these tables are given in the Quarterly Bulletin.

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NOTE FOR THE RECORD

cc. Mr. Hancock  
Mr. Beighton  
Mr. Andren  
Mr. Truman  
Mr. Gedling  
Mr. Workman  
Mr. H.S. Lee

European Space Conference

Mr. Workman and Mr. Lee saw the Minister of State this morning and reported that a request had been received via the Foreign Office from the Minister of Technology at this year's European Space Conference in Bonn, asking for Treasury agreement to his proposing that the next European Space Conference, which would take place in 1970, should be in London. He would only make this proposal if the present Conference seemed to be arriving at a compromise acceptable to H.M.G., and would certainly not make it if the Conference seemed to be breaking up in disagreement. It did not seem that he wanted to make this offer in order to help persuade the present Conference to accept U.K. proposals on substantive issues. The Foreign Office were content that the decision on the Minister of Technology's request should rest with a Treasury Minister.

The Minister of State said the only purpose of holding the Conference in London would be to demonstrate that H.M.G. was and would remain an active participant in European Space ventures. Accordingly, should it become apparent from the additional information about the proposed European Space projects that would be available by 1970 that these did not meet the economic criteria set by H.M.G., it would be much more difficult for us to say so in plain terms, and, if necessary, withdraw from the projects at a Conference where we were hosts. Thus the advantages of holding the

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Conference in London seemed to be clearly out-weighed by the risks,  
and the Minister of Technology should be told that the Treasury  
Ministers did not agree with his proposal.



(G. E. FITCHEW)

14th November, 1968

CONFIDENTIAL



Note of a Meeting held at 4.15 p.m.  
on Wednesday 11th July in the  
Chancellor of the Exchequer's Room

PRESENT

Chancellor of the Exchequer (in the chair)  
Sir David Serpell  
Mr. K. Berrill  
Mr. F.R.P. Vinter  
Mr. D.E.J. Dowler  
Mr. R.T. Armstrong  
Mr. J. Harris  
Mr. J. Marshall  
Mr. P. Baldwin

Public Expenditure 1969-70

The meeting had before them the Chancellor's memorandum to S.E.P. on this subject (S.E.P.(68)67).

British Rail

The Chancellor said that he had found the Minister of Transport's arguments against the proposed saving of £10 million difficult to deal with. The matter had not been settled at S.E.P. on Monday, partly because he preferred to go back to it in the light of decisions on later items; but he thought there might be advantage if he were to see the Minister separately before the meeting of Cabinet the following day. The official view still was that there was something to be had here, even if not the full £10 million. It had to be remembered that for every million pounds saved in 1969-70, there would be a consequential saving of some £3 million in 1970-71.

Nationalised Industries

The Chancellor said that there was a strong feeling among some of his colleagues that the whole basis of accounting for the public expenditure exercises was wrong, and that therefore the economies now sought were on a false basis. He felt there was some force in this, although there was no doubt it was sometimes used as an excuse. It had however been pointed out that the Brookings Report had taken the view that the U.K. spent too little on roads and too much on electricity supply; but because of the exclusion of nationalised industry investment from the P.E.S.C. total upon which Ministers operated, any offset between the two would still leave the public expenditure total higher than the publicly committed figure. In discussion it was pointed out that the reason for the distinction rested upon the degree of commercial

/independence



independence enjoyed by the nationalised industries, although of course their investment was very much under Treasury surveillance. This was, however, one of the points which would be brought into the review under Sir David Serpell; but whatever the outcome of that might be, it was clear that one could not change the definition of public expenditure in the middle of an exercise of the kind now in progress.

#### Airbus

It was pointed out that, if this were cancelled, there would be savings of £12 million in 1969-70 compared with the survey figures, but if it were not cancelled but left to go ahead there would be an addition to the survey figures because in the meantime the cost had risen. The Ministry of Technology were not expected to fight very hard for this item, but there were of course international political difficulties about cancellation.

#### I.R.C.

If the I.R.C. used £50 million of their £80 million ration for the two years 1968-69 and 1969-70 in the first year, there might be larger savings in 1969-70 than the £5 million which had been scored; but it would be unwise to count on more at the moment.

#### Research Councils

The proposal was a cut of £2 million in 1969-70, and it was pointed out that this was a great deal more severe than a cut of, say, £1 million because it would involve an open confrontation with the Council for Scientific Policy.

#### Agriculture

The £2½ million proposed reduction consisted of scraping together a variety of small savings.

#### Housing

The advantage of getting reductions in the housing programme was that it provided a useful carry-through to 1970-71.

#### Education

In the S.E.P. discussion earlier in the week it had been suggested that the Chancellor's proposals would involve difficult legislation. In fact only one of the proposals - the imposition of a school transport charge - would involve legislation; and this was the fairly modest proposal to charge the parents the equivalent of the ordinary public transport fare for use of specially provided school buses.

/The proposal



The proposal to get £2½ million off minor works in schools was not an extreme one, and would not involve the stopping of all minor improvements. A more extreme proposal would have been a cut of £6 million.

The cuts in further education were problematical in the sense that they were within the discretion of local authorities, whose conduct could only be influenced by pressure by way of circulars and operating through the Rate Support Grant.

The saving under teacher training was the result of allowing a decline in staff/student ratio, and was feasible in the sense that it was wholly within the control of the Departments.

The University saving was the one most favoured by the Secretary of State, but it would not be easy to obtain since the quinquennial grant to the Universities had been settled and it would mean reducing that. Furthermore, it could not be guaranteed that the Universities would cut the ratio of academic staff to students, but might seek to make the saving in some other way. It would doubtless rouse a good deal of complaint. It had to be remembered, however, that the £9½ million saving in 1969-70 represented a saving of £17 million in 1970-71.

#### Health and Welfare

The £2 million saving on hospitals capital expenditure was deliberately small, and was of a once for all character, relating only to minor works. Technically it would be perfectly feasible to cut the hospital building programme quite heavily, but this was not proposed in view of the views previously indicated by the Chancellor. On hospitals revenue expenditure, it should be noted that this would still show an accelerating rate of growth even after the proposed cut.

#### Accommodation (Home)

The proposed cut of £2½ million was not easy, since postponements of this kind were cumulative over the years and could lead to trouble. Nevertheless it was feasible in that it was within the Government's own control.

#### Land Commission

The saving in 1969-70 represented rather more than the projection of the expected underspend in 1968-69, and it was not yet possible to be certain that it was feasible.

#### Defence Budget

The Chancellor agreed the proposed £30 million saving in 1969-70, and indicated that for 1970-71 he would prefer to see a

/proposal

proposal for a further reduction of £30 million rather than the £20 million which he had seen suggested.

Other External Relations


This covered the Secret Service, and the possibility of a reduction on this was being pursued separately.

Roads

The Chancellor said that the Minister of Transport had challenged the allegation made in his brief that, even after the cuts, the road programme would still rise by 10 per cent in 1969-70. In the Minister's view it would rise by only about 1 per cent. Mr. Baldwin undertook to investigate this further and provide a note.

Timetable

Further meetings of Ministers had been arranged for Monday and Tuesday. The Chancellor had indicated to his colleagues that the problem for 1970-71 would be greatly eased if agreement were reached on his 1969-70 proposals; but nevertheless a paper on the position in 1970-71 would be necessary in order to clear matters up and get a directive from Ministers on the review which would be needed to cover the period 1970-71 to 1972-73. It was agreed that a draft would be put to the Chancellor that evening in the hope that any necessary amendment could be made immediately after the Cabinet meeting the following morning, and the amended version circulated to S.E.P. later that day in preparation for the meeting on the following Monday.

  
(J.A. Marshall)  
11th July, 1968

DISTRIBUTION

Those present	Mr. A. Mackay
Mr. Houghton	Mr. D. McKean
Mr. Fitchew	Mr. L. Pliatzky
Mr. Hay	Mr. P. Rees
Mr. Hawtin	Mr. J.E. Fraser
Sir A. Cairncross	
Professor N. Kaldor	
Mr. M. Posner	
Mr. R. Gedling	
Mr. I.P. Bancroft	
Mr. R.F. Bretherton	
Mr. N. Jordan Moss	

COPY NO. 1 of eight copiesNOTE FOR THE RECORDc.c. Sir Douglas Allen  
Mr Goldman  
Mr Figures

When the Governor came to see the Chancellor of the Exchequer this afternoon there was some discussion about the possibility of a reduction in **Bank Rate**. There was general agreement that no decision on this ought to be taken before the July trade figures were known. If the July trade figures showed the improvement in June was being maintained, and if United States interest rates showed signs of coming down, it would then become appropriate to consider a reduction of **Bank Rate**.

RTA

(R. T. Armstrong)  
10th July 1968



NOTE FOR THE RECORD

c.c. Mr Hawtin  
Mr Goldman  
Mr Figgures  
Mr Hubback

When the Governor saw the Chancellor on 10th July, he expressed the ~~view~~<sup>view</sup> that any question of dealing with outflow for portfolio investment in Australia should be subordinated to the "safety net" operation for dealing with the sterling balances.

2. The Chancellor said that it was his clear view that we could not afford a continued outflow for portfolio investment at the rate we had experienced in the first quarter of this year. If the outflow continued, we should be getting our priorities wrong if we did not take action to deal with it. He noted that the recent letter from the Australian Treasurer had been unsatisfactory on this subject. On the other hand, he fully accepted that the completion of the Basle arrangement was more important and should have priority. He would accept that no action should be taken on portfolio investment until the Basle arrangement was tied up, but reserved the right to press for action thereafter.

3. It was suggested that this question was not likely to arise in the context of discussions with the Australian Government about the Basle arrangement. But it could well arise in the meeting of Commonwealth Finance Ministers at the end of September, if only because the Australians might well be pressing us, not merely not to restrict portfolio investment by individuals, but also to withdraw the voluntary programme.

RAA

(R. T. Armstrong)  
10th July 1968



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MARSHALL FM  
LAW ARR. PMS

HOUSE OF COMMONS DEBATE

Some possible interruptions (or points for the winding-up speech)

You have not said what the Government will do if the negotiations at Dublin fail

(One version of this might come from Mr Peter Shore : "If the Government decides to amend Section 2(3) of the European Communities Act, - governing the payment of contributions - this would have the Opposition's full support).

That sounds as if the Hon Member wishes HMG to threaten rather than to discuss. The Government is working for success, not failure. HMG has no desire at all that the Community should be pushed into any sense of crisis over this matter. I hope that our partners are looking for an equitable solution. Both they and we need a strong Community in a tough and troubled world environment.

Linkages - fish, sheep etc

The idea of linkages or packages is wide of the mark. Issues which the Community have to deal with in the various Councils are necessarily important issues. Each needs to be dealt with on its own merits. The UK's net contribution is inequitable, and a remedy must be found. Of course I hope that other issues will be solved, too, with due regard to national interests. But we are not trading off one issue against another.

The EMS

Whether sterling should join the margins scheme is a question for decision on its own merits. It is my impression that the other member countries agree with this. The Government has not yet made its decision. But the British net contribution to the EEC Budget ought to be brought into broad balance irrespective of the decision whether it would be in the interests of the Community as a whole for sterling to be observing the EMS margins.



1% ceiling

The 1% ceiling may well be reached before too long. I have observed that some - not all - of the EEC partner countries attach very great importance to sticking to it. If the Community does agree to stick to it, that ought to be a powerful weapon in bringing about some new thinking about wasteful expenditure on surplus products. But that will not be the issue before the Dublin Council. And it ought to be kept separate from the discussion of the UK's case for equity on the Budget. In any case, efforts to reduce and contain CAP expenditure, admirable though these would be, would not provide an immediate solution to the UK's budgetary problem.

What do you mean by broad balance?

You will not expect me to put a single figures on our requirement at this stage. It could all too easily become an upper limit for the negotiations. But we see no good reason why the UK should not be in a position at least as favourable as France, the self-professed guardian of all that is communautaire, which in recent years has been sometimes a net contributor and sometimes a net recipient, <sup>both</sup> on a small scale.

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\*

UK BUDGETARY RECEIPTS

The following table shows the breakdown of the UK's forecast receipts from the Community Budget in 1979 and 1980 :

	<u>1979</u>		<u>1980</u>	
	<u>Actual</u>	<u>as % of Community total</u>	<u>Actual</u>	<u>as % of Community total</u>
FEOGA Guarantee Section	456	5.2	597	5.5
FEOGA Guidance Section	84	19.4	53	15.1
Social Fund	132	25.0	138	25.0
Regional Fund	131	27.0	162	27.0
Research, Energy and Industry	35	12.7	55	12.2
Reimbursements	202	27.0	224	28.6
Administration	3	0.4	5	0.5
<hr/>				
Total ("exporter pays")	1041	8.1	1234	7.8
MCA's	723		260	
<hr/>				
Total ("importer pays")	1764	12.9	1493	9.2
<hr/>				
Total Budget	13,717		16,245	

Note: Discrepancies due to rounding.

Source: Commission  
"reference paper"

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14.

[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 no faster than 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

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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



305/7

Peter Gorm  
Chancellor.

Forum: Actives.

I am getting to PQ as quickly  
as possible. But it was need  
and to me on the phone and  
sounds very bit as bad as feared. ✓

J



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MR DYER

- cc Mr F K Jones
- Mr Morris
- Mrs Diggle
- Mr Bent
- Mr Dixon
- Mr Davies
- Mr Mortimer
- Mr Butt
- Mr Chambers
- Mr Crawley )
- Mr Newcombe ) IR

REVIEW OF BUDGET PROCEDURES (PRESS NOTICES)

As you say in your minute of 25 April, the handling of this year's Press Notices was not entirely satisfactory. The general problem was aggravated because, with the Statement being broadcast live, the Chancellor restricted its contents to only the most important items. The inevitable result was that several items mentioned in either the Budget Resolutions or the FSBR were not mentioned in the Statement, or else were only mentioned very briefly; and this left us with an obligation to provide further details for MPs, for the press and other interested parties. I am sure it would be prudent to assume that this will happen next year as well.

2. I think that option (a) of your minute must be ruled out. We want the Budget decisions fully and accurately reported and we must not be constrained from issuing desirable Press Notices by administrative constraints. Options (b), (d) and (e) would be sensible administrative reforms; as with all matters relating to the Budget, the sooner things are tied up and briefing etc has been prepared the better. But we must accept that, given the pressure on Ministers and on officials at Budget time and delays in reaching final decisions, this will not always be possible. Option (c) is another which we could, perhaps, pursue with the House authorities, but it depends essentially on what Members want.

3. The critical reform which I would suggest, and which I hope would help to ensure that many of this year's problems do not recur, would be at the earlier stage of preparation of the Press Notices. Many of the problems you had in handling the Press Notices this year stemmed, I suspect, from the lack of early consideration as to precisely what Press Notices were going to be issued and when they would be ready. I would suggest that one person in each Department - either from a co-ordinating seat or from the Press Office - should be put in charge of all Press Notices. Each would be responsible for

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agreeing say two weeks before Budget day with Divisions what notices should be issued although some revisions to the list might later have to be made. He would also agree by when each notice should be ready. The Treasury co-ordinator would provide Parliamentary Section and Ministerial offices with a combined list, together with deadlines, and be in charge of the overall arrangements for duplication and transport to the appropriate offices.

4. Although it would be unrealistic to suppose that all Press Notices would be available earlier - for example the final copy of that for which FP1 was responsible this year could not be settled until after we had heard the outcome of the Budget Cabinet - at least some of them should be. If we could ensure that at least some of the notices were ready before the weekend, there would be less difficulty in processing those which were unavoidably delayed. In addition a lot of unnecessary confusion would be avoided if everybody wanting to discuss or to know about Press Notices could go to the same person in each Department.

JHB

L J H BEIGHTON  
10 May 1978

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- 1 MR HEIGHAM
- 2 MR BUTT

- cc Mr Beighton FP
- Mr Dixon IDT
- Mr Taylor Accts
- Mr Chambers EOG
- Mr F K Jones C/O
- Mr Dyer Parly Sect
- Mr Peet FP3
- Mr Ritchie o.r.
- Mr Bridgeman
- Miss Brown
- Mr Butler
- Mr France
- Mr Hancock
- Mrs Hedley-Miller
- Mr Isaac
- Mr Lovell
- Mr P G Davies
- Mr B S Morris
- Mr Bent
- Mrs Diggle

REVIEW OF BUDGET PROCEDURES

Your minute of 21 April refers, in which you invited circulation of comments to recipients of your minute by 19 May. When EB discussed its local arrangements shortly after the <sup>Budget</sup> exercise, this threw up the following points which may be of interest outside EB. (For the purposes of this minute "EB" includes our colleagues from IDT who took part in the exercise up here.)

We discussed the feasibility of preparing and circulating the unclassified "historical" and "comparative" material in the Brief a while before Budget Day. It was thought that this could be useful in particular to IDT (when talking to the Press beforehand on the state of the economy as a back-drop to an approaching Budget) and could reduce the bulk of paper needing to be reproduced and circulated at high speed under security conditions at Budget time. But it would mean that certain contributors would be asked to contribute to the Brief in two instalments. (Possibly this would be welcome to them too as a way of spreading the work?)

This was one suggestion related to the recurring question: how contributions to the Brief could be limited to the essentials necessary. It was felt that some contributors (especially in Inland Revenue) had in mind what would be useful during Finance Bill debates rather than in the immediate Budget period, and we questioned whether the Brief was the right vehicle for this.

B

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should welcome contributors' and users' views on what is optimum size and scope of the Brief.

I have already had Mr Heigham's views (his minute of 28 April to Mr Peet) on the consequences of the selective security restraints applied within the office to certain items. May I underline that exclusion of members of the EB team means a less good job can be done on the Brief, the summary of the Speech and the "snapshot". Last minute insertions in (or deletions from) the documents which are to be released outside the Treasury risk drawing attention to those very items and suggesting there has been internal controversy and/or mind-changing in a way which does not do the image of Government's decision-making any good. Selective security also results in less lucid, logical and self-consistent presentation in documents for outside and internal use, eg helpful cross-references cannot be inserted in the Brief (or existing ones are rendered incorrect - and so pointless - by last-minute interpolations of new matter) and the contents list has to be less helpful as a guide to the material within.

You and certainly EOG are well aware of the following point but may I emphasise again that if documents which are otherwise ready for duplication have to be held back or released subject to addition or alteration this adds considerably to the strain on reproduction services and hinders a rational use of their finite resources. More trust reposed in less senior officials would mitigate this. (EB is grateful to CRU especially for the forbearance they display - perhaps because they recognise the handicaps imposed on us?)

Finally, arising out of EB's review rather than your own minute, would <sup>it</sup> be appropriate and helpful for arrangements to be made to distribute in Budget week duplicated copies of either the Broadsheet or the "snapshot" to the generality of Treasury officials for their information (perhaps through clerical sections on the basis of one per room of officers below N/S level?)

M M Deyes

M M DEYES  
EB

16 May 1978

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MR BUTT

cc Mr Beighton  
Mr Dixon  
Mr Heigham  
Mr Chambers  
Mr F K Jones ✓  
Mr Dyer  
Mr Bridgeman  
Miss M P Brown  
Mr F E R Butler  
Mr France  
Mr Hancock  
Mrs Hedley-Miller  
Mr Isaac  
Mr Lovell  
Mr Unwin  
Mr P G Davies  
Mr B S Morris  
Mr Bent  
Mrs Diggle  
Mr Peet

#### REVIEW OF BUDGET PROCEDURES

The Account Division principal involvement in the Budget concerns the production of the Financial Statement and Budget Report in its separate blue and red versions.

We produce well in advance a detailed time-table setting out the various stages involved in the production and calling for contributions from those on whom we must rely for the necessary raw material. We have checked this year's results against the time-table and, with two or three exceptions, the results were good. Two of the exceptions, the Economic Outlook to mid-1979 and the 1978-79 figures in Tables 6, 7, 14 and 15 were a direct consequence of Ministerial delay; but the substantial revision of the Introduction to Part II was a last-minute change which I felt it ought to have been possible to dispose of at least 24 hours earlier.

Nevertheless we met the final deadlines with both the Press and ourselves working throughout the Saturday; in theory at least, the Sunday remained an unused cushion against further delay. We were, however, forced to cut out a number of intervening page proof stages during the course of the week, thereby raising somewhat the risk of error but so far I have only been made aware of one which got away! There is, of course, the further point that this year we



were not at risk from industrial trouble at the Press and did not need to mount an internal Treasury back-up operation to produce a version of the FSBR for use in the House and by the Information Division.

My conclusion is that next year's time-table should follow the pattern which has been established over the past two or three years, recognising that it contains about 48 hours of "fat" represented by the intervening Saturday and Sunday and that further small economies can be achieved by cutting out some of the intermediate page proofs, albeit with some raising of the level of risk of error.

On the question of security, I noticed that there was a marked movement of names from List B to List A and I wonder whether the maintenance of separate lists continues to be justified. But I cannot pretend that the security arrangement inhibited the work of the Accounts Division save that I found it necessary to intervene specially to ensure that I was provided with copies of the draft Speech from the outset.



L J TAYLOR  
16 May 1978

MR. F.K. JONES

- cc Mr. Morris
- Mrs. Diggle
- Mr. Bent
- Mr. Beighton
- Mr. Dixon
- Mr. Butt
- Mr. Chambers

REVIEW OF BUDGET PROCEDURES

(Press Notices)

One of the Parliamentary Section's functions on Budget day is to ensure that copies of all the Budget-related documents are available to Members, in both Houses of Parliament, at the end of the Statement. This entails the despatch of 600 copies of each such document to the Deliverer of the Vote and 150 copies to the Printed Paper Office; who issue them to Members from the Lobby when the Chancellor sits down.

The trend towards shorter Budget speeches in recent years has meant that more of the detail about proposals has to be set out in Press Notices. This year, in addition to the usual Budget publications, there were 20\* Press Notices - more than twice as many as the previous year.

The sheer mass of paper, together with the security and time constraints involved, very nearly caused a complete breakdown in the issuing system this year. I subsequently received (not unexpectedly) a rather emotive letter from the Deliverer of the Vote complaining bitterly about this year's arrangements and the chaos that ensued. The floor behind the Lobby window was awash with Press Notices; whilst he and his harassed staff opened embargoed pouches and tried to collate these Notices into sets for waiting Members. With upward of 200 impatient Members milling around waiting for copies, it is hardly surprising that some abuse was directed at the issuing staff.

Obviously, if we are to maintain the goodwill of the House Authorities and ensure that the House and Members are served effectively on future occasions, we must seek for improvements in our present arrangements and procedures. Indeed, I have promised the Deliverer of the Vote that we

\*21, if one counts the Notice on school meals withdrawn at the last moment.

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will be reviewing our Budget procedures - with a view to making his task easier on future occasions - and will be putting some solid proposals to him in the near future.

There are a number of ways in which we might do this (and, incidentally, at the same time tighten up our security and control of these "embargoed" documents). I suggest we consider a combination of some of the following possibilities:-

- (a) reducing the number of Press Notices;
- (b) running-off copies of the Press Notices 24 hours earlier - ie on the Monday morning;
- (c) placing in the Vote Office and the Printed Paper Office, only those Press Notices which are actually mentioned or referred to in the Speech - ie the key notices;
- (d) collating and parcelling the Press Notices - including those from Customs and the Revenue - into sets before they are sent to the Deliverer of the Vote (possibly in the Treasury Committee Section);
- (e) arranging for a van (because of the weight of material) to transport the parcelled sets to the House earlier in the day (circa 2pm), so that staff in the Vote Office have more time to prepare for the onslaught at the end of the Speech.

I appreciate that whatever we do, there is always going to be some risk of chaos on the day, but we must try to improve on our present arrangements - and present the Deliverer of the Vote with some concrete, and more satisfactory, proposals for the future.

*P. Farrell*

p.p. B.O. DYER  
25 April 1978.

MR. BUTT

cc Mr. Beighton	Mr. Hancock
Mr. Dixon	Mrs. Hedley-Miller
Mr. Heigham	Mr. Isaac
Mr. Taylor	Mr. Lovell
Mr. Chambers	Mr. Unwin
Mr. F K Jones <sup>1/2</sup>	Mr. P G Davies
Mr. Dyer	Mr. B S Morris
Mr. Bridgeman	Mr. Bent
Miss M P Brown	Mrs. Diggle
Mr. France	Mr. Peet

REVIEW OF BUDGET PROCEDURES

Reflecting on GEP's participation in the Budget, the secrecy relating to the public expenditure measures after 4 April led us into some difficulties.

There were two particular instances:-

- (i) The embargo on DHSS working out with the Treasury the detailed consequences of the decisions on uprating of benefits;
- (ii) The difficulty we got into over not being able to consult Departments about the detail we were announcing about their expenditure measures on Budget Day.

On the second, if we had been allowed to consult Departments, I think there would have been advantage in issuing a press notice about the expenditure measures as we originally envisaged. Without a press notice, one either has to get all the necessary detail into the speech; or else rely on IDT to answer the immediate questions we can hardly refuse to answer (e.g. on this occasion, about amounts allocated to individual programmes). On this occasion, there was some last-minute worry about how far we should go in answering such questions without anticipating announcements Departments themselves would want to make.

In future, therefore, I would prefer to have a press notice setting out the information the Treasury is prepared to give so that we do not have to rely entirely on the Budget speech and so that the Departments know what has been said and what remains to be said. But this requires our being freed from the security imposed on this occasion.

F.E.R.B.

F E R BUTLER  
26 APRIL 1978



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