

NOTE FOR THE RECORD

Mr. Stowe
c. Mr. Ridley
Mr. Wolfson
Mr. Ryder
Mr. Cartledge

The Prime Minister called me and Mr. Ridley in to the latter part of a meeting which she had with the Chancellor of the Exchequer this evening. While we were present, the following points were made.

- i) The Prime Minister raised the question of whether it was necessary to back-date to the beginning of this financial year the direct tax cuts in the Budget. She understood that there could be administrative difficulties in achieving this - the Inland Revenue would no doubt complain about the extra work load. Nonetheless, it was vital that there should be no back-dating. In this way, there would be revenue savings, and the tax cuts would not look significantly less than if there was full back-dating. The Chancellor agreed to follow this up.
- ii) The Prime Minister said that, in her view, the sale of assets could make a very useful contribution to getting the PSBR down. She had particularly in mind the sale of derelict land. She thought Irwin Bellow would be able to provide good advice on this. Mr. Ridley pointed out that too much dependence on sale of assets to finance PSBR reductions would be bad for confidence. The Prime Minister agreed that a balance was needed as between this and other measures.
- iii) The Prime Minister said that the Budget, in her view, should not involve any stimulation of the economy. It was essential to secure a significant reduction in PSBR and also to reduce the growth of the monetary aggregates.
- iv) As regards public expenditure cuts, the Prime Minister said that Departments should not be told what particular activities to cut but rather to make reductions of particular amounts: thus, it would be for spending Ministers to decide where to cut. However, it would still be necessary for them to consult with colleagues on the political aspects.

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- v) The Chancellor said that inflation was likely to rise over the next six months even in the absence of any increases in indirect tax. The Prime Minister said that in view of this, and if there were to be increases in VAT, it would be important to maintain a high exchange rate. The Chancellor mentioned the worries which the CBI had expressed about the growing price uncompetitiveness of some areas of industry as a result of sterling's strength. The cheapening of imports of raw materials was of course a benefit from having a high exchange rate; but a high exchange rate also meant cheaper imports of manufactured goods.
- vi) The Prime Minister questioned whether any immediate decisions were required on EMS. The Chancellor replied that no immediate decisions were required. It would be best to leave over the question of joining the exchange rate regime until the review which the EMS members had agreed for September. He hoped to insert a sentence in The Queen's Speech on EMS which would imply a neutral position for the time being. The Prime Minister could take the same line in her discussions with Chancellor Schmidt later this week. In addition, there was the question of whether we should deposit 20 per cent of our reserves with the European Monetary Corporation Fund and receive ecus in return. On the face of it, this was only a paper transaction; and it could be done without any difficulty.
- vii) The Prime Minister said that she hoped that the Finance Bill would be short and straightforward. The Chancellor said that he hoped it would be but there were certain tax changes which could involve a significant number of clauses. He mentioned changes in CGT to allow for the effect of inflation. On this, he proposed to go for either indexation or tapering, whichever proved simpler. The Prime Minister said that she would prefer tapering. Mr. Ridley said that the Chancellor's ideas for changing stock relief could also involve complex drafting.
- / viii). The Prime Minister

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viii) The Prime Minister raised the question of raising the £25,000 cut-off point for income tax relief on mortgages. She thought that this cut-off was holding back the housing market above a certain level. The Chancellor said that he would prefer to remove the surcharge on stamp duty for purchases above £15,000. This would be no less popular, and by reducing the fixed cost of housing transactions, it would help to improve mobility. The Prime Minister agreed that the Chancellor should try to find the extra revenue to make this change.

R.

7 May 1979

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