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Thank you. I should like to consider with you on my return, a concession with our advice.

OK 25/9

TREASURY THINKING ON ECONOMIC POLICY

In the course of a useful conversation over lunch, Ryrie gave me some idea of how Treasury thinking is developing. The main point to emerge was the relative lack of contact between ministers and officials and the fact that officials were more concerned about the PSBR and the necessity for fiscal action than ministers.

Wass, Burns and Ryrie had a meeting with the Chancellor, Lawson and Biffen on Monday. The three officials pressed the case that a significant fall in interest rates reasonably soon was desirable on many grounds and the pressure for it might well become irresistible. In their view this could only be achieved credibly by being combined with action to reduce the PSBR.

The centrepiece of the proposals on the PSBR would be a low ceiling for central government and local authority pay. (It was agreed by all that not much can be done about the nationalised industries.) Three options were discussed: 8%, 4% and zero. Wass apparently argued most hawkishly but ministers, supported by Ryrie and Burns, were tending to go for 8% or something near to it. The main grounds were that this could be defended as in the same area as the private sector settlements would probably come out; and therefore should have no "catch up" implications for the following wage round. A freeze on the other hand would, it is argued, look temporary and special and would be bound to generate more pressure in 12 months' time.

A number of other minor ways of improving the PSBR, largely concerned with acceleration of timing, I believe (such as the proposed change

in timing for the levying of VAT on imports) were discussed but do not seem to have been pushed very far. The main other proposal pressed seriously by the officials was that it should be announced that employees' National Insurance contributions would be increased - or increased more than they would normally be, I think - at the next budget. The merits of this proposal were that it would be a way of directly raising quite large sums out of the personal sector surplus with perhaps minimum inflationary or other undesirable implications.

According to Ryrie, ministers were very reluctant to consider any such proposals. Lawson explicitly is interested in confining any new measures to the monetary sphere. His preferred package appears to be Restricted Indexed Gilts; more National Savings (it is not clear what more could be done than is being pressed on with now); the consumer credit proposals, which were got ready as a contingency plan in the spring; and inflow controls.

In general, ministers did not give Ryrie the view of being very seized with the urgency of the situation - either of the urgency/difficulty of getting the M3 numbers down or of the urgency of getting interest rates down.

Cwm

25 September 1980