MR. WALTERS

Copy No. 2 of 3 Copies

8

10 DOWNING STREET

From the Private Secretary

25 February 1982

I am writing to record the outcome of a number of discussions which the Prime Minister has had with the Chancellor on the matters raised in the Chancellor's minutes to the Prime Minister dated 18 February, 23 February and 24 February.

Monetary Policy

The Prime Minister has noted that the Red Book will again contain an updated version of the medium-term financial strategy; that the medium-term monetary objectives will be expressed not only, as hitherto, in terms of Sterling M3 but also of the wider aggregates generally, as well as M1 and the narrow aggregates; and that it will be said that the exchange rate will be taken into account in assessing monetary conditions. The Prime Minister has also noted that the precise ranges to be shown for the aggregates will probably be fixed at 8-12 per cent for 1982/83, with declining ranges for subsequent years.

Fiscal Stance

The Prime Minister agrees with the Chancellor's aim to go for a PSBR for 1982/83 of about £9½ billion. She thinks it very possible that the oil price will go down some way below 30 dollars a barrel, and on this basis believes that tax reductions with a PSBR effect in 1982/83 of around £1.5 billion are at the top end of what can be afforded within the £9½ billion figure.

Detailed Proposals

On the specific duties, the Prime Minister is content with the proposals set out in Annex A to the Chancellor's minute of 18 February. In two contexts, the Chancellor and the Prime Minister discussed the possibility of raising the proposed 5p increase on petrol and derv: in connection with the Cabinet's decision not to proceed with the proposal to recover motor accident NHS costs from insurers; and also in the context of recent falls in the oil price. Their conclusion was to stick to the proposed 5p increases.

On the national insurance surcharge, the Prime Minister was doubtful about the economic merits of the proposed 1½ per cent cut to take effect from August. She was concerned about the effect on pay, and doubtful about the wisdom of a tax reduction

/which

which reduced banks' and insurance companies' costs as much as it did those of manufacturing industry. She acknowledged, however, the political case for some move here; and also the need to help industry. She has agreed, therefore, to a 1 per cent reduction over the year as a whole; she recognises that, to secure this effect, it will be necessary to reduce the surcharge by 1½ per cent from August when the cut will take effect. The Prime Minister is most concerned that the cut should not be described as a 1½ per cent cut in the surcharge; and that there should be no implication that there will be an automatic continuation of the 1½ per cent in 1983/84.

On personal taxes, the Prime Minister accepts the Chancellor's proposal for an increase in tax allowances and thresholds of 15 per cent, i.e. three percentage points above the minimum required by the "Rooker-Wise" legislation. The Prime Minister accepts that it may be necessary to trim this figure downwards, in the interests of containing the tax reductions to around £1.5 billion.

On the "Additional Measures", summarised at Annex B of the Chancellor's minute of 23 February, the Prime Minister accepts that there should be no element in respect of domestic gas prices (her immediate inclination was to reverse the planned October increase, and to include an element in Annex B on that account). She has agreed, however, to the proposal made by the Secretary of State for Energy, and accepted by the Chancellor, that industrial gas prices should be frozen after the March 1982 increase up to the end of calendar 1982.

On the mortgage interest relief ceiling, the Prime Minister has agreed not to press her proposal that the ceiling should be increased to £35,000. She has indicated, however, that she will certainly wish to increase this ceiling in next year's Budget. To meet her concern that the Budget was not doing enough for home ownership, the Chancellor proposed that the bands on which stamp duty is charged should all be raised by £5,000. This would cost somewhere in the region of £70-100 million, and would benefit labour mobility as well as home ownership. The Prime Minister accepted this proposal.

M. C. SCHOLAR

John Kerr, Esq.,
HM Treasury.