

PRIME MINISTER

1. I agree with the broad assessment of the Chancellor. However, I would judge it wise to plan for a rather tougher figure of net reduction of £2 billion, mainly because this "tougher -than-expected" stance would further ease funding and interest rates and probably the exchange rate. The latter two effects would, of course, assist industry across the board but especially the export sector.
2. Of relief for business generally, beyond the capital tax measures, I am more keen than the Chancellor on reducing the NIS by a reduction of at least 0.5 per cent to 3.0 per cent (cost £0.6Bn). We could present it as an employment measure - a reduction in the tax on employment designed to provide more jobs. True it would not be weighted in favour of the export sector, but I would expect that the export sector suffering will best be relieved by exchange rate adjustments.
3. Generally I do not think the budget is appropriate for dealing with the distortions brought about by a high exchange rate. Tax rates will persist for the financial year - yet we may well see a dramatic change in the value of sterling (as we have seen before). And in any case such budget measures would be crude and inevitably discriminatory.
4. I am concerned about the monetary targets and, above all, the mechanism of money control. There is at present no effective control of the money supply and I am pursuing further discussions with the Chancellor, Middleton and others. I propose to report progress to you on Monday.

Aw.6 February 1981