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

9th May 1979

Dear Tim,

.....
I attach a note on the problems
inherited by the Chancellor of the
Exchequer and the Chief Secretary.

Yours ever,
Martin

(M.A. HALL)

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IMMEDIATE PROBLEMS

The main problems requiring immediate attention may be summarised as follows:-

1. Economic Outlook generally: Prospects are sombre. Output is rising very slowly and the rate of inflation likely to increase to about 11 per cent by the year end before taking account of any Budget increase in indirect taxes. Control of inflation is a paramount requirement and this will require tight monetary and fiscal policies. The outlook for productivity, profits, output and employment is equally discouraging. The Budget will be the first major step in tackling these fundamental problems.

2. Fiscal Policies: With a large deficit in prospect there is little room for manoeuvre in the short-term if we are to keep tight control over the money supply without increasing interest rates. The scale of reductions in direct tax, which are crucial, make all the more important the need to reduce public expenditure.

3. Public Expenditure: Some immediate expenditure cuts are essential in 1979-80 as part of the Budget. Urgent decisions are needed on cash limits; those set by the previous Government, based on their 5 per cent pay guideline, were unrealistic and are now untenable. We also need to set in hand now a wider review of the scope for cutting expenditure in the medium term, but the main action on this will be in June/July rather than the first month.

4. Public Sector Pay: We are half-way through this year's annual public sector pay settlements, but major cases are outstanding. These include teachers (most immediate), armed forces, doctors and dentists, post office, electricity and gas. Our aim must be to hold settlements within the broad pattern already established and avoid any action in the pay field

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prejudicial to our fiscal and monetary policies. We shall also need to determine the future of the Clegg Commission.

5. Europe: No progress has been made in correcting the inequitable arrangements under which, though 7th in GDP per capita, we are by far the largest net contributor to the Community Budget and our position will worsen as the transitional arrangements end. Radical changes in the financial mechanism are necessary; we must make a start at the Finance Ministers' Council on 14th May. The Government will need in due course to make its position clear on EMS.

6. Internationally, the main issues of imbalances between the major economic blocs, growth and employment and currency instability need to be considered in preparation for the Tokyo Summit. These factors all affect the UK's room for manoeuvre on domestic policies.

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