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10 DOWNING STREET

From the Private Secretary

14 November 1979

The Prime Minister held a meeting this evening at 1700 hours to discuss the measures which the Chancellor of the Exchequer proposes to announce tomorrow. The Home Secretary, the Chancellor, the Chief Secretary, the Financial Secretary, the Attorney General and the Governor were present. The meeting had before it the Chancellor's minute of today's date together with the draft of his Statement. The following are the main points which came up in discussion.

The Prime Minister first outlined the problems on the monetary front with which the Government had to deal. In view of the very bad money supply figures for October, it was essential that there be a sharp improvement in the figures for November; and this meant the need for heavy sales of gilts in the next few days. Against this background, an increase in MLR was inevitable. In addition, measures needed to be taken to reduce the PSBR for 1979/80, since it was now forecast to be significantly higher than at the time of the Budget.

MLR

The Governor said that it was essential to sell £500 million of gilts by the close of next Tuesday. The only way of being sure of achieving this was to raise MLR to 17%. The three-month rate was now standing at over 16%, and all the advice he had had was that anything less than 17% would carry with it the risk of failure. He found it very unpleasant to have to recommend such a large increase, and there was the added difficulty that we might be accused of aggravating the problems of the Dollar arising from the Iranian situation. But there was no alternative if the Government's monetary strategy was to remain in tact. The Governor went on to say that there was £350 million still available from the 1989 tap; the Bank intended to issue a new long tap amounting to £1 billion, and this would be part-paid with £150 million planned for receipt before the end of the banking month.

The Chief Secretary added that it would be fatal to undershoot on the MLR increase. If Ministers did not accept the advice of their professional advisers and went for say 16½%, there was a real risk that the increase would not have the desired effect; if that happened, there would be a real crises and no doubt a full fiscal package would be required. Having adopted a strategy of firm monetary control, the Government must stick to it.

/The Prime Minister

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M.R.

The Prime Minister said that she was very disturbed that it was now thought necessary to raise MLR to 17%. With the measure to bring forward payment of PRT (see below), she felt that 16½% might be sufficient. Before taking a final decision, she asked Treasury Ministers to make a fine judgement balancing the political problems of raising MLR to 17% against the market risks of going to 16½%. (At a reconvened meeting later in the evening, the Prime Minister agreed reluctantly that the increase should be to 17%.)

The Home Secretary commented that an increase to 17% would indeed be a political shock both for Ministerial colleagues and for the country. He wondered whether more reliance could not be placed on measures other than MLR to control the creation of credit. The Chancellor responded that other possible measures to control credit to the private sector had been fully examined; there were none which would provide an answer to the current difficulties. One possibility which he was looking at was to reduce the tax relief available on borrowings; but no changes could be made on this front before the next Finance Bill and they would involve complex legislation.

PRT

The Chancellor said that advance payment of PRT could bring in £700 million in 1979/80 and a further £300 million in 1980/81. This would require legislation, and there were legal risks. But on balance he was convinced that this would be a useful additional measure. It would go a long way to bringing the PSBR back into line with the Budget forecast.

The Attorney General commented that an announcement tomorrow to oblige the oil companies to make advance payments of PRT was much too close to the recent BP share sale for comfort. Some of the contracts relating to this sale were still not complete. Moreover, the Securities and Exchange Commission document relating to the sale gave specific dates of payment of PRT. If the BP share price were to fall significantly following the announcement, and if a shareholder were then to start proceedings against the Government for not having made its intentions clear at the time of the sale, it seemed quite likely that the judgement of the Court would go in his favour. At the very least, the Government would have great difficulty in proving that it had not intended to proceed with the PRT decision when the share sale was announced.

The Chancellor, however, pointed out that the extra financial burden on BP would not be all that great. In terms of the interest which they would have to forego, the extra net cost to the private shareholders was likely to be only about £6 million. The Home Secretary added that, politically, there would be great advantage in including the PRT measure in the Chancellor's announcement. It was generally understood that oil companies were making large profits following the recent oil price increases, and there was a general feeling that the Government ought to be taking a larger slice.

The Governor commented that, if it were decided to go ahead with the PRT measure, it should be presented in a low key manner. It could be presented as a means of counteracting the delay in the payment of VAT and Post Office bills. It would be a mistake to give the impression that it was a major new fiscal initiative since it clearly was not.

/The Prime Minister

The Prime Minister said that, despite the risks of a row and even possible law suits, it would be right to include this measure in the Chancellor's announcement.

Other possible measures to reduce the PSBR

The Chancellor said that he had examined the possibilities for speeding up VAT demands. He had concluded that there was little that could be done. He had ruled out the use of the regulator because of its effect on the RPI, while its effect on the PSBR would be relatively small.

On the other hand, there was scope for a further £100 million from forward sales of oil; and the contingency reserve could probably be trimmed by £150 million because that amount had been set aside for assistance to Rhodesian refugees - and it seemed very unlikely that it would now be needed this financial year.

The Prime Minister said that the Treasury should be looking at the possibility of increasing the tax on bank profits. (I wrote to Tony Battishill earlier today about this.)

The Prime Minister also wondered whether there were possibilities for reducing public expenditure in the short run. The only significant option appeared to be to reduce the UK's EEC contribution, and she would have to say at Dublin that - against the current economic background - the UK had no alternative to eliminating its net payment. Another possibility might be to slow down capital spending.

The Financial Secretary said that it would be right to reconsider the public expenditure figures for 1980/81; but this must be done in an orderly fashion. It would be a mistake to give any indication in the Chancellor's Statement tomorrow that the recently published figures were going to be changed.

National Savings Measures

The Chancellor said that these should produce a net inflow of £700 million in the present financial year. This would be a substantial help in funding the PSBR.

The Prime Minister said that she was not altogether happy with the measures in so far as they would take funds away from the building societies. But she agreed they should be included in the Chancellor's Statement as he proposed.

Roll-forward of the M3 Target

It was agreed that the present 7-11% target should be rolled-forward for the 16 months from mid-June 1979 to mid October 1980.

Extension of the "Corset"

The Prime Minister said that it was an unnecessary hostage to fortune to announce that the "corset" would be phased out

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after 6 months. It might, in the event, be needed for more than 6 months. It was agreed that the Statement should be redrafted so as to leave open the possibility of its continuation beyond 6 months.

Iran and the Dollar

Finally, the Chancellor reported on a conversation he had had on the telephone during the course of the meeting with Secretary Miller. Miller had explained the background to President Carter's order freezing official Iranian assets held in the USA and in US banks abroad, and had asked for HMG's co-operation in making the order effective. He had responded sympathetically, and had said that HMG would certainly be willing to consider any proposals from the US authorities.

I am sending copies of this letter to John Chilcot (Home Office), Bill Beckett (Attorney General's Office) and Sir Robert Armstrong (Cabinet Office).

T. P. LANKESTER

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