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FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR

cc Chief Secretary
Sir D Wass
Mr Bridgeman
Mr Middleton

REFLECTIONS ON FRIDAY'S MEETING

1. Mood. We have a theoretical choice between playing down and playing up; between saying that everything is more or less on course, that we have simply had one month's freak figures, but that these do require an adjustment as was implied by our already-stated determination to adhere to monetary targets etc; or on the other hand dramatising the situation in order to demonstrate our determination to adhere to our declared targets and root out inflation come what may, and to affect expectations favourably by the very drama of what we are doing.

I see no sense in any middle course; and if that is so, it seems to me that we are forced towards the second: I see no way in which an all-time record high MLR, higher even that in the crisis of 1976, can be presented as a routine adjustment. In which case I see no point in shrinking from sensible measures merely because they might smack of a 'second budget'.

2. The PSBR. We have to accept that the prospect is of a £1 bn overshoot this year - which, because of the peculiar profile of this year's PSBR, will become apparent before the year is out and may indeed appear even worse than is really the case. I am not too worried by the £400m phone bill shortfall, but it remains highly desirable to take fiscal action to cancel out the rest of the overshoot. The immediate announcement of legislation to advance payment of PRT by a month, which I suggested at your meeting on 7 November, and which the Revenue in their note of 9 November reckon would bring in £700m in 1979-80, looks the best bet. I would be strongly opposed, incidentally, to any further increase (to £600m) in BNOC forward oil sales, although we

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should certainly ensure we get the full £500m originally planned.

One major reason for the PSBR overshoot this year is likely to be delayed payment of VAT. From soundings I have made over the weekend, substantial companies are indulging in this on a significant scale, and deliberately. It is not all that surprising: the higher the rate of interest, and the greater the amount of VAT involved, the greater the incentive to delay payment and enjoy a substantial interest-free loan. It seems clear that we must seriously consider legislating in the Finance Bill to charge interest on overdue VAT. It would be helpful to have an early decision on this, since we may wish to announce our intention to legislate in advance. In the meantime, are there any ways in which IR or Customs and Excise could or should retaliate by delaying tax refunds due to traders?

3. Bank lending. On a previous occasion I have sought official advice as to the effect of stock relief on the level of bank lending, with inconclusive results. However, anecdotal evidence is unanimous that stock relief is causing a deliberate and massive artificial build up of stocks, much of which is financed by bank lending. No company with a calendar year ending on 31 December (and there are a very large number of these) is going to run down its stocks now and thus incur a corporation tax liability: the (tax-deductible) interest rate penalty is peanuts when set against this consideration. This, too, is something we clearly cannot put right until the 1980 Finance Bill; but if we are in a position to do so there might be some gain from announcing in advance our intention to legislate then.

4. Pay. The break in inflationary expectations we are seeking has to affect all markets, of which the labour market is one. Here the only sensible direct action, which I greatly hope we will take, is to engineer a situation this winter in which we take a firm stand on a specific public sector pay claim and win.

5. Public expenditure. Clearly nothing can be done in the context of 1979-80, but 1980-81 is a different matter. The most hopeful prospect would appear to be a substantial increase in the disposals figure, via BNOC.

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NIGEL LAWSON
12 November 1979