

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary  
 Financial Secretary  
 Mr Burns  
 Sir Kenneth Couzens  
 Sir Anthony Rawlinson  
 Mr Ryrie  
 Mr Middleton  
 Mr Unwin  
 Mr Folger  
 Mr Ridley

Misc

## MONETARY AND FISCAL POLICY

Tuesday's statement on the August £M3 figures appears to have contained the immediate situation. I have, however, been considering what contingency work should be done in case the September monetary figures (due for release on Tuesday 7 October) and CGER figures (release 9 October) turn out to be bad also.

2. On the plans to which we have hitherto been working no major statement on monetary policy or public spending is due until 19 November, when the roll-over of the £M3 target, the bulk of the nationalised industry EFLs and the inflation allowance for next year's cash limits will be announced. If the September £M3 figures are reasonably good and nothing else intervenes to shake political or market confidence, it may still be possible to keep to these plans.

3. However we cannot rule out the possibility that another set of poor financial figures in early October will raise serious doubts about the adequacy of the existing stance of policy. And the problem would be exacerbated if the new NIF also due in early October and, on present plans, due for publication in November, predicted a PSER for the current year well in excess of the Budget forecast (say £10 billion or more).

Timing considerations

4. However bad the September figures may be, I do not think that there could be any question of announcing new measures before the Party Conference which opens on 8 October. It would in any case be a mistake to try to reach any final decisions until we have all the information that will be available in early October. Besides the NIF

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this should include the views of Mr Middleton's group on the possibility of raising big new sums from North Sea oil profits from 1981-82 onwards as well as our conclusion on the case for adopting a Monetary Base Control system - the latter now being dependent on the outcome of the seminar timed for the end of this month. If we were faced with bad figures on 7 October of such a kind that you decided that policy had to be strengthened the only immediate course open to us would be to reassure the markets, through appropriate briefing, that the Government were actively considering appropriate measures and that an early announcement would be made. The Party Conference would then be something of an ordeal for you and for the Prime Minister. But an announcement would have to be made fairly soon thereafter. And to be in a position to do this I think we need to put contingency work in hand now.

### Options

5. A theoretical option for dealing with the kind of situation postulated would be a further increase in short term interest rates. But for many obvious reasons I think this must be ruled out. It would cause dismay to industry, not least because it would probably cause sterling further to appreciate. It would I submit be anathema to the Prime Minister.
6. In the longer run we may be able to find a more satisfactory system of monetary control that will lessen the risk of monetary growth getting out of the target range for sustained periods and, possibly, reduce reliance on a continued high level of nominal interest rates. But even if, in the light of the work now in hand, this does prove possible we could probably do no more this year than announce our broad intentions for reform and start work on the details of a new system. Reform of the system is not available as a substantive and relevant response to the situation that could emerge over the next month or so.
7. I am driven to the conclusion, therefore, that any measures would need to contain a substantial fiscal component ideally with a measurable impact on this year's PSBR.

8. Such a fiscal package would not be easy either to construct or to sell to your colleagues. There are real difficulties in finding expenditure savings or extra revenue that can be switched in half way through the year. But though the effect on 1980-81 would be important, confidence in the Government's policy depends on getting the underlying fiscal position right, and measures that could be expected to have a substantial effect on the PSBR in a full year could also serve to reassure political, industrial and financial opinion; and we must remember that our financial plan is primarily a medium term one. We should not be too obsessed with the short-run.

9. Within the package, a substantial share would have to come from public spending cuts. This would imply painful decisions which some of your colleagues would strongly resist, not only on political grounds but in the belief that the reduction in the PSBR would be deflationary. Beyond volume cuts in programmes I think that we should have to think in terms of explicit curbs on pay in the public services. The revenue side would have to make its contribution too, though there would be no easy options here given the need to avoid measures which would affect the RPI directly.

10. The monetary element of such a package would need to include a declaration about any new approach on monetary control. It might be bolstered also by further initiatives on funding - eg another tranche of National Savings. It would be logical to announce the monetary roll-over at the same time.

11. A good deal of work will have to be done to develop further the idea of such a package and I do not want to go further into the substance of its possible contents in this minute. I have, however, already authorised on a contingent and restricted basis some preliminary preparation on the fiscal possibilities. Sir Anthony Rawlinson is drafting a note on the expenditure options and I shall be able to put this forward to you next week. Mr Ryrrie is looking into possibilities on the tax and national insurance contribution sides and into the consequences of an explicit move on public service pay. All this is proceeding essentially "in house", although we have had some consultation, on a strictly confidential and contingency basis, with Inland Revenue and the CSD.

An early approach to the Cabinet

12. We can take matters well forward on this "in house" basis. But to develop the expenditure proposals properly would of course, require consultation with and help from the leading Departments, such as DHSS. If therefore you think that it would be right to develop a contingency package further on the lines I have suggested it is for consideration whether at Cabinet on Thursday next you should alert your colleagues to the contingencies I have described. Without showing too much of your hand you could, for example, (orally rather than in a paper) explain that this week's statement had bought time, stress the importance of keeping within this year's PSBR forecast, but warn that you could not exclude the possibility of a need for swift action after the Party Conference if the monetary situation does not improve. You would seek their agreement that, on an entirely "without prejudice" basis, their officials should work with us on costing the options and deciding which would be practicable if a "crisis" should arise.

13. There are of course risks in raising the issue at Cabinet next week. It would risk a premature debate about the whole thrust of the strategy; you might be rebuffed and there might be leaks. But on the other hand, if spending Ministers are not alerted to the possibilities on 18 September the contingency plans we could have ready for you on your return from Washington would be much less complete, certainly on the expenditure side. And if the first that your colleagues were to hear of the possible need for action were at Cabinet on 2 October (the morning you return home) there must be a high risk that you would not be able to marshal their support in time for the right package of measures to be announced reasonably quickly after 7 October. Ministers would also find themselves on less firm ground in dealing with Party Conference concern about another set of poor money figures.

14. This is not an easy decision and you will want to give it careful consideration. You may indeed want to take the Prime Minister's mind before reaching a conclusion. My own view on balance is against raising the matter at Cabinet next week at any rate other than in a fairly low key way for fear that you may generate premature opposition which would gather strength in your absence abroad.

15. It would be helpful however if we could discuss this note when I see you on Monday. As I said above, my purpose is not at this stage to prejudge the issues of substance, but to ensure that, given the awkward timing constraints, we allow ourselves sufficient time to make any dispositions that you think necessary.

DW

DOUGLAS WASS  
12 September 1980

2. Several commentators have written about the growth we have provided - the 11% growth rate for the 30-monthly range for July and August 1979 - and have sought to incorporate their own estimates into their own models. My own feeling is that the "average" growth rate for the 1979-1980 p.a. reported by the Department is in the right area, but this is based on general estimates rather than written reports.

3. The only written estimates we have received (all prior to the statement) are:

- (i) Phillips and Wood put underlying growth at "over 10% p.a." since February.
- (ii) Woodwell's key underlying growth is unlikely to have been much lower than 10% p.a. in October-July period.
- (iii) David-Care Report argued "10%" is the best guess (i.e. 1980 - average sterling growth) at a growth rate of 10% from July-July.
- (iv) Peter Sigell quotes growth rates of 11% - 12% p.a. for "broader measures of liquidity" since February.
- (v) I think Reg Wotton's piece on 11 September implies an underlying growth rate of over 10% p.a. since February.