

cc via Joan Jannan
w/c
already a Gen ref.

15.1.81

SECRET & PERSONAL

THE GOVERNOR

Copy to The Deputy Governor - only

for 15/1.

SHORT TERM ECONOMIC POLICY GROUP (STEP)

Meeting of 14th January 1981.

The two subjects on the agenda were economic prospects, and budget decisions in the broad term. The last part of the discussion was of considerable interest.

After presentation of the forecasts, discussion centred on the plight of industry, with Robin Ibbs in the lead, stating his case very well, and Sir Peter Carey on this occasion being less forceful. The to and fro of discussion after some time produced recognition that action to ameliorate the recession - whether via reduction of the exchange rate or by significant aid to industry - could not be done within the present economic strategy. Douglas Wass allowed this conclusion to emerge, while himself maintaining a white mantle of orthodoxy - stressing for instance that there was no room for tax reliefs given the need to keep the PSBR to £10 (or just possibly £11) billion: Ken Couzens was equally orthodox on the dangers of tampering with the exchange rate lest any fall get out of hand. But the general feeling was quite clearly despairing worry at the developing recession and the growing unemployment. The mood seemed to me very clear and unanimous with no difference between Terry Burns and the rest.

Douglas Wass asked, then, was there anything which those at the meeting, permanent secretaries as they were of the main economic ministries, should do. Should they seek to make Ministers take stock of the political dangers facing them - not just a ½ hour discussion in Cabinet, but ½ a day at Chequers? Robert Armstrong took up someone's remark that there would be a clear "kickback" if civil servants started to try to tell Ministers about politics. -

Rec'd from GAS 20/1/81

"Kickback is just the word". No political taking stock would take place unless the PM desired it, which she did not. (Armstrong himself evidently thinks quite strongly in terms of lowering the exchange rate by any means possible, and of joining EMS.) This did not give me the feeling that no discussion of the real issues would occur but that it would not happen because of what bureaucrats said.

We were told of the Cabinet decision to raise the pay limit on the Civil Service and the Health Service from 6% to 7% (settlements were not expected in fact to be under 7½%) to be announced in about 2 weeks.

JCRD

15th January 1981.

J.C.R. Dow

*dated as 15.1.81
The Governor*

*ADM
ART
8/6*

*ED
MC*

in 2

OUT

COPY NO. 36

NO 38

shredded

STEP(81)1st Meeting

HER MAJESTY'S TREASURY

SHORT TERM ECONOMIC POLICY GROUP

MINUTES of a Meeting of the Group held in Sir Douglas Wass' room, Room 80, Second Floor, Treasury Chambers, Parliament Street, London SW1P 3AG on WEDNESDAY, 14 JANUARY 1981 at 3.00 pm.

PRESENT:

Sir Douglas Wass
Treasury (In the Chair)

Mr J C R Dow
Bank of England

Sir Robert Armstrong
Cabinet Office

Sir Douglas Lovelock
Customs and Excise

Mr R Ibbs
Central Policy Review Staff

Sir Kenneth Barnes
Department of Employment

Sir Donald Maitland
Department of Energy

Sir Peter Carey
Department of Industry

Sir Lawrence Airey
Inland Revenue

Sir Kenneth Clucas
Department of Trade

Sir Peter Baldwin
Department of Transport

Sir Kenneth Couzens
Treasury

Mr T Burns
Treasury

Sir Anthony Rawlinson
Treasury

Mr W Ryrrie
Treasury

Mr H Evans
Treasury

SECRETARY:

Mr Mowl

CONTENTS

<u>Item No.</u>	<u>Subject</u>	<u>Page No.</u>
I	THE PRE-BUDGET FORECAST	1
II	THE BUDGET	2

C O N F I D E N T I A L

Before starting the formal agenda the Group was given an oral report on the discussion of cash limits at that morning's Cabinet E Committee.

I THE PRE-BUDGET FORECAST

2. The Group had before it the latest report on the short term prospects (STEP(81)1). Its main features were outlined to the Group. The fall in output in 1980 was concentrated in manufacturing and the fall in demand concentrated in stocks. Two important factors underlying these developments were the strength of the exchange rate and a tight fiscal and monetary policy in 1979-80, which had since eased. The forecast, which was contingent on its policy assumptions, was not very different from the Industry Act Forecast.

3. A slowing down in the fall in output was expected because a lower rate of de-stocking was expected to offset a fall in private fixed investment and exports. Competitiveness had deteriorated by 60 per cent since 1978 and the forecast showed a big loss of effective competitiveness in 1981 and 1982. The effects of the loss of competitiveness were a matter for contention and the forecast could be wrong about them. Inflation in 1981 was forecast to be near single figures and in single figures if the effect of rents and nationalised industry price increases were excluded. The PSBR forecast for 1980-81 had been revised upwards due to higher expenditure and a shortfall in Customs and Excise taxes. The PSBR was expected to be lower in 1981-82 in both money and percentage terms.

4. In discussion it was suggested that the cycle could be more pronounced than in the forecast because the stockbuilding cycle could be more pronounced and the effect on exports of the loss of competitiveness could be smaller than in the model. Also the profile of inflation could be rather different with lower inflation in 1981 and an upturn in inflation in 1982. The downward pressure in the system was increasing but world pressures would be exerting an upward influence in 1982.

5. There were a number of other comments. Recent forecasts of the PSBR had been systematically poor. This may have been partly due to the squeeze on companies encouraging them to delay tax payments and bill the public sector early. None of the variants, all of which reflected optimism, changed the picture for 1981 very much. The continuing rise in unemployment forecast had worrying implications for the long-term unemployed. The forecast superficially did not look too bad for companies but it implied that companies might not be able to compete effectively in five years' time. So far companies had been cutting away fat, but there was little more scope for this.

II THE BUDGET

6. The discussion focussed on what help could be given to companies and in particular whether anything could be done to achieve a lower exchange rate. Four main methods for lowering the exchange rate had been suggested: intervention; two-tier interest rates; inward exchange controls; and a tax on deposits. The Treasury had looked at all four and concluded that none would have a sustained effect on the rate and the short-term effects could be perverse. Intervention would have to be large and sustained, and would involve abandonment of the monetary target. A lower exchange rate would lead to higher inflation.

7. Discussion took place of what might be the right level of the PSBR but no firm conclusion was reached. It seemed doubtful whether massive relief could be given to the company sector within the likely PSBR constraints and in the light of the difficulties of substantially adding to the tax burden of the personal sector. Various measures of relief were discussed, again without conclusion.

III NEXT MEETING

8. The next meeting of the Group will be on Tuesday, 17 February 1981.