

MR. LANKESTER

PRIME MINISTER

MEETING WITH THE CHANCELLOR: WEDNESDAY 16 SEPTEMBER: 1715 HOURS

The Chancellor wishes to raise with you the following subjects:

(i) EMS

You told Cabinet yesterday that the Chancellor was re-considering the possibility of our joining the EMS, and you agreed to John Nott's request that no final decisions should be taken without the approval of Cabinet or E. Treasury officials are working on a paper which they hope to have ready for the Chancellor to show you before he leaves for Washington. I understand that the paper is unlikely to come up with a firm recommendation; rather, it will set out the facts and considerations that have to be taken into account. The Chancellor will wish to take your mind on how you want to carry all this forward. I am sure you will want a discussion with him and the Foreign Secretary before anything is circulated to other colleagues. Whether you should have this discussion on Friday, or when you and the Chancellor are both back, really depends upon the time scale the Chancellor has in mind for decisions. No doubt the Foreign Secretary would like to have a meeting this week so that the issue can be brought to Cabinet, say, on 20 October before you leave for Mexico. However, the Chancellor is - I know - reluctant to be pushed into a quick decision by the Foreign Office. Indeed, he may say that he wants to have a first discussion with you without the Foreign Secretary. My own view is that this is unlikely to be profitable; it would be better to bring the Foreign Secretary in from the beginning.

(ii) Future of the CSD

At your request we have arranged a meeting on Friday afternoon with the Chancellor, Robert Armstrong and Douglas Wass. The Chancellor wants a preliminary word with you on what you hope to get out of that meeting. Robert has already spoken to Douglas about it, and I hope - by the time the Chancellor comes to the meeting - Douglas will have spoken to him also.

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(iii) Defence Cash Limit

As you know, officials in the Treasury and MOD have been reviewing the case for adjusting this year's defence cash limit. (It was agreed in Cabinet last November that the 1981/82 defence cash limit should be reviewed taking account of (a) the reduction required to offset the 1980/81 overspend (in the event £64 m); (b) the cost of any pay increase beyond the 6% provided; and (c) any change justified by the movement of defence prices in relation to the 11% provided for). Treasury Ministers and the Defence Secretary have now met, and have reached an impasse.

Mr. Nott is predicting an overspend of £350 m, largely on account of higher than expected inflation (in turn partly due to the worse than expected exchange rate). He has also argued that there should be an extra £64 m allowed against the deduction for last year's overspend. In short, he has argued for a supplementary estimate of £414 m.

The meeting apparently finished with Mr. Nott saying that he may be able to get by with an increase of £300 m; Treasury Ministers said that they might be prepared to go up to £200 m. Mr. Nott told them that if the supplementary was restricted to £200 m, the cash limit would simply be overspent and there would have to be a second supplementary in the spring.

As in previous years, I fear you will have to resolve this. With the current market uncertainties, any supplementary now is going to be difficult. I think it would be better to go for a lower figure now - i.e. £200 m - and risk a further supplementary in the spring.

(iv) Public Expenditure Decisions in October

The Chancellor wants to take your mind on the handling of these decisions. He has in mind, I understand, some sort of "grand jury" consisting of a few senior Ministers who would grill spending Ministers now before the Chancellor brings his proposals on public expenditure to Cabinet on 20 October.

J. P. LANKESTER

16 September 1981