PRIME MINISTER

INTERVIEW WITH THE FINANCIAL TIMES

The Financial Times have given notice of the following areas of questioning:

- post-Strasbourg
- economic policy including changes under new Chancellor, exchange rate policy, tax policy
- quality of life with the environment moving centre-stage
- future of Thatcherism; running out of steam? Future challenges?

Having a panel of four will make this a difficult interview.

- Philip Stevens was formerly their economic correspondent and he would love to use his expertise to trap you into some statement which he could demonstrate is inconsistent with something the Chancellor has said;

- Sam Brittan is a strong supporter of ERM and would love to put you in a poor light over Mr. Lawson's resignation;

- Joe Rogaly is no supporter.

Essential part of your preparation must be to look through the Chancellor's TCSC evidence. You should stick as closely as possible to that, referring questioners to it if necessary. I have marked up the most significant answers.

EXCHANGE RATE POLICY

Their aim will be to get you to admit that there has been a change of policy.

<u>Has Exchange Rate policy been modified</u>?

There has been no change since Mr. Major took over. Policy continues to give priority to bringing down inflation. But cannot be indifferent to the exchange rate. If it is too weak it will undermine the tightness of monetary conditions which high interest rates and the Budget surplus are trying to achieve.

<u>But exchange rate has fallen sharply in recent weeks</u>?

In effective terms it is very close to what it was two years ago. Therefore do not accept that we are tolerating a weak exchange rate.

<u>Is the DM undervalued</u>?

(Do not be drawn on this). Always perilous for a politician to lay down the law on what is the correct rate for his own currency. Doubly so to express views on the right rate for other countries' currencies. True that the pattern of surpluses and deficits in Europe is unbalanced and needs to be corrected. But that is a long way from specifying particular changes in nominal exchange rates as these are only one means by which adjustment can come about.

<u>You described Mr. Lawson as resigning over personalities but Mr. Baker said there were differences of policy. Which was it</u>?

Set out my position in the LWT interview. I can only go by what Mr. Lawson told me. It was he who related his decision to Alan Walters.

<u>ERRORS OF POLICY</u>

They may try to revive the argument about the effects of shadowing the DM. The Chancellor, in answer to Q239-240 deliberately refused to be drawn on this as it leads straight back into a discussion about exchange rate policy. He generalised the point by referring to the relaxation of monetary policy after October 1987 (Q197) without being specific on the role of the 3-DM policy. In addition to the mis-timed relaxation of monetary policy, he drew attention to the failure to perceive just how strongly the economy was growing and the excessive notice given for the ending of double mortgage interest relief.

EXCHANGE RATE MECHANISM

At Madrid you set out 'conditions' for UK entry, but are these really 'obstacles' to enable you to postpone something you fundamentally oppose?

The conditions set out in Madrid are objective and necessary and are no more or less stringent than they need to be.

- It is clear that the UK is not on a steady growth path. Excessive growth of the last two years has produced inflation and a current account deficit. Sensible to get this sorted out before undertaking the commitment of a fixed rate system.

- The removal of exchange controls could have a major impact. Surely right to absorb this before expanding ERM;

- Completion of single market, including the removal of restrictions in the financial sector, is a major enterprise. Again sensible to absorb impact of this before sterling joins the ERM.

You give impression that monetary policy in the UK has been successful while those who have gone for fixed exchange rates have had problems. In fact we have run into difficulties while those who went into the ERM have done well out of it.

There have been difficulties in the past two years in this country but between 1981 and 1987 we enjoyed low inflation and steady growth, faster even than that of the ERM countries. Only Germany of the major countries has lower unemployment.

<u>TAX POLICIES</u>

They may try to get some hints about the next Budget. You should quickly close off this line of questioning by saying that the Chancellor has only just finished work on the Autumn Statement and has barely begun his consideration of the Budget.

Sam Brittan may try to coax some statement out of you about mortgage interest relief. Again, you should resist. You could, however, point out that the major impact has come from liberalisation of the financial sector which has allowed people to mobilise the rising value of their houses as security for greater borrowing.

<u>FUTURE OF THATCHERISM</u>

<u>Has the process of reducing the size of the public sector now run its course? Isn't the priority now to improve the performance of what is left in the public sector?</u>

Certainly the case that there is still a great deal of scope for improvement in the provision of public sector services such as health, education, public transport and housing for the lower paid. A great deal of work is going into all of these. Priority is increasingly turning to <u>implementation</u> of the legislation which has been passed or is in train.

But that does not mean that efforts to reduce the size of the public sector have come to an end. Have reduced public spending as a proportion of national income from around 47 per cent to around 39 per cent over the past seven years and it is implausible to suppose that the change over the next seven years will be as great. If growth can be sustained over a number of years it is possible to achieve both rising levels of public sector provision while allowing public spending to decline as a proportion of national income.

AT

ANDREW TURNBULL

<u>8 December 1989</u>

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ANNEX

TRANSCRIPT OF CHANCELLOR'S EVIDENCE TO TCSC

Q197	Origin of policy errors on economic management
Q206/207	Role of exchange rate
Q209	Origin of fall in savings
Q212	Does current account deficit matter
Q221/222	Can exchange rate be ignored if monetary policy is kept tight
Q223/225	Broad v. narrow money
Q235	Target for debt/GDP ratio
Q239/240	Effect of shadowing DM
Q254/255/256/257	Does a falling exchange rate cause inflation
Q260/261	Significance of fall in £ against DM
Q265/266	Is policy to maintain value of £
Q269/270	Is fall in exchange rate in spite of or because of Government policy
Q276	Does current account deficit matter; is it self correcting
Q282	Can a rise in interest rates be ruled out
Q286	Import penetration
Q291	Would Government prefer a firmer £
Q292	Impact of depreciation on inflation