

Subject CC MASTER

NOTE FOR THE RECORD

CHANCELLOR'S BILATERAL MEETING WITH THE PRIME MINISTER

The Chancellor met the Prime Minister on 2 May. The main points made in discussion were as follows.

- (i) The Chancellor reported on his visit to Italy. The Finance Minister, Signor Carli, had said that he saw attractions in devolving power from the essentially weak central government in Italy upwards to the EC and downwards to local government. The PR system had led to weak central government. Accordingly Signor Carli saw some attractions in EMU, it would take responsibility away from central government. It could also lead to lower interest rates in Italy: this was particularly beneficial since debt servicing costs absorbed 5 per cent of Italy's GNP.
- (ii) In the discussions with Signor Carli it emerged that the Italians were less clear on the details of the stages towards EMU. The Central Bank view was that stage 2 should be short, essentially comprising the setting up of the institutions. Italy would not be concerned about the lack of accountability in a European-wide Central Bank: they recognised that if the new institution were accountable, it could not be independent. Given the weakness of central government in Italy, they preferred independence. The Italians did acknowledge that the famed independence of the Bundesbank was less real in practice.
- (iii) There was a possibility that the Germans, French and Benelux countries might move ahead quickly to a single currency. The French had achieved a remarkable position of low growth in wages, low inflation, high but long-standing unemployment and a very firm exchange rate combined with good growth.

- (iv) The UK exchange rate remained weak. There was concern that if the local election results were very poor on Friday that would go down badly in the exchange markets. There could be further downward pressure next week when the RPI figures were released.

- (v) In the local election campaign the message that the community charge would be lower if Conservative councils were elected might not have been got across successfully. It would be important not to raise expectations now about the prospective scale and scope of changes to the community charge regime. There could be attractions in Cabinet being asked to play down any public statements of the review now in progress.

- (vi) The Chancellor and the Environment Secretary had been invited by Cranley Onslow MP to speak to the 1922 Committee. It would be desirable at that meeting to dampen down expectations about changes to the community charge system and to take the opportunity to reinforce the message that the public expenditure and fiscal position was extremely difficult. There was no scope for increases in public spending beyond present plans. There was a high risk that what was said at the meeting would be made public. The message needed to be tailored accordingly.

- (vii) Ministers had discussed the proposed transfer of responsibility for community charge to local authorities next April. Further work was in progress to assess how the transfer could be undertaken without adding to existing public spending plans and without risking excessive increases in community charge.

- (viii) The Chancellor's preference was to go ahead with the community care transfer providing satisfactory means of limiting the expenditure could be found. But he was concerned that the implementation of the health service review should be paced in such a way as to avoid any

risk of health authorities running out of money next year. A system of shadow pricing could have a role to play. The Prime Minister agreed that it would be useful for Treasury Ministers to make the Health Secretary aware of their concerns. (The Health Secretary is due to report on the programme for implementation of the health service review shortly.)

- (ix) Finally the Chancellor said that M. Mitterrand might raise the question of IMF ranking. The UK position was that they were content to accept the fourth equal rank proposed by the French provided the French could find quota from other IMF members. In practice this condition could not be met.

BHP

(BARRY H. POTTER)

3 May 1990

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PRIME MINISTER

BILATERAL MEETING WITH THE CHANCELLOR

I asked the Chancellor's office whether there is anything specific which the Chancellor might wish to raise with you at tomorrow's bilateral.

I understand that the main item he wishes to discuss is how to handle the economic and political news over the next couple of weeks.

First, while my separate minute today records a reasonably satisfactory outcome on BR pay, Thursday will bring news of the high offer to the electricity supply industry manuals.

Second, there is the outcome of the local elections on Friday.

Third, and perhaps the most critical, is the RPI figure to be released next Friday.

The Chancellor is not likely to pursue further the community charge: the first meeting of officials will take place on Thursday afternoon. But you may wish to discuss community care depending upon the outcome of tomorrow morning's meeting.

BHP

Barry H Potter

1 May 1990

c: bilateral (MJ)