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SECRET AND PERSONAL



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LONDON SW1A 2AA

From the Private Secretary

17 April 1990

Dear Tancred,

SEMINAR ON THE ECONOMY

Following today's seminar attended by the Prime Minister, Chancellor of the Exchequer, the Chief Secretary, Sir P. Middleton, Sir T. Burns and Mr. Scholar, I thought it would be helpful to set down the main proposals for further work which emerged.

I should be grateful if you could ensure that no copies of this letter are taken without your permission and that the letter is seen only by those with a strict need to know.

The proposals can be grouped under five headings:

- (a) the public expenditure/fiscal position;
- (b) growth of credit, especially consumer credit;
- (c) construction of the RPI;
- (d) the community charge;
- (e) exchange rate mechanism.

On (a) the public expenditure/fiscal position, my letter of 5 April to Carys Evans recorded the Prime Minister's view that the Chief Secretary should write to Cabinet colleagues describing the severity of the public expenditure position for this year and the very difficult situation for the forthcoming Public Expenditure Survey.

At today's meeting, it was agreed that the Chancellor should lead at Thursday's Cabinet in describing the severe difficulties on public spending; the link to, and wider implications for, fiscal policy; and the inter-relationship with monetary and interest rate policy. The Chancellor would copy to the Prime Minister tomorrow evening the draft speaking note he would propose to use at Thursday's Cabinet.

On (b) credit, following a long discussion, it was agreed that the Treasury should examine ten possible measures which might contribute to the tightening of the availability of credit from banks and building societies particularly to the personal

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sector. These are as follows:

- Summon heads of the retail banks and building societies and make clear to them the need for restraint on consumer lending. The mode (whether led by the Prime Minister plus the Chancellor, or the Chancellor plus the Governor), and the format, (dinner, seminar, etc.) are to be considered by the Treasury and options, and proposed approach, reported back to the Prime Minister.
- Restrictions on mortgage lending. This might be achieved by limiting the qualifying purposes for which second mortgages would be granted. It would probably be too draconian to stop such lending altogether; but the idea of requiring interest rates closer to normal overdraft rates, where such second mortgages were directed to consumer expenditure, should be investigated. Building societies could be asked to look again at the multiple of salary and the proportion of the security that they were lending.
- Restricting the marketing of credit. Could TV advertising of credit be stopped and junk mail drops be further restricted or discouraged? A possible role of the Advertising Standards Authority should be explored.
- Amending the favourable write-off of personal sector debt by banks for tax purposes. The present practice should be reviewed (though it was recognised that such write-offs were relatively unimportant in terms of determining banks' tax liability).
- Review again the write-offs of other debt, including sovereign debt dealt with under the Matrix. The review could extend to the wider tax position of the banks.
- The introduction of reserve asset ratios for banks
- Re-examination of a monetary base approach, (as an alternative approach to reserve asset ratios).
- Over-funding on a modest scale (by postponing the buying in of debt). This could be linked with vigorous efforts to convert conventional into index-linked gilts.
- Raising the minimum percentage of outstanding debt on credit cards to be met each month. At present this was 5 per cent. Could it be doubled or increased even more?
- Reinvigorating National Savings. (See my separate letter.)

On (c) the Retail Price Index, work should continue on whether community charge capping and transitional relief could be handled in a way that would reduce the expected rise in the April Index. Whatever the outcome of that work, officials should prepare an assessment of what the April Index would have been, if it had been constructed on the basis used until 1986, i.e., so that community charge and rent rebates would have been included. Officials should also investigate what a consumer price index derived on a base broadly comparable with German practice, would show for April. More generally, options for restructuring the RPIAC, and for bringing the RPI more into line with corresponding indices in Europe should be investigated. This could take the form of a Community initiative to produce a standard index or a UK initiative to revise its own index to bring its concepts more into line with European practice. One possibility would be to link any change in the construction of the RPI with the actual or proposed joining of the ERM.

On (d) the community charge surcharge, the Prime Minister was keen to proceed with investigation of her proposal for an extra community charge to be levied on all those with incomes above £50,000 per annum, possibly with a second extra community charge to be paid by those with incomes above £100,000 per annum. The practicalities of this, including the level of the charge; the year in which it would be paid; and the year's income to which it would relate should be investigated urgently. It would be helpful if a paper on this could be circulated in time for consideration at the wider Ministerial meeting on the community charge scheduled for 26 April.

Finally, on (e) the ERM, Sir Peter Middleton undertook to provide a paper on options, mechanisms, difficulties and possible dates of joining the ERM.

I am copying this letter to Carys Evans (Chief Secretary's Office).

Yours ever,

Barry

Barry H. Potter

Tancred Tarkowski, Esq.,
H.M. Treasury.