

PERSONAL AND CONFIDENTIAL



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A N Ridley
Special Adviser

CF

PM

Dec 17th

Dear Tim,

R
18/12

You might like to see, and show
the PM, the attached conclusions
of an early draft of the Treasury
Select Committee Report which were
not, in the end accepted. It is, I
suspect, largely the work of Jeremy
Brag.

It shows two things: the radical
hostility to Govt. policies of many
members of the committee (I have
no reason to believe it reflects Brag's



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views alone); and the fact that there
is some effective opposition to
the more extreme ways in
which such criticisms can be
expressed. I believe the final
report will be short of any
explicit concluding para when
the CFI goes round today

Yours

Adam

at end insert

Conclusions

1. The fact that the government has not been able to achieve its target for EM3 or its expectations for PSBR casts doubt on their practicality, given the state of the economy when they were announced in March 1980.
2. The effort to achieve the targets has resulted in severely deflationary policies, directly through high interest rates and cuts in public investment, and indirectly through reductions in stocks and the effect of the exchange rate on exports.
3. The effect of the deflation of demand has been to squeeze profits and reduce inflation.
4. The contribution of the exchange rate to reducing inflation will be unwound if a decline in the pound restores a greater degree of competitiveness to manufacturing industry.
5. With no controls on capital movements, inwards or outwards, the Committee appreciates the difficulty in judging the timing and magnitude of the effect on expectations, capital movements, and the exchange rate of any action on the part of the authorities. Continuing doubt about the basis and direction of the government's monetary policy does not however make it any easier for the market to form equilibrating expectations.

6. The government has set other considerations above the achievement of its monetary targets in the short term.

7. The action of the authorities should continue to be based on an assessment of their effect not only on monetary targets, but also on competitiveness, investment, output, inflation and employment, in the shorter and longer term.

8. On balance the Committee believes that the continuation of such tight monetary policies will do more to cut output, investment, and exports than it will to cut inflation, in both the shorter and the longer term. The Committee agrees with the Chancellor that the rates of growth of M3 and PSBR are likely to be substantially lower in the second half of the financial year 1980/81 than they were in the first.

9. In the further relaxation of monetary policies the priorities should be:

- (i) a reduction in interest rates;
- (ii) any measures to reduce the exchange rate below its level in November 1980;
- (iii) measures to ease the liquidity pressures on private ^{manufacturing} industry including Bank of England intermediation for medium term loans to industry;
- (iv) maintenance of investment in the public sector.

10. The effects of specific fiscal measures should be judged by their effects on the final objectives of output, employment, and inflation, and on money supply, and not just on the PSBR, which is not an adequate proxy for the other variables.

11. Pay restraint in the public and private sector in the shorter and the longer term would make it possible for the government to pursue less tight monetary policies than would otherwise be necessary.

12. The government should not ignore the short term social distress and the possibility of long term damage to industrial relations from a high level of unemployment.

13. A fresh basis for the medium term financial strategy and its implementation is needed to maintain the necessary monetary discipline while allowing the economy to recover from the present severe recession.