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ISSUES ON WHICH PAPERS ARE REQUESTED

1. Briefing papers provided on arrival in HM Treasury in 1979.

2. Papers connected with preparation of first (1979) Budget, including records of first meetings. Cont'd

3. Papers concerned with relaxation and abolition of Exchange Control. ??? 84/01 Exc

4. Preparations for 1981 Budget:

   - HM Treasury to/from Number 10, Bank
   - Chancellor to/from Prime Minister, Governor
   - ? Papers for Parliament and Budget speech

5. Preparation for and of Chancellor's paper to Cabinet in [?] September, 1982 on long-term public spending.

   - Including with and by CPRS
   - Including with and by Number 10/Prime Minister

6. Papers (Cabinet and Cabinet Committees) on Civil Service pay claims, strike and settlement. Some

7. Papers in and from HM Treasury/Chancellor to/from Foreign and Commonwealth Office, Ministry of Defence regarding withdrawal of HM "Endurance" from South Atlantic. Some more to find

8. Selection and appointment of Terence Burns as Chief Economic Adviser. (!) 79/80

9. Selection and appointment of Robin Leigh-Pemberton as Bank Governor.

10. EC Budget - 1980 "Settlement" (papers preceding and surrounding).

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MTFS

CHEVENING DISCUSSIONS 15/16 JANUARY 1983

This note seeks to set down the principal points emerging from the Chevening discussions of 15-16 January 1983. It is not a full record of everything that was said.

Towards the Budget - DAY ONE

2. Policy should generally speaking remain as before. As between any alleged trade-off between output and inflation, it was noted that it would be wrong to give any impression that this existed; policies to beat inflation were policies to promote output. Moreover, markets would take it amiss if any such trade-off were admitted; and even more so if there were any overt acknowledgement that pursuit of output were taking precedence over beating inflation.

3. Even the apparent distinction (as set out in the Burns paper) between policies needed to achieve a further significant reduction in inflation in the medium-term, and policies required to stabilize the inflation rate and permit some recovery in output, was not clear cut. It was not the objective to single out a further significant reduction in inflation as a policy aim, regardless of the cost this might bring. On the other hand nor was it the policy simply to stabilize the inflation rate. The aim was somewhere inbetween.

4. It was noted that on the inescapable arithmetic inflation was likely to rise during 1983. This would have to be accepted publicly. The question was whether this should be presented as merely a blip upwards in the course of an onward downward path, or whether it should be seen as the manifestation of a plateauing out around the present (RPI) level. We should lean towards the first interpretation.

5. There was a disturbing inconsistency between the Treasury forecast of year end inflation of $5\frac{1}{2}/6\frac{1}{2}$ per cent, and that presented by the Bank which appeared to be more of the order of $8\frac{1}{2}$ per cent. There were various possible reasons for this, which should be pursued.

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6. Generally speaking it was felt that especially given the recent fall in the exchange rate, the relatively tight monetary and fiscal policies should continue to be followed. There appeared to be no reason to shift from the general approach set out in the last MTFS.

7. Specifically on monetary targets, the range of 7-11 per cent for 1983-84 was endorsed. It was noted that the fact that inflation was now lower than had been expected at the time of the Budget was in no way a reason for revising this figure downwards. It was left open, however, whether all the aggregates should, as last year, continue to comprise within this 7-11 per cent; or whether different treatment might be appropriate for different aggregates. The exchange rate should continue to be given its current weight in assessing the tightness or otherwise of monetary policy.

8. Specifically on fiscal policy, it was noted that the size of the PSBR for 1983-84 depended on a number of factors including the reaction of the markets, the forthcoming election, and the size of the fiscal adjustment which would accompany it. In summary, it was thought that a PSBR of £8 billion coupled with a fiscal adjustment of up to £2 billion might - assuming the arithmetic of the forecast so permitted - be about right from the differing points of view of the market and home presentation. There was a case for a lower PSBR, and if the fiscal adjustment showed signs of coming out at more than say £2 billion then that case could become very strong.

9. So far as where any fiscal relief might go, the view taken was that, having regard to the recent fall in the exchange rate, and noting what had been done for industry in the Autumn Statement, it was probably not necessary to do as much now for industry as might otherwise be the case. There was a feeling that this year, in contrast to what was done last year, the desired increase in personal thresholds should be built into the arithmetic as a requirement, with any possible reduction in NIS (or other company help) taken as the residual.

10. Looking specifically at elements in possible Budgets, it was noted that it would be unwise to think too far ahead until it was clearer what fiscal adjustment could be available. Illustrative Budgets of £1.5 billion had been circulated, and the possibility of a £2 billion Budget was mentioned at the meeting. On specific elements in possible Budgets the following points were noted :-

a. On the indirect taxes there was no case, generally speaking, for other than straight revalorisation. However it was noted that some Ministerial colleagues might suggest doing less than this, both for presentational reasons and to help with the RPI (though from this point of view non-revalorisation was a very bad buy). However individual indirect taxes might have to be looked at separately.

b. There was a case for seeking to go for 8 percentage points over Rooker/Wise on thresholds, which would take the tax and NIC burden back to the 1978-79 level as a percentage of average earnings. It would also, of course, help with poverty and unemployment traps, and with Inland Revenue staff numbers.

c. The question of child benefit, in this context, was discussed. Further submissions would be necessary, but if a number of percentage points over Rooker/Wise were given on the thresholds then certainly something over the 3 per cent already built into public expenditure plans would have to be given on child benefit. The view was expressed that within reason such an increase (which would affect 1984-85 more than 1983-84) might be capable of being accommodated within the public expenditure contingency reserve.

d. There was considerable argument over NIS and the three options; do nothing more; reduce by ½ percentage point (leaving it at 1 percentage point); and abolition. Cases were made out for each of these three

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options.

e. The idea that Corporation Tax might be reduced by 2 percentage points to 50 per cent found a good deal of favour, if this could be accommodated within the arithmetic.

f. It was noted that an amount of £300 million, unspecified, had been provisionally allocated for "packages", including the possible cost of any increase in the Mortgage Interest Relief ceiling. These packages would have to be pursued in more detail.

g. A number of fiscal risks not otherwise identified were noted. These included (i) North Sea oil on which work was in hand (and where the interaction of any possible reduction in Corporation Tax would have to be borne in mind) (ii) the petrochemical industry, where submissions should be made urgently (iii) coal prices, where submissions should be made but where it was thought both unlikely and undesirable for any cost to arise (iv) unemployment measures, where it was noted that any costs for 1983-84 might be small though there could be future developments worthy of mention in the Budget Speech (v) industrial rates, which although much pressed was not thought to be any kind of starter for the 1983 Budget and (vi) the motoring taxes, on which a separate submission is being prepared.

11. It was noted that in considering possible fiscal action for the 1983 Budget two particular points should be borne closely in mind :-

a. The impact on 1984-85, both in reality as constraining the 1984 Budget and presentationally as affecting how the 1984-85 fiscal adjustment would appear in the 1983 FSBR, and

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b. The public expenditure element (see for instance child benefit above and also reflected in some of the packages), having regard to the separate constraints that exist here.

The International scene - DAY TWO

12. A number of points were made in discussion.

13. It was noted that concern this year on the international scene might continue to be expressed by the question "Where is the growth going to come from", to which the answer had to be "Keep calm; it will come". But it was suggested that 1983 could be the year of the turning point, when growth would indeed begin and the question would then arise as to how fast this growth was coming, and whether it might not in fact be too fast having regard to the need always to continue to keep control of inflation. On the other hand it was pointed out that there was still considerable downside risks, not perhaps so much in the United States but in Europe.

14. There was debate as to whether variants in the exchange rates as between given currencies were self-cancelling. On the whole it was felt that this should be so, but that it need not always be so especially if individual countries took individual steps to frustrate or otherwise alter the "natural" effect of the effect on them of changes in exchange rates. The Dollar still dominated. A lot depended, as ever, on the stance of US domestic monetary and fiscal policy, and on the world's expectations resulting from it. It was important to try to avoid the 1977 (and previously) experience where the behaviour of the Dollar, coupled with higher national deficits world-wide, reinforced each other in slowing up world growth.

15. It was necessary to continue to keep pressure on the United States so as to support the elements there which looked for restraining the budget deficit. The general benefit to world trade of the lower interest rates this would bring about would surely be more beneficial than the effect of trade of the additional deficit spending in the United States. Such an approach was not, of course, inconsistent with the stance of British domestic fiscal and monetary policy.

16. It was difficult to see what, in terms of "agenda items" could be discerned to help the general process along. It was suggested that there were signs in the Jurgensen Group that the United States might be starting to see the need to take more account of international factors, rather than just their "benign neglect" attitude. But it did not appear that any new institution or machinery was necessary, what was really required was a fresh attitude and intention.

17. The notion of "convergence" was one which had to be carefully watched. "Convergence" towards a given aim might well be acceptable, provided that aim were the right one. But what was dangerous was the notion of "convergence" towards some kind of average, implying that some countries should go in the opposite direction to what was surely desirable. There were signs in both OECD and the EC that this latter notion was very much alive. In this context it was noted that the United Kingdom's domestic "fiscal adjustment" was not to be seen as "room for manoeuvre" within fiscal policy; it ought to be seen as something which necessarily had to be dealt with if a pre-stated downward path for fiscal deficit were to be achieved. The 1981 Budget showed that this could work both ways.

18. It should be noted, realistically, that two of the important countries on the world's financial scene - the United States and the United Kingdom - both had important elections in the near future. It was thus unreasonable not to expect domestic considerations to be of great importance to them.

19. Turning to the European Monetary System (EMS) a number of points were made. It was thought it would not be at all desirable to join before the election, even if joining were justified on merits. On those merits there was room for disagreement. On the one hand if the United Kingdom is a continuing member of the European Community then it would make sense in a number of ways to join. On the other there was the possibility of the EMS itself not surviving, and in any case the pattern of our trade, and in particular our possession of oil, put us in rather a different category to the other member countries.

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In any case following the election there would no doubt be a period of possibly difficult adjustment in the exchange markets, when again joining EMS would probably not be appropriate.

20. In terms of the EC Budget problems it was not thought that joining EMS would "buy" anything. There was no reason why the other member countries should pay anything to get Britain to join. On the other hand in the context of any general settlement for future financial arrangements, such as surely have to come, joining EMS could be a useful "flavour"element. Much depended on whether one saw the European Community as an important ongoing social, political and economic supa-national entity, on the one hand, or merely a brutal forum of individual national interests, on the other.

21. There was some discussion as to whether in the context of the EC Budget negotiation we were approaching it the right way; would it not be more appropriate to tackle yet again the reform of the Common Agricultural Policy? It was noted that this had been discussed a number of times recently, and in any case could hardly be mounted in time to deal with some of the immediately Budget problems - which included the need to obtain full and proper title to the £500 million due to us for 1982, the need for a proper settlement for 1983, and then onwards the need for a proper long-term settlement.

22. Turning to the question of sovereign debt and the problem of default, it was suggested that the risk might be bigger than hitherto appreciated - particularly on the question of the real oil price, where a reduction might help some non-oil countries such as Brazil but could severely imperil oil producers such as Nigeria. A worsening of the position on international debt could greatly hinder the whole question of world-wide recovery.

23. In a question of dealing with potential default situations the importance of speedy rescheduling arrangements was stressed. Otherwise there could be a tendency for individual banks to take the opportunity of the situation to get out. This might be

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particularly so where geographical interest appear to emerge - for instance the United States appeared more interested in coming to the aid of Latin American countries than to the aid, of say, Yugoslavia.

24. Arrangements for dealing with potential defaulting countries were not good, either domestically within Whitehall and internationally. There ought to be better sorts of machinery. The different loyalties which could emerge - for instance Foreign Offices' wish to stay friends with people and Central Banks' wish to protect the debt owed to them and to those for whom they were responsible, had to be very much borne in mind.

25. The meeting did not have time to consider the questions of trade policy and protectionism, and a further discussion within the Treasury would be set up on this in due course.

The participants were :-

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Littler
Mr Middleton
Mr Kemp
Mr Kerr
Mr Ridley
Mr Harris
Mr French
Sir Lawrence Airey (Day One)
Sir Kenneth Couzens (Day Two)

E P KEMP

17 January 1983