



NOTE OF A MEETING BETWEEN ECONOMIC SECRETARY AND MR LOUIS LEHRMAN
(US ECONOMIST), ECONOMIC SECRETARY'S ROOM, HM TREASURY, TUESDAY
1 MARCH 1983

Those Present: Economic Secretary
Mr Lehrman
Mr Buckley (Assistant to Mr Lehrman)
Mrs Bresnick (US Embassy)
Mr Harrison

The Economic Secretary welcomed Mr Lehrman and his colleagues, who were paying a courtesy call.

Mr Lehrman said he would like to put some questions to the Economic Secretary about economic policy. He first asked how the government proposed to restore low long-term interest rates and reasonably full employment. He said that in both the UK and the US, real interest rates were at historically high levels. He calculated that UK borrowers currently faced real rates of 11-12%. He could not understand why interest rates and unemployment were so high in these two countries, whose governments had been adopting economic policies which were "like a breath of fresh air". The Economic Secretary disputed the suggestion that real UK interest rates were as high as Mr Lehrman suggested. Nevertheless, he pointed out that high real interest rates were to be expected in the course of emergence from a period of high inflation. He referred to the size of the US Federal deficit. There was also the fear of a resurgence of inflation; it was difficult to eradicate deeply-ingrained inflation expectations. The sensitivity of exchange rates was increased by the extreme volatility of capital surpluses. Mr Lehrman said that he could not understand how, when the Fed had "completely and utterly repudiated monetary goals, and had not the remotest interest in quantity targets", US interest rates had fallen.

Mr Lehrman said that he also found it difficult to understand how the sterling exchange rate had risen substantially during the time when the monetary targets were being overshot; and now that monetary restraint was being more successful, the exchange rate had fallen. The Economic Secretary pointed to the influence of oil price expectations. He said that he did not adhere to the purist monetarist view that real factors had no influence on monetary variables - at least in the short run. He noted the ^{current} political uncertainties.

Mr Lehrman asked how the government felt about entering an election with massive unemployment and very high real interest rates. The Economic Secretary said that most people were very aware of recent falls in interest rates. And while the polls showed that unemployment was invariably the main concern of voters, very few attributed it to government. Asked by Mr Lehrman how the government would hope to continue its progress in the next Parliament, the Economic Secretary said that this would essentially consist of maintaining the transformation of attitudes in industrial relations, and improving recognition of the need to win back markets on the basis of quality not price, in contrast to the tendency in recent years to trade down-market on the back of a depreciating currency. The government would aim to continue reducing the share of the public sector in GNP, reducing taxation, and increasing competition and reducing the monopoly power of nationalised industries.

Mr Lehrman asked about relations between the Bank of England and Treasury. He said he had the impression that the Bank had considerable independence in practice, despite superficial gestures in the Treasury's direction; he felt that a "form of malignant neo-Keynesianism still prevailed". The Economic Secretary said that he could not agree. He did not detect any great conflict between the Bank and Treasury.

Mr Lehrman said that he could not see how the substantial intervention by the Bank in the money markets was consistent with the government's general principles of non-intervention.

The Economic Secretary said that the government inevitably had to take a view about the desirable level of interest rates; its principles were not so purist as to inhibit it from a certain amount of intervention in the money markets. He pointed out that in 1981, changes were made to the operation of monetary policy so that it became much more market-orientated.

Mr Lehrman thanked the Economic Secretary for seeing him.

C D HARRISON

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Littler
Mr Middleton
Mr Lavelle
Mr Monck
Mr Bottrill
Mr Sedgwick
Mr Turnbull
Mr Ridley
PS/Foreign and Commonwealth Secretary