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Econ 102

Ref. A01674

PRIME MINISTER

Medium-term Financial Strategy

(C(80) 17)

BACKGROUND

You are familiar with the origins of this paper, and have discussed it in draft with the Chancellor of the Exchequer and with the Governor of the Bank of England. Sir Kenneth Berrill and I have both already given you our views on substance (in our minutes of 25th February and 26th February).

2. The intention now is to publish some illustrative figures and some text (yet to be finally drafted) in the Financial Statement and Budget Report (FSBR) on Budget Day. The Chancellor does not propose to circulate the text in advance to colleagues, though he will no doubt show it to you. He will need to send it to the printers early next week, so a decision at this meeting is highly desirable. If a decision has to be postponed, it should be possible to bring this back to Cabinet next Tuesday.

3. In addition the Chancellor has secured your agreement (Mr. Lankester's letter of 10th March) to the publication of a consultative document on monetary control, which implies the existence of such a medium-term financial plan: paragraph 1.1 says: "The Government considers that a progressive reduction in the rate of growth of the money stock is the only viable way of achieving a permanent reduction in inflation". Paragraph 1.3 begins "The Government believes that the money supply must be controlled consistently over a period of years". He proposes to publish that document on 20th March. There is not much overlap between the two papers, apart from this implied commitment.

4. The critics may argue that the Chancellor's memorandum is not only deceptively short but also deceptively bland. It does not disclose the path by which the money supply growth target is to come down from 7-11 per cent in 1980-81 to 4-8 per cent in 1983-84, though I believe that he intends to publish figures showing

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the range as falling by 1 percentage point each year. It does not include any of the references to "transitional losses of output" which feature in the draft section for the FSBR. It states even more elliptically that that draft the absolute primacy to be given to the money supply target over all other policy objectives. There is no hint of the Governor's doubts about what is proposed. You may want to make sure that these points, and their implications, emerge in the discussion, because if they do not some of the colleagues, when they see the published text, may argue that it goes significantly beyond what they thought they were agreeing to in Cabinet.

HANDLING

5. The tactics will require some care. You may well want to introduce the discussion yourself. The danger is that discussion could go to the root of the Government's economic strategy and lead to a polarisation of views. You will have your own view on the best way to handle this. One tactic would be to imply at the outset that the strategy is common ground, that much of the information will all be a matter of public record in due course anyway, and that the sole question for Cabinet is not whether the strategy is right but whether it is right - or indeed avoidable, if the credibility of the strategy and the firmness of the Government's commitment to it is to be reaffirmed - to reassert the strategy in this quantified form.

6. You might then ask the Chancellor to introduce the paper, and call for quick comments from a few of his leading supporters, and from one or two potential critics. A possible sequence would be the Secretary of State for Industry: the Secretary of State for Employment: the Secretary of State for Trade: the Minister of Agriculture (or the Lord Privy Seal). You might bring the Home Secretary in at the end, to round off the discussion and rally support for the Chancellor.

7. The Chancellor may well be asked his intentions about indicating a path of monetary targets, in the intervening years, leading to the target for 1983-84 referred to in paragraph 5 of his paper. It is in fact, we know, the Chancellor's intention to give indicative figures for the intervening years in the FSBR. The precise way in which these intervening year figures will be presented will reflect the Chancellor's need to accommodate the Governor's worries, and only the figure

for the final year will be a firm "target". The Chancellor will no doubt be ready to explain all this if asked, and should perhaps be encouraged to do so, in order to reassure the doubters.

8. The Chancellor may face questions in Cabinet now, and later in public, about the implications of his forward plan for employment, inflation, GDP growth and so on. The Chancellor can be expected to resist such pressure - as involving spurious precision and offering all too many hostages to fortune. But again a discussion of this aspect of presentation might help the Chancellor and reassure those who are sceptical or unhappy.

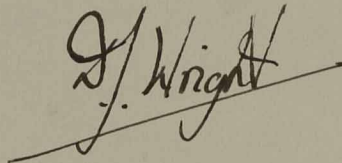
9. If, despite your initial steer, discussion does centre on the underlying policy, questions which might be posed are:-

- (a) Is there any viable alternative to making the money supply the centrepiece of the strategy despite its short-term implication? It is for those who are unhappy about the present course to offer an alternative. The Chancellor's figures (with PSBR still positive in 1983-84) suggest that in fact there is very little room for manoeuvre if inflation is to be overcome, taxes reduced and healthy growth resumed, within the timespan of the present Parliament.
- (b) Is the speed of adjustment right or should it be "a policy for two Parliaments"? The job has to be done some time, and 1984 imposes its own imperative. If the blue skies do not arrive before then, the second Parliament may not be available to carry the policy through to a conclusion.
- (c) Does the Government need to publish this "plan" at all, remembering the problems and fates of earlier "plans"? The arguments here are familiar - without a coherent indication that the Government's policies can work, the short-term misery will be that much harder to bear and to justify; but if the Government shows that it knows where it is going and that the end result is not only palatable but demonstrably credible, the decision-takers in the economy will be heartened and prophecy aided to self-fulfilment. Note: If nevertheless the collective view of Cabinet is against publication some consequential amendments will be needed to the Green Paper on monetary control.

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CONCLUSION

10. The conclusion to which you will hope to guide the Cabinet is authority for the Chancellor to publish a passage in the FSBR on the lines indicated in his paper.



ROBERT ARMSTRONG

*(approved by Sir Robert Armstrong
and signed in his absence)*

12th March, 1980

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