PERSONAL

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FINANCIAL TIMES

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Dear Mr. Wolfson,

As this article appeared on an inside page on an unusual day, perhaps you could put it among the Prime Minister's Papers, especially the marked passage.

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Yours sincerely,

Samuel Brittan

Samuel Brittan

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David Wolfson, Esq.,
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20/2/80

LOMBARD

A low surprise in the PSBR

BY SAMUEL BRITTAN

THERE IS every sign that the Chancellor is planning to take the City by surprise by budgeting in 1980-81 for a Public Sector Borrowing Requirement lower than the £9bn to £10bn that had been expected. There is a regular cycle in PSBR estimates from the shock horror figures that come out around November and to later revisions early in the New Year. This time the downward change has been greater than usual, partly because of increased revenue expected from higher North Sea oil prices and deferred receipts of tax due in 1979-80.

These have more than offset the gloomy initial reports from the forecasters which are being revamped to reflect the different views of both Ministers and top officials, who expect an output drop of "only" 2 per cent. The real technical argument, however, appears to be not on the forecasts themselves, but on the relation between economic activity and the PSBR.

For what it is worth, present estimates are for a PSBR of £8½bn to £9bn. The Chancellor is likely to strain every nerve and every asset sale or massaging idea which can be produced to secure a figure nearer £8bn, and thus a clear drop from 1979-80.

A respectable reason—or at least talking point — is Sir Geoffrey's Celtic background, which makes him suspicious of talmudic justifications for high borrowing. But the serious reason is that the Chancellor and his advisers are desperately concerned to reduce nominal interest rates as soon as possible.

On the main point Sir Geoffrey is right. It is certainly best for industry and employment to use any extra £1bn or £2bn to create conditions in which interest rates are able to move down and thus remove the artificial element in the sterling exchange rate. This is surely better than to give an old-fashioned fiscal support to demand from a high PSBR. The issue is too important to be left to highly inadequate forecasting models. But I fear that the link between public sector borrowing and interest rates is more long-term and less mechanical than Ministers would like to think; and political inhibitions about letting interest rates rise in the very short-term—evidenced by the extremely unfortunate special help given to the banks last week—are undermining the credibility of counter-inflation policy.

But it would be a hollow victory, if a slight *forecast* reduction in the PSBR were made an excuse to jettison the idea of a medium-term monetary framework. The forecast could go wrong in many ways.

In the context of a medium-term strategy for reducing monetary-growth public sector borrowing, a PSBR overshort in a recession year could be seen for what it is. So could short-term year-end fluctuations in the revenue yield. It is absurd that public sector finances should still be tied to a period based on the crop cycle.

If one remembers that the 11 per cent monetary target—which is at least 13 per cent allowing for distortions—is still to be achieved; that there is a reluctance to reduce it much if at all; and there is a risk of over optimism on interest rates; and that a fall in sterling is itself inflationary, something other than a hopeful PSBR figure is needed. There must be some background analysis or explanation — which would be meaningless if confined to one year.

If the Prime Minister realised how much ground she has already lost from the delay in publishing medium-term objectives last year, and that a further Budget on traditional one-year only lines would be a sign that we were settling down to Latin American inflation rates, she would cross over from the ranks of sceptics to that of enthusiastic demanders to see the monetary framework "this instant."

Of course, actions speak louder than words. But actions are rather limited in view of the political hang-up over interest rates and taxes. But at the very least, a coherent explanation of those actions which are taken, and some guidelines which will distinguish short-term departures by spending Ministers from a Heath-style policy reversal, are essential if anti-inflationary policy is to carry the slightest conviction.