

DOCUMENT IS THE PROPERTY OF HER BRITANNIC MAJESTY'S GOVERNMENT

C(80) 17

COPY NO 82

11 March 1980

CABINET

MEDIUM TERM FINANCIAL STRATEGY

Memorandum by the Chancellor of the Exchequer

1. The economic outlook is difficult whatever policy we follow. But there is general agreement that the immediate imperative is to bring down inflation. And there is general agreement too that, although other policies are very important, proper monetary control is central to the battle against inflation.
2. Since the Election we have only succeeded in stopping the rot we inherited. To achieve positive success our policies must do more. The business world, financial institutions, labour markets and ordinary people (particularly Government supporters) must have a vision of how we intend to proceed hereafter. They want to know the course we intend to steer in relation to expenditure and taxes, and what our commitment to monetary discipline might mean. Furthermore, the way the policy works implies that they need to be given a clear indication of the limits within which we intend to manage public spending and the money supply, so that they can adjust their behaviour rationally to fit in with those limits. But they also need a demonstration that our intentions and the policies which will realise them are consistent, technically sound, and will bear fruit.
3. We need, therefore, to illustrate the modest realism of our goals and to marshal the wider support which will follow from so doing. The more we do so the more we can hope to get into the virtuous circle in which greater confidence in our policies makes them more effective and their effectiveness increases their credibility.
4. The further public expenditure reductions we have now made, together with the likely revenue from the North Sea, make a substantial difference to the prospect. Although the next two years are still likely to be tight, there should be growing room for manoeuvre thereafter. The prospect of a steady and significant decline over the medium term in the Public Sector Borrowing Requirement (PSBR), interest rates and taxation is now a real one.

CONFIDENTIAL

5. I propose, therefore, to re-state in the Budget our commitment to targets for declining monetary growth over the medium term, indicating a target range of 4 - 8 per cent for 1983-84. Many people believe - and I agree with them - that setting figures to our intentions will have a significant and useful effect on expectations.

6. To show how falling monetary growth can be achieved at the same time as lower interest rates and substantial progress towards our tax objectives, I shall provide some illustrative figures in the Financial Statement and Budget Report. These will rest on the agreed public expenditure totals and make the deliberately cautious assumption that the average growth rate of the economy over the period 1980-1983 could be about the same as the 1 per cent a year recorded for the period 1973-79. Given the general expectation of a fall in output in 1980 this implies a significant recovery in output over the latter part of the period, and a decent rate of growth of Gross Domestic Product (GDP) by its end.

7. The following summary table indicates what I have in mind. But the figures which are on a price basis consistent with the Public Expenditure White Paper to be published on Budget Day, are at this stage still provisional and will need to take account of the Budget decisions.

PUBLIC SECTOR BORROWING

1978-79 Prices (£ billion)

	<u>1978-79</u>	<u>1979-80</u>	<u>1980-81</u>	<u>1981-82</u>	<u>1982-83</u>	<u>1983-84</u>
Total Expenditure	73.8	75	73½	72½	70	69½
Total Receipts	64.7	66	67½	66½	68	70½
Implied Fiscal Adjustment	0	0	0	0	-2½	-4½
PSBR*	9.3	7½	6½	5½	4½	3½
(PSBR as % of GDP at market prices)	(5½)	(4½)	(4)	(3½)	(2¾)	(2.0)

*Assuming that present direct and indirect tax rates and allowances are increased in line with inflation.

It will be seen that the table contains what is called a 'fiscal adjustment'. This is the change in Government revenue necessary to reach a PSBR consistent with the money supply target and lower interest rates. The figures suggest scope for substantial reductions in the real burden of taxes in the last 2 years.

CONFIDENTIAL

8. Such projections are subject to wide margins of error. Even if we knew about developments in the economy generally, it would be difficult to predict revenue and expenditure with any precision. We all hope that the outturn may be better, and to that end we have erred on the side of caution wherever possible. It would, of course, be imprudent to count on a better outcome in advance. If even the modest growth I have assumed were not achieved in the event, fiscal and other policies would need to be adapted to secure our monetary and inflation objectives.

9. I should, however, warn that the prospect for unemployment is worrying, whatever policy is followed. The cautious growth assumption probably implies some increase beyond the levels stated as working assumptions in the forthcoming White Paper. But I am clear that this risk is unavoidable whatever strategy we adopt. Although slacker fiscal and monetary policies might improve the prospect in the very short run it would be at the cost of higher inflation and still worse unemployment before long.

10. It would be damaging to publish these projections if they showed prospects for the PSBR and taxes which seemed inconsistent with our monetary objectives. But with the expenditure reductions we have recently agreed the framework of the strategy has taken convincing shape. Nearly all the information we propose to publish has, as a rule, been included in recent public spending White Papers. There is a widespread hope that we shall publish our strategy - and, by the same token, a risk that failure to do so will be deemed an admission of defeat. Moreover much, perhaps all, of the information is bound to become public anyway, if only as a result of pressure from the new Treasury Committee. I believe it would be right to take the initiative in presenting it in a convincing framework.

11. In short, I believe that we should show the country, and in particular the financial, business and industrial communities, some of the foundations of our overall economic strategy in a coherent framework covering the lifetime of the present Parliament. In this way we shall be better able to achieve understanding of and support for the necessarily stringent policies we must continue to pursue for some time to come.

12. I invite my colleagues to endorse these proposals.

G H

Treasury Chambers

10 March 1980