SECRET 16. 7.82

THE GOVERNOR

Copies to Mr Loehnis)
Mr George)
Mr Walker)
Mr Fforde) ONLY
Mr Coleby)
Mr Flemming o/r)
Mr Holland)
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CR 21/7

I agree generally with ICRD's approach, as indeed I indicated in our discussion yesterday. On 'X', I understand that Patrick Jenkin put in a paper arguing the case for a fiscal stimulus of £1 billion (mainly NIS) in the autumn — unless interest rates move down substantially in the meantime.

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POLICY AND THE RECESSION

You asked for any suggestions as to the line you might take in

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POLICY AND THE RECESSION

You asked for any suggestions as to the line you might take in discussion with the Chancellor. I have two, which are not very sensational, but may be worth passing on.

Fiscal stimulus?

Any immediate thought of a fiscal stimulus seems (politically) out of the question at the moment. The Chancellor will presumably not want seriously to consider such a possibility until the Cabinet discussions on expenditure have been resolved; and this will not be till near the end of the year. It might thus appear that no question really arises till the Budget.

However it is possible to announce in advance steps that will only come into effect at the Budget - and indeed this was done in respect of the general increase in national insurance contributions last year. It would therefore be possible at least to consider in the autumn the possibility of a reduction or abolition of the NI surcharge for announcement at the turn of the year. This could have some impact in advance of implementation.

The Chancellor will probably hanker for concentrating any possible "relief" on income tax reductions, whose announcement would clearly have to wait for the Budget. Any pre-announced reduction of NIC reductions would thus probably have not to rule that out. Nevertheless there is a strong case for something on the indirect tax side (the price reducing effect). (I would personally prefer VAT reductions, but that is probably not on.)

All this depends of course on the total "space" for tax reductions. At the moment the projections suggest there will be very little room eg £1 billion. But it could be argued that the MTFS targets are unduly tight. The planned lower % PSBR figure (2 3/4% in 1983/84 against 3½% this year) does imply a tightening fiscal stance at a time of continued recession. Even accepting the MTFS logic, it could be argued that, since recovery is likely to be less rapid than forecast, the PSBR next year may be cyclically enlarged above the previously expected figure, and that any such excess could be neglected.

These are detailed questions not worth going into much now. The short answer I suggest on the question of fiscal stimulus is the cautious one that we see no scope at the moment, but that we should think further in mid-autumn

Monetary policy

I have nothing to suggest beyond cautious pursuit of lower interest rates as occasion offers.

But personally I would be happier if the effective rate were a bit lower (eg under 90 rather than over 90). I know that one hesitates even to <u>think</u> of an aim in these terms. For public consumption I think it might be useful if possible to reduce the idea that we have an 88-92 band for the effective rate. The only way I can see of weakening that idea is to stress how much the recent stability has owed to circumstances rather than policy.

Cabinet discussion of Expenditure and the Economy

I gather from Terry Burns that this went well from the Chancellor's point of view. Restiveness about the poor state of the economy was not pressed. Contrary to earlier fears, there was general acceptance that the guidelines for spending were still possible and desirable, and no general disagreement that efforts should be made to meet them.

16 July 1982

J C R Dow