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NOTE FOR THE RECORD

MEETING BETWEEN THE PRIME MINISTER AND MRS THATCHER

The Prime Minister met Mrs Thatcher this afternoon in his room at the House of Commons to brief her on current issues. He began by reporting on his trip to Washington and his meeting with King Hussein and then gave his own assessments of prospects for the Gulf.

The discussion then turned to the economy. Mrs Thatcher said conditions in the economy were very tough indeed, and she urged early and large cuts in interest rates. A reduction of one per cent would not be enough. She believed there was a danger of creating a mirror image of "Lawson" inflation - a recession created by excessively high interest rates created by a policy of targeting exchange rates (though in fact she did not mention the ERM explicitly). She believed there was a danger of repeating Winston Churchill's historic error of fixing the parity for the £ at too high a level. The Prime Minister pointed out that for Churchill's policy to have worked it would have been necessary to secure actual reductions in the price level. The current situation was not remotely comparable.

The Prime Minister agreed that economic conditions were tough but pointed out that the Government's fiscal position was deteriorating. Although the Budget might just be balanced in 1990/91, a deficit seemed unavoidable in 1991/92. Most of the problem lay in the shortfall of revenues as, apart from the Gulf, few additional expenditures had been agreed.

The Prime Minister hoped it would be possible to reduce interest rates before too long; as inflation differentials with Europe narrowed the market would accept such a move. But he warned against snatching at an interest rate reduction at the first opportunity. This would create the impression that the Government was determined to get interest rates down come-what-

CONFIDENTIAL

CONFIDENTIAL

- 2 -

may and would only delay any further reductions. He believed the prospects for getting down inflation next year were good. The target of 5.5 per cent by the 4th Quarter could well be exceeded. Mrs Thatcher hoped the opportunity would then be taken to bring about a reform of the basis of the RPI.

The discussion then turned to the community charge. The Prime Minister said it was now likely that, on present policies, the average charge would exceed £400. He doubted whether this was politically sustainable. The difficulty was that the Government could not relieve the position in a way which made the fiscal prospect even worse.

He defined two problems. First, there was the general level of the charge. When the policy had been first considered Ministers had in mind a charge of £180 - 200. At such a level it would be accepted as reasonable for everyone to make a contribution. Secondly, the introduction of the Business Rate had increased the gearing of the community charge in response to changes in expenditure by local authorities. He did not think, however, that there could be any going back on the UBR. He said Ministers were looking at Community Charge Transitional Relief. In particular he was looking into whether it could be restructured in a way which would enable the statisticians to reclassify it so that increases in CCTR had the effect of reducing the RPI.

Mrs Thatcher pointed to the difficulty of criticising the principle of the community charge. Local authorities would draw the conclusion that it was such a bad tax they could put it up as much as they liked and blame the Government. Her solution would be to take education away from the local authorities and with it a large part of RSG and UBR. Local authorities would be left with a much smaller but more clearly identifiable group of functions which they would be able to finance largely from the revenues remaining to them through the community charge.

The Prime Minister said he saw the case for taking responsibility for education away from local authorities but preferred to do this

CONFIDENTIAL

CONFIDENTIAL

- 3 -

through promoting Opting Out. Mrs Thatcher agreed with this, saying that this would enable schools to retain a much higher proportion of the funds available for education. The Prime Minister noted that such changes would call into question the existence of two-tier authorities.

Mrs Thatcher sought assurance that the Government was still going to press ahead with the health reforms. The Prime Minister said there was no question of back tracking on this. He mentioned that the increase in waiting lists might be a product of the new GPs' contract. It would be unfortunate if what was a major improvement in preventive medicine were over-shadowed by a negative side effect.

The Prime Minister reported that developments on EMU had been favourable. Support for the Delors' plan was beginning to fragment. The Germans, in particular, were expressing reservations. Herr Waigel had described the Delors' plan as "not a document on which we can begin to negotiate". The Prime Minister commented that M. Delors had made the mistake of attacking other countries as well as the UK.



ANDREW TURNBULL

3 January 1991

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