

33/016

cc Principal Private Secretary
 PS/Chief Secretary
 PS/Financial Secretary
 Mr Burns
 Mr Ryrie
 Mr Middleton
 Mr Cassell
 Mr Evans
 Mr R Allen
 Mrs Gilmore
 Mr Aaronson
 Mr Folger
 Mr Ridley

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HTS
 THE BUDGET AND DEFLATION

Following the Prime Minister's request last night you asked me to let No 10 have a piece answering the charge that the Budget is too deflationary.

2. I attach a piece that I passed on to No 10 this morning (given the urgency Mr Lankester asked me to dictate it over the telephone). I gather it has been more or less taken into the Prime Minister's speech. I fear I was only able to show it to Mr Cassell before passing it on.

3. I have also let Mr Lankester have some material on activity rates in the UK compared with the rest of the EC (an appreciably higher proportion of the population is in the labour force here than the European average, and in any single country except Denmark); and also on unemployment now compared with that in the inter War years (the bases of comparison here are tricky and Mr Allen is following this up).

4. For the record also, I advised Mr Lankester against referring to a "net £1 billion help to industry" as on page 10 of the draft of the Prime Minister's speech circulated this morning. We could only reach anything approaching this total if £5-600 million were counted in for the MTR reduction - and the Chancellor had previously ruled that we should not proffer this. Mr Lankester countered by saying that the Prime Minister understood that the Chancellor himself had used the figure in briefing and the Prime Minister therefore did not see why she should not use it. I have asked Mr Wiggins to pursue this further, bearing in mind also that the specific duties increases

have an adverse effect on industries' cash flow of around £1 billion.



J B UNWIN

11 March 1981

BUDGET TOO DEFLATIONARY?

To describe the Government's policies as deflationary is absurd. It reflects two peculiar forms of myopia.

First it considers one side of the fiscal account only. It is necessary to look at the whole fiscal stance. It is true that yesterday's Budget measures will increase net tax next year by some £3½ billion. But it is true also that the reason for this is that public spending next year will be much greater than originally planned. In fact in cash around £6 billion more than planned a year ago. Now much of this, of course, is due to the recession (extra spending on special employment measures, support for industry, unemployment benefits etc). So to offset it all by tax increases would be too restrictive. The Chancellor made this clear yesterday. This is why we are not providing for the PSBR of £7½ billion which the Medium Term Strategy published last year suggested would be appropriate given the higher level of economic activity then assumed. What we are doing is to offset a reasonable part of the extra spending by tax increases and to provide for a PSBR of around £10½ billion which is actually higher than the PSBR for which we originally provided in the current year. It is absurd to describe this as deflationary. What it enables us to do is to keep the pressure on inflation, to get interest rates down, and to continue laying the foundation for genuine and sustainable growth of output and jobs in the future.

The second form of myopia is to put a particular set of measures under the microscope and treat them as if they have no relationship to anything else and are divorced from the Government's strategy as a whole. This is deliberate and mischievous misrepresentation. It wilfully ignores the fact that yesterday's Budget proposals form but one part of the Government's longer-term strategy for defeating inflation. Until we restore sound money and beat inflation there is no prospect of getting unemployment down and keeping it down. This Budget is a vital further step in that strategy. It is particularly absurd to abuse it as deflationary when the only alternative is not reflation but more inflation.