

PRIME MINISTER

BUDGET

Tell Alan

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Oil Price Revisions

1. You will have heard of the revisions for forecast PSBR brought about by revised expectations of lower oil prices. This has reduced our room for manoeuvre by at least £1bn in 1982/83. This suggests that the maximum tax remission we should be aiming for is about £1bn.
2. This sharpens the contrast between the various options which are being considered. In the event that we attempt to hold the PSBR at £9bn, and I think we should, it is likely that there will be direct competition between a 1% national income surcharge reduction and a straight 5% increase in income tax allowances.

Rooker-Wise + 5%

3. I believe there is a much more powerful case for raising the threshold (which would cost £535m in 1982/83) rather than the reduction of NIS 1% from October (which in 1982/83 would cost £425m gross and £1.25bn in 1983/84).
4. I confess that I would ideally prefer two Rooker-Wise to bring us back to the pre-March 1981 condition. But at least the increase of 5% would restore the basic threshold to 1978/79 values and to the level of the national insurance pension which is also the subsistence level determined for supplementary benefits. More important, as Patrick Minford has pointed out so cogently, tax rates at these low levels of income do greatly inflate unemployment. We have dealt with high confiscatory marginal rates of tax at the upper end. We should at least get back to our policy of dealing with them at the low end of the income scale.

NIS

5. The national income surcharge reduction, although of course desirable in itself, should have a much lower priority. Much of it accrues to nationalised industries, public sector bodies, and service industries such as the banks. Some will be clawed back from nationalised industries etc. The Treasury believe they will claw

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back some £75m of the £425m gross revenue cost in 1982/83 and some £450m of the £1,250m cost in 1983/84. Perhaps so, but I doubt it. Money has a habit of disappearing without trace down the public sector drain.

6. Rather than reduce NIS, it would be much better if we reduced interest rates below the level they would otherwise attain. This would benefit industry to the tune of about three-quarters of a billion pounds for each 1%, and at the same time the banks would pay a significant part of this cost, rather than benefit it as they do under the NIS reduction.

Political Considerations

7. There is considerable pressure coming from the CBI and large industrialists (but not IOD) for this reduction in NIS. Indeed there is a widespread expectation that at least some relief is going to be provided. It would be disappointing to industry and to many colleagues who expressed their strong support for a reduction in NIS. It would reduce labour costs by 1% and so increase employment eventually by some 100,000. It can be represented as an element of an "employment budget".
8. On the other hand, a budget which raised the thresholds 5% above Rooker-Wise could be represented very much as a "caring Budget". Not only does this measure assist the poor, but more important it gives the right kind of help. It gives an incentive for those at the bottom of the income ladder to work hard and climb it. It is an incentive not a hand-out. Furthermore, it can be represented as a measure to encourage employment and so part of an employment budget. True it does not reduce directly the cost of labour, but it does restore incentives to work - still a good basis for Tory policy.
9. I suspect that during 1982/83 the recovery will be greater than the Treasury are forecasting. This is likely to mean that the PSBR realised realised over 1982/83 will be considerably less than the one we forecast in March 1982. However, I do not regard this as a good argument for aiming substantially over £9bn. Keeping our sights

/at £9bn

at £9bn will allow us to have stable monetary conditions, lowish interest rates and very considerable room for manoeuvre in the 1983 Budget.

10. Barring disasters, it should then be possible to deliver both a reduction in standard rate, increased thresholds and reductions in excise taxes (ie only partial valorization) which would in turn enable an apparent reduction in inflation to appear in mid-1983. And all this would be no risk to our long term strategy.

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ALAN WALTERS