

cc Douglas  
S. Hodgson  
M. Walters.



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10 DOWNING STREET

From the Private Secretary

24 February, 1981.

Dear Mrs.

As you know, the Prime Minister had a further discussion with the Chancellor and Sir Douglas Wass this afternoon about the Budget.

Commenting on the Chancellor's minute of 23 February, the Prime Minister said she was dismayed at the prospect of a PSBR for 1981/82 of £11½b. She doubted whether it would be possible to justify a reduction in MLR unless the PSBR was reduced to around £10½b. From a political standpoint, she thought it might now be possible to justify a 1p increase in the basic income tax rate on account of the increased spending on the NCB and BSC.

The Chancellor explained that he had mentioned an estimate for the PSBR of £11½b at the meeting on 13 February. Although a PSBR at this level would certainly involve risks, he and his Ministerial colleagues remained of the view that an increase in the basic rate would be extremely difficult politically and would be very bad for business morale. He did not think that the increased spending on coal and steel would provide an adequate justification: on the contrary, many people would say that the Government was having to raise taxes on account of its own failures. It also had to be recognised that, even with a PSBR of £11½b, many would criticise the Budget for being excessively deflationary. Sir Douglas Wass added that he was not as pessimistic as the Prime Minister appeared to be about the prospects of funding a borrowing requirement of £11½b. - for example, the indexed gilt and the extension of Granny Bonds would be a considerable help; and he still believed that a 1% reduction in MLR could be justified.

The Prime Minister said that she remained concerned at the risks that the Chancellor was taking, but she was prepared to accept his political judgement that an increase in the basic rate was not possible.

There was a brief discussion about other possible measures of raising revenue, in addition to the indirect tax package already agreed. The Prime Minister suggested that revenue could

be found from restructuring the ITV levy, and by applying VAT to all advertising. As regards the former, the Chancellor explained that, while the present levy was in need of improvement, nothing could be done in the Finance Bill. Discussions on a possible restructuring of the levy were taking place between the Treasury and the Home Office; if changes were to be made, separate legislation would be required.

As regards VAT on advertising, Sir Douglas Wass said that he believed that VAT already applied to all advertising except in newspapers; but he would look into this further. I have now heard from Tony Battishill that this is indeed the case, and that newspaper advertising has always been exempt from VAT both for political reasons and because it is thought that to tax classified ads would seriously damage the provincial newspapers. Imposing VAT on business advertising would not raise any revenue. (I will mention these points about advertising to the Prime Minister.)

The Chancellor told the Prime Minister that he had decided, after all, not to suspend the land development tax because he was afraid it might be wrongly exploited. But he still proposed to make certain minor changes in the tax.

*L. m.*

*T. L. L.*

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