NOTE FOR THE RECORD

The Prime Minister held a further meeting this afternoon with the Chancellor of the Exchequer, Sir Douglas Wass, Mr. Burns, Mr. Wolfson, Mr. Walters and Mr. Hoskyns to discuss the Budget strategy.

The Chancellor said that the PSBR forecast for 1981/82 had now risen to £13½-13¾ billion. His latest thinking on how this might be reduced was as follows:-

I He had in mind twice revalorization of the specific duties. This would raise £1 billion. It would mean a 2% addition to the RPI, but it should still enable the published forecast for November to November to be 10% - which would in turn mean social security uprating of 9%.

II He envisaged raising thresholds by 7½%, rather than 15% which would be necessary to fulfil Rooker-Wise. This would yield about £1 billion. A 6½% uprating would be the absolute minimum if a substantial number of people - for example, widows - were not to be brought into tax; he had chosen a slightly higher figure of 7½% largely for presentational reasons - because it was half the 15% implied by Rooker-Wise.

III He had decided firmly on the proposed bank levy.

These measures would reduce the PSBR to £11¼-11½ billion. He very much wanted to find room for a package of measures to help industry. He had concluded that nothing was possible on the National Insurance Surcharge. But he was minded to provide some relief on electricity and gas prices to bulk users, possibly the suspension of Development Land Tax and an increase in the first year allowance on industrial buildings from 50% to 75%, and an enterprise package aimed at small businesses which would cost less than £100 million in the first year rising to £300 million in a full year. The enterprise package might include some or all of the following: an Aunt Agatha scheme

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(which would be renamed enterprise investment), a loan guarantee scheme, an extension of the venture capital scheme, relaxation of the Investment Income Surcharge, raising the threshold of small company corporation tax, and some minor capital tax concessions.

The Chancellor said that, ideally, it might be desirable to reduce the PSBR below £11 billion. But he did not believe this was politically possible. In his view, an increase in basic tax rates had to be ruled out; 2% was the maximum that could be borne on the RPI; and he did not believe that colleagues would agree to a further round of public spending cuts.

Mr. Walters said that, in his view, the markets would be disappointed by a PSBR of £11 billion (after the Budget measures), and consequently there was a strong likelihood that the Chancellor's proposals would be insufficient. Given the possibility that the PSBR might in any case overshoot the forecast, he feared a funding crisis either in the summer or the autumn. A PSBR of, say, £10 billion would be no more deflationary than one of £11 billion - because the latter would be worse for expectations and for interest rates. It would be worth paying a premium now in terms of a tougher Budget, in order to avoid having to introduce supplementary measures later in the year. Serious consideration should be given to raising the basic rates of income tax by one or two per cent.

The Chancellor said that he was well aware of the risks. But he did not believe it would be politically possible to adopt a more stringent approach than he had outlined. It was going to be difficult enough as it was to introduce what would be represented as a deflationary Budget at a time of the deepest recession since the 1930s; to include an increase in basic rates would be impossible. If it turned out that the Budget measures were inadequate, then further action would have to be taken during the year. The need for such action would arise against a background of rising interest ~~rates and a~~ faster than planned

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expansion of the money supply; and therefore it would be easier in political terms than tougher measures in the Budget itself.

The Prime Minister indicated that the measures outlined by the Chancellor on indirect taxes and on income tax were, in her view, the most that were politically sustainable. She also did not dissent from the proposed bank levy.

In further discussion, the following points were made:

(i) The Prime Minister questioned the possibility of raising additional revenue by reducing the relief on life insurance premia. This seemed particularly apposite when the insurance companies were reported to be making a substantial pay settlement. The Chancellor said that this would not be an appropriate measure for the forthcoming Budget, but it was a possibility that the Treasury were looking at for some future Budget.

(ii) The Prime Minister pressed the case for abolishing the Postponed Accounting Service for VAT on imports. The extra £600 million which this would yield in 1981/82 would be very useful, and she did not believe that it would place as big a burden on the corporate sector as had been suggested - since to some extent, the earlier payment of VAT would be financed by suppliers overseas. Moreover, the corporate sector could be protected by restricting the change to the import of finished goods only. The Chancellor, referring to his minute of today's date, said that he had come down strongly against the change. The extra burden on the corporate sector would outweigh all the measures he hoped to introduce to help the corporate sector in the Budget. To the extent that it would tilt demand in favour of UK manufacturing

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cuts, he would bear it in mind for a future Budget; but it would be wrong to make the change now. The Prime Minister said that the Chancellor should at least keep the option open a little longer in case he needed the revenue.

(iii) The Chancellor said that three choices had been put to him for the uprating of child benefit - 50p, which would reflect the November to November RPI forecast; 75p, which would be in line with Rooker-Wise; and 95p, which would return child benefit to its real value in 1979. Following discussions with Conservative backbenchers, he had concluded that child benefit should be uprated in line with the Social Security uprating - i.e. by 9 per cent or 45p. The Prime Minister said she agreed.

TL

13 February, 1981

SUBJECT.

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cc. Master set.

SECRET

R H

B/C: Sir R Armstrong
Mr Wolfson
Mr Hoskyns
Mr Walters

10 DOWNING STREET

From the Private Secretary

13 February, 1981

BUDGET

Dear John.

I enclose my note of the meeting the Prime Minister held this afternoon to discuss the Budget.

Tim Lankester.

A J Wiggins, Esq
HM Treasury

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FILE COPY

MW.

MR WHITMORE (FIRST)

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