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Chancellor

1981 Budget

1. I attach a summary of Ministers' and Advisers' first shots at possible structures for next year's Budget. These are – reasonably enough – couched in essentially practical terms, and do not discuss the underlying policy approaches they imply.

2. The papers prepared by the office, by contrast, do raise the underlying issue, if in a rather oblique way: how far can the 1981 Budget be presented as based on a monetary target consistent with the MTFS?

3. Two alternative approaches can be imagined:
   (i) We simply accept this year's target over-run, and indicate that we shall be pursuing broadly the MTFS numbers for monetary growth in 81/82 to 83/84.
   (ii) We aim to recover this year's base drift over, say, 3 years – & so aim for a target in 81/82 somewhat below the MTFS 6–10% range.

4. Neither approach appears to be consistent with current policy & continuing commitment to the MTFS. (i) would strike some people as in effect ignoring our own target, and in practice not trying to steer by £M3. (ii) would require interest rates above present levels, or substantial further fiscal deflation which would be hard politically to defend. It would also imply that the 24 November MLR reduction had been wrong.

5. So you may think we have to consider how far we should seek to redefine/reinterpret the MTFS. So far as monetary aggregates are concerned we can
   (i) focus attention on narrower aggregates than £M3 (but that is what Lord Barber did in 1973–74);
   (ii) argue that the change in the world economy & in the UK position in relation to it – reflecting in particular the oil situation – means that the relationship between £M3 and GDP/the inflation rate is no longer what it was when the MTFS was prepared (but we then don't know what the new appropriate level of £M3 would be, i.e. how much base drift we should "accept").

6. My instinct would be in favour of concentrating more on the fiscal policy aspect of the MTFS, as being more nearly within the Government's control than £M3. The general standpoint would be that we would keep the PSBR on a (cyclically adjusted) downward trend much as indicated in the MTFS. This would in a sense imply that our target in financial terms was in terms of the gross financial indebtedness of the public sector (see para. 4 of Annex B) rather than in terms of a subset of all financial assets which is defined as "money". We would then make some general remarks about our intention to persuade the private sector to hold relatively less liquid financial assets, but would avoid committing ourselves very precisely to a monetary growth path. This policy stance would certainly be consistent with "minimising the burden of the public sector, so making possible lower interest rates" and "maintaining continuing downward financial pressure on inflation".

7. Personally I doubt the merits of going for a notably tighter fiscal policy next year than our current stance would suggest. The political difficulties don't need stressing — and it hardly seems necessary to add to deflationary pressures now that inflation is coming down quickly. It is worth remembering that cutting the PSBR at the same time cuts the private sector financial surplus requiring to be invested — this won't increase the supply of funds in the capital markets seeking investment outlets in the private sector (although it may help towards a better portfolio balance for investors if the amount of public sector debt they have to absorb is reduced — & that would tend to reduce the general level of interest rates a little).

8. Whatever the Government do is going to require care in presentation, given the MTFS and the importance the Government attached to it as a means of influencing expectations.

JW

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	1. 1981-82 PSBR as % of GDP (Ind.Act 4.2%)	2. Revenue (i) Ranking of sources of addl. rev.	(ii) Increase specific duties > RPI?	(iii) Less than full indexation of income tax thresholds?	(iv) Uniform treatment for all thresholds?	(v) Other ideas
CST	3.6%	Personal taxes up £2b, company taxes down £½b	Inc. in RPI plus one third	Uniform deindexation "up to one quarter" Similarly CB	Yes	VAT block ing for petrol. 1p rise i I.T. not excluded
FST	3% plus adjustment to allow for lower demand than in FSBR	1. Bank profits 2. VAT on imports (up to extra 1%) (see across)	3 = more than full reval.	3 = less than full reval.	Yes	See (i)
MST(C)	Not lower than 1980-81	1. Excise duties 2. Car tax, VED Increase in VAT	Yes	Preferably not	Yes	Narrow VA zero ratin In extremis, 2% o VAT
MST(L)	4½% (same in money terms as 1980-81)	specific duties	Yes	Preferably not	Yes	VAT block ing for petrol Higher NI on services
Mr. Ridley	As FST, and less than Ind.Act forecast	Income tax, Banks, perks, mortgage relief	Can't decide yet	Can't decide yet	Yes	
Mr. Cropper	2.4%	Income tax	No	No, but extra 5p on all rates	Yes	None

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	3. How far should we try to offset transfer of resources away from companies	4. Tax reductions (i) for private sector as a whole, or more limited?	(ii) Other ideas
CST	Reduction in heavy oil duty. Lower energy prices. Lower NIS on young employees Enterprise package	Corporate sector only	No tax on banks
FST	Find up to £1b to help companies	Abolish heavy oil duty Enterprise package	
MST(C)		Heavy oil duty NIS	
MST(L)	Yes, if possible, but doubts practicability	Indexation of capital taxes	
Mr. Ridley	Temporary steps only. Reduce interest rates. Lower energy prices	Fuel oil duty NIS on manufacturing Devices to encourage issue of debentures	Abolish earnings rule Enterprise trusts. Progress on techniques of monetary and public exp. control
Mr. Cropper	No	None	