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THE BUDGET JUDGEMENT

Statement by the Rt Hon Nigel Lawson MP, Financial Secretary to the Treasury, speaking to journalists on Thursday 12 March 1981

We have fully taken into account the effect of the recession - and in particular the fact that the recession is proving deeper than we expected when we published the MTFS a year ago.

In his Budget speech the Chancellor pointed out that the effect of the recession on the PSBR is even greater in 1981-82 than in 1980-81.

Our best estimate is that the extra severity of the recession has of itself added probably £2½ billion to the 1980-81 PSBR and will add some £3 billion the 1981-82 PSBR.

It is this additional £3 billion, on top of the £7½ billion originally implied by the MTFS, when it was launched a year ago, as an appropriate PSBR for 1981-82, which explains the Chancellor's Budget judgement that the appropriate PSBR for 1981-82, in current circumstances, taking full account of the recession, is £10½ billion.

Is it really argued that this figure is too low? If, for example, because of a lower expenditure forecast the prospective PSBR for next year on an unchanged taxes basis had been not £14 billion but £11 billion, would it be argued that there should be a reduction in taxation in the budget?

I suspect not. The problem is not the Chancellor's Budget judgement, but the point from where we were obliged to start: the disturbing prospect of a £14 billion PSBR. And this, like the £13½ billion PSBR, cannot be explained away simply as the consequence of the recession. As I pointed out a moment ago, we reckon that some £2½ billion has been added to this year's PSBR by the additional effects of the recession. But that is only half the £5 billion overrun: the rest is due to other factors.

There is, quite simply, no getting away from the fact that increased expenditure on, say, BSC, BL, for restructuring purposes and other reasons wholly unconnected with the recession, has to be paid for. And this means higher taxation.

But suppose we were to run away from the tax implications of the current high levels of public expenditure, and simply borrow more, run a bigger budget deficit, as the Opposition urge?

We first have to ask ourselves whether the intention would be to abandon or retain our monetary growth targets. If we decided to retain those targets, the effect of borrowing more would be higher interest rates which is the last thing that industry wants and which would, of itself, cancel out much - if not all - of the benefit to the level of economic activity from the attempted fiscal boost. Make no mistake. Without this Budget the downward movement in market interest rates which occurred in anticipation of firm measures would have been reversed. This would have been damaging to economic activity in general and the financial position of companies in particular.

There may be a short run boost to activity before the higher interest rates bite - although that is by no means certain - but the main lasting effect would be to change the pattern of the economy by benefiting consumption at the expense of investment.

But perhaps the intention is to accompany a higher PSBR by higher monetary growth, too. If so, again there may indeed be a short term boost to activity - but it would be very short term indeed; before long the extra monetary demand would simply be transmuted into higher inflation. That, indeed, has been the history of the past 10 years and if not longer. It is a history which the Government is determined not to repeat.

Indeed, given the key part that expectations play in the economy, there might not even be a short term boost from a deliberate relaxation of monetary targets. For in present circumstances a U-turn of this kind would be likely to cause a major shock to confidence, both in the domestic and international financial markets, which would threaten to undo all the progress that has been made in reducing inflation, and from which the only escape route would be a painful crisis package far more painful even than this Budget.

I hope this answers those who are concerned that the Budget is deflationary - by which I take it they mean contractionary.

For whether conditions are contractionary or not essentially depends - except as I have said in the very short term, and even here the likely effect of this Budget is very slight indeed - not on the fiscal stance, but on the relationship between the rate of inflation and the rate of monetary growth. The current underlying rate of inflation is within the new monetary target, so that judged by that yardstick there is no reason whatever to characterise this year's Budget as contractionary.

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