

PRIME MINISTER

THE PSBR

In my memorandum from Washington I suggested £6 billion as PSBR target and I thought that it would be wrong to exceed £7 billion. I now believe there are more cogent and pressing reasons to aim for the £6 billion.

The overriding reason is the deterioration, both economically and politically in the United States. I always suspected that the deterioration would occur fairly rapidly this year, but now I believe it is more likely since the political circumstances have changed against Reagan over the past few weeks. This will make markets more nervous and liable to panic.

If we plan for a £6 billion PSBR now, we shall be in a position for dealing with any such deterioration in the American economy. And, on the other hand, if the US rides out this year without a substantial run-down, there will be no harm and I believe some good done in having the extra billion in hand.

Within the framework of the existing budget proposals this could be done most easily by foregoing the increase in the thresholds above the 5½% for inflation. As you know, I have always regarded the threshold changes as a very high priority. Nevertheless, both politically and economically it may be a good idea to delay the threshold increase this year. We can represent the whole budget package this year as a reform of business taxation. We can express our intention to deal with the reform of personal taxation in subsequent budgets. It will not be bad politically to have quite considerable reductions in personal tax to have ready as a precursor to the next election.

CONSUMER CREDIT TAX

I believe this is a very important tax which we should implement as soon as possible. It effectively imposes a VAT of about 4% on credit services. This goes quite a long way towards widening the base of our tax system and VAT in particular. Thus it makes progress towards possible progress towards lower rates.

No I believe that such a tax is already widely expected by the banks and has been discounted in the fall of bank shares already. If we do not implement the tax then there will be a capital gain as the shares bounce back.

No In any case it is important to establish the principle that our main tax reform is towards widening the base and reducing the rates. The policy is to eliminate multiple boxes on savings and to switch from income to spending taxes. This tax on credit is consistent with that strategy.

Medium Term Tax-Benefits Strategy?

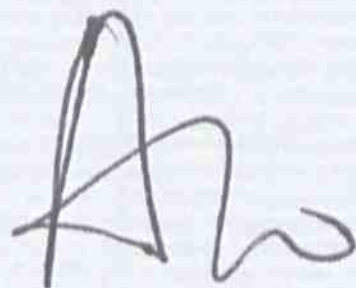
It would be useful to consider whether we should set out the policy in a major statement - a Medium Term Tax/Benefits Strategy (from 1984-1989). The main elements would be:

- (a) a change in the incidence of taxation from earning to spending;
- (b) a widening of the tax base and a reduction in rates;
- (c) a reduction, heading towards virtual elimination, of distortions particularly in business taxes/subsidies;
- (d) a reform of the benefits/tax system (in 1987/8) to reduce the disincentives to work, simplify the system of poverty-relief, to eliminate the benefit-induced distortions of normal family life, and to reduce the bureaucratic involvement in our lives.

The timetable of such a strategy must be rather flexible, but on some of the main items we can reasonably promise definite progress. But, of course, we should promise only what we can be reasonably certain to deliver. This will provide an external promise and an internal discipline.

/Given the containment

Given the containment of public expenditure, and the additional incentives to control spending that the MTT/BS will induce, this will provide the frame of reference for the next five years. The sine qua non of the MTT/BS is of course continued progress towards stability of the price level. We must have an inflation-free economy by 1988/9.



ALAN WALTERS
1 March 1984

BUDGET SECRET



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10 DOWNING STREET



From the Private Secretary

Prime Minister ⁽²⁾

To note Alain's views. He would prefer to devote the money being devoted to extra increases in thresholds to reducing the PSBR. But what effect does this have on the political balance of the package

He strongly endorses the consumer credit tax. Even if the Chancellor does not proceed with it this year, it could be kept in reserve for next.

On the Medium Term Tax (Benefits Strategy the Budget makes good progress on (a), (b) and (c). Raising thresholds would help (d) but much of the work is subject to Norman Fowler's reviews. The Central Council speed is a forum for reporting progress.

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