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PRIME MINISTER

THE 1983 BUDGET

We spoke on 20 January about the 3 February Cabinet, and I now enclose the paper which I plan to circulate. It is very similar to the one I circulated last year - C(82)1 - which produced a rather successful discussion on 28 January.

2. I am sure that we should again resist any pressure for changes in the monetary and fiscal framework which we have established. Sustaining present policy is right, both economically and politically.

3. My present thinking therefore is that:-

a. for the monetary aggregates we should, as envisaged in last year's Red Book, reduce the target range from this year's 8-12 per cent to 7-11 per cent for 1983-84. Our policy in respect of the exchange rate should remain unchanged (though in periods of weakness due to political factors, we should not allow interest rates to rise.)

b. the 1983-84 PSBR should certainly not be much higher than the estimated 1982-83 outturn, now put at £8 billion: indeed we have spoken of the case for showing a lower figure next year. We published a figure of £8 billion (2½ per cent of GDP) for 1983-84 in the Autumn Statement. Our latest forecast (before any changes beyond revalorisation) is some £6 billion.



4. This would give us room for tax cuts of some £1.5 to £2 billion, depending on whether we in the end go for a PSBR of £7.5 or £8 billion. It is far too soon to settle this; indeed it is important to stress that we are still at an early stage: the picture, and the figures, may change a lot before 15 March. In order to retain freedom of manoeuvre, my Cabinet paper does not mention the £6 billion and £2 billion figures.

5. I should prefer that colleagues concentrate their advice on how best we should target our fiscal measures. As the draft Cabinet paper says, the fall in the exchange rate has to some extent changed the balance of claims for relief as between persons and companies. Given the fall in interest rates over the last year, and the reductions in NIS which we announced in the autumn, it could be argued that the bulk of tax reductions in March should go to raising income tax thresholds. Within a total fiscal adjustment of £2 billion, there may be scope for raising them some 8 percentage points over the Rooker-Wise revalorisation, giving around 13½ percentage points in all. This would restore allowances to roughly the same percentage of average earnings as in 1978-79.

6. But there are also strong pressures for further help for companies; and it is of course true that substantial problems of profitability and competitiveness remain. And we do want to encourage output, as well as demand. Moreover, a Budget that contained major tax reductions, but none for companies, would be out of line with what we have tried to do in recent years, and could be misconstrued as electorally-motivated.

7. I am at present inclined to helping both individuals and companies. Action on industrial rates is ruled out for the present largely on grounds of practicality. A further reduction in NIS, or indeed its abolition, is widely sought; and if there is room some small move - say a further half per cent reduction -



would certainly be desirable. Conceivably there may be a stronger case for a reduction in the Corporation Tax rate, from 52 per cent to, say, 50 per cent.

8. The indirect taxes ought I believe to be revalorised in line with inflation in most cases. However I shall want to look carefully at the individual components; and, as you have asked, will look in particular at the petrol and derv duties. But the real price of petrol at the pumps has in fact dropped since the last Budget, and a failure to revalorise these duties would cost some £0.25 billion.

9. I am also working on a range of possible measures to promote enterprise and small firms, to encourage wider share ownership, and to stimulate technology and innovation. I envisage further concessions on oil taxation as an encouragement to North Sea development. And I am looking again at the ceiling on mortgage interest relief.

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10. The questions posed in my Cabinet paper are designed to give colleagues an opportunity to express their views on the broad strategic issues, and on the right blend of fiscal change. What we must of course avoid on 3 February is any attempt to reach precise quantified decisions: the whole picture could change sharply as a result of major oil price, or exchange rate, movements. I shall wish to keep you in the picture throughout; but I would not want to have to go back to Cabinet to seek the reversal of decisions reached too soon, too precisely, and too collectively.

11. We might perhaps discuss this, and the draft paper, at our meeting on 27 January.

(G.H.)

26 January 1983

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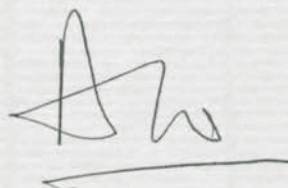
PRIME MINISTER

1983 BUDGET: CHANCELLOR'S MEMORANDUM OF 26 JANUARY

The Chancellor's proposals are very similar to those which I have discussed with Peter Middleton. On the whole I think they are on the right lines. I have one or two reservations, mostly of a minor kind.

1. I would prefer the lower PSBR £7-7½bn for reasons I have sketched before.
2. I think this is an opportunity to get rid of the investment income surcharge, especially when we are at the same time proposing to do a super Rooker-Wise. It is doubtful whether we shall have such a good opportunity again for a year or so.
3. I think there is a much more powerful case for reducing Corporation Tax from 52 per cent to 50 per cent, than for yet again decreasing the NIS. A decrease in Corporation Tax will go to profitable companies, whereas a fall in NIS will go to all corporations, profitable or loss-making. We believe in the profit motive.
4. On the monetary aggregates, I think the Chancellor is about right. I would be inclined to put them at 6-10%, but I would not regard it as a critical argument to win.

In the Cabinet paper I do very much welcome the point the Chancellor makes in para 13, where he says that there is very little difference between, for example, reducing the national insurance charge paid by employees and that paid by employers. In the medium term there is really no difference at all.



26 January 1983

ALAN WALTERS

SECRET