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MS

PRIME MINISTER

I saw Alan Walters today about his contract for returning to No.10. No problems here.

He will be seeing you early in December. But he asked me to pass you two messages.

(1) On the economy, he was satisfied about its progress. The higher interest rates appeared to be working faster than many had expected. It was too early to come to judgments about the Budget, but he thought that the priority area for action would be capital taxation. He believed that, despite the theoretical arguments for unifying the income and capital gains tax (CGT) rates, a CGT rate of 40 per cent was too high.

It was effectively a tax on savings; and we needed more incentives to save, not disincentives. Moreover, a 40 per cent CGT would not, in Alan's view, raise as much revenue as a lower rate. This was because with the rate at 40 per cent, taxpayers would do their best to find capital losses to offset against their capital gains and so reduce their tax bills. If the CGT rate was lower, tax payers would have less incentive to do that and the working of the Laffer curve would produce higher net revenue.

Whatever the economic merits of Alan's point, the politics of divorcing the CGT and income tax rates only one year after so much credit has been taken for their unification, would be very difficult indeed.

(2) Alan thought that Mr. Bush would want to begin his Presidency with a dramatic economic gesture. His guess for that gesture was an oil import tax, which would be bad news.

N.L.W.

N. L. WICKS

11 November 1988

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