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PRIME MINISTER

There are three courses open.

The Lawson way

Allow an extra c. £1.8 billion on public spending and reveal the extra c. £1.5 billion of revenue (concealed last autumn).

Hope the Fowler reviews deliver some offsets. — The Chief Secretary's note makes some suggestions.

Then proceed with a budget which raises thresholds, reforms CGT, abolishes DLT, changes the shape of employers National Insurance to create jobs particularly for the lower paid and announces expansion of the YTS and CP.

The "Heseltine" way

Announce no increase in thresholds, no uprating of unpledged benefits and no "help the rich" capital tax changes. Make the whole - and only point - of the budget austerity and retrenchment.

A modified Lawson way

Proceed with the kind of budget envisaged two months ago - a budget for jobs - and a budget of capital tax reform. "Give away" less in view of the public expenditure and money/£ problem.

Announce that public expenditure will be held to the White Paper totals and that some additional spending measures may be necessary to achieve this.

Which way?

The "Heseltine way" is bad politically and economically. It does nothing to reassure on jobs. It disappoints our supporters - who want their tax cut - and the Opposition who will oppose the absence of social security uprating. Freezing the basic pension would be a disaster.

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It fails to increase the gap between benefit levels and in work incomes, ruins an already shaky record on direct tax reduction, has nothing of interest in the measures and puts back the switch from direct to indirect tax. Yet again capital tax reform will be stifled.

The Lawson way is better, with the proviso that giving in on Public Spending may scoop the headlines and will definitely make holding the line in future more not less difficult. A central tenet of this Government's faith - holding PE level - will turn out to be negotiable. Some of our supporters will wonder if they might not be better off with the SDP who would spend the extra with more grace. It stakes everything on a good outturn to the Fowler reviews.

The modified Lawson way is the only one to consider. But to make it credible there has to be some move on Public Spending.

Remember that the Treasury forecast of an extra £2 billion of public spending is deliberately gloomy. You have to assume the worst on the length of the coal strike, the level of price inflation for social security uprating, the impact and endurance of high interest rates, local authority overspending and policy changes. The Contingency Reserve is likely to be busted, but not by that much.

Our separate note on public spending suggests ways and areas. There are three big issues:

i. can unpledged benefits be frozen and thresholds raised? Yes if you are prepared to be bold and argue:

a. we need to lift the tax level above the benefit level for jobs reasons.

b. child benefit goes mainly to those who will benefit from the tax changes.

Freezing would be both a harbinger of any Fowler reforms

and a reminder of why it was necessary to review the system.

(ii) can some of the promised efficiency be delivered?

When can MOD lop a few hundred million off their procurement? When can PSA cut its estate? When will Crown Supplies cut the supplies bill? Can FMI be given some Ministerial bite?

(iii) Can we take other action?

e.g. A moratorium on regional and industrial grants.

A moratorium on agricultural grants.

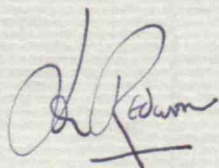
A major reduction in new ECGD risk or an increase in premia.

Further sales of index debt instead of ordinary gilts.

A major acceleration of the privatisation programme.

You could cobble together £500 million - £1 billion of reductions which would be enough to show earnest to the markets.

Then you could have a reforming jobs oriented budget - as planned and as needed. The new National Insurance for employers is a nil cost beneficial measure and should stay whatever else is done.



(J. Redwood)

22 February, 1985