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PRIME MINISTER

12 February 1986

CABINET: BUDGET AND ECONOMIC STRATEGY

Considerable Caution

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The Chancellor has struck just the right note in his submission on Budget strategy for tomorrow's discussion at Cabinet - "considerable caution". With current oil prices of \$16.70 pb, 3-month oil futures prices of \$15.40-\$16.10, and great uncertainty over the longer-term outlook, the room for manoeuvre is severely limited.

Aiming for a PSBR of more than £7.5 billion, on top of the extra asset sales of £2.5 billion, would be seen by investors as abandoning the MTFS. It would risk higher inflation and higher interest rates.

The benefits of falling oil prices

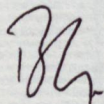
Colleagues may need to be cheered up. Falling oil prices may be bad for Treasury receipts, but they are good for the economy as a whole. A fall in the oil price is rather like a tax cut - but one for which the Chancellor can't take the credit. It raises output and reduces inflation. Even the CBI can smile as manufacturing gets a double boost - lower costs and a lower exchange rate.

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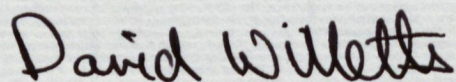
The timing of tax cuts

If the economy performs as the Treasury expects, there is still room for tax cuts in 1987. Far better to be cautious now and cut later, than cut now and have to raise taxes next year.

This view is reinforced by the Institute of Fiscal Studies Report published today. That suggests that, while the decline in oil prices eliminates the 1986 fiscal adjustment, it increases the amount by which the Chancellor can cut taxes in 1987.



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EMBARGOED UNTIL NOON, WEDNESDAY 12 FEBRUARY 1986
10 FEBRUARY 1986

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PRESS RELEASE

IFS GREEN BUDGET 1986

Although plummeting oil prices mean that there is now little scope for the Chancellor to make tax cuts in 1986 he could well find in excess of £4bn to give away in 1987. This is one of the major findings of an IFS analysis published today (Wednesday 12 February 1986). The Chancellor's options for his Budget on 18 March is presented in the fifth annual IFS 'Green Budget' together with a supplementary report 'Oil Prices and Budget Strategy' by Michael Devereux. This considers in detail the effects on the Government's financial position caused by the dramatic decline in oil prices in recent weeks.

This year the conflicting pressures on the Chancellor will be more than usually difficult to reconcile. Only a few months ago it was widely expected that tax reductions of £3 billion or more could be made without jeopardising the Government's target of a £7.5 billion PSBR in 1986/7. But by mid-January, as IFS shows, most of that prospective 'fiscal adjustment' had been eliminated by falling dollar oil prices and a rise in the dollar value of sterling. With the further fall in oil prices that has since taken place, it would now be necessary to increase taxes in 1986 to keep the PSBR to its target level - even when full credit is taken for the £2 billion that the Government plans to raise during the year from additional asset sales.

So the Chancellor must either disappoint the strong political constituencies

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for reductions in income tax and measures aimed more directly at reducing unemployment, or he must revise his PSBR target. We expect that he will disappoint those expecting tax cuts in this Budget.

We do, however, believe he could promise and be able to deliver tax cuts in 1987. The decline in oil prices creates only a temporary hole in the Government's financial position while it eliminates the 1986 fiscal adjustment (with an unchanged PSBR target), and the IFS analysis shows that it actually increases the amount by which the Chancellor should be able to cut taxes in 1987 by over £4 bn.

The debate about the appropriate way to reduce tax levels therefore remains relevant. The 'Green Budget' discusses the merits of reducing rates of income tax or raising allowances and looks at other direct tax changes that could form part of another 'budget for jobs'.

- Ends -

Note to Editors

The IFS 'Green Budget' Conference will be held on Wednesday 12 February 1986.

IFS Report Series No.20 Budget Briefing 1986: The IFS "Green Budget" edited by John King.

IFS Report Series No.21 Oil Prices and Budget Strategy by Michael Devereux.

Further information on the conference and on the publications (price £10 each) are available from the Institute for Fiscal Studies, 180-182 Tottenham Court Road, London W1P 9LE.