

cc: Chief Whip

NBN,
MR NORCROVE

The Prime Minister this afternoon asked me to dig out my minute on Budget Presentation. I attach 2 copies.

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BERNARD INGHAM

17 March 1987

c: Mr Wicks

1. MR NORGROVE
2. PRIME MINISTER

BUDGET PRESENTATION

I was struck today by the intro to the attached cutting from today's FT and its link with a briefing I had from Young and Rubicam last night on their latest research.

It seems obvious that in a potential election year, a prudent Chancellor would seek to combine lower taxes with lower borrowing (and lower interest rates), and that if he could do so the Opposition parties would have an uphill task.

What is already clear is that the Labour Party has an uphill task anyway. The steepness of its climb is related to the performance of the SDP/Lib Alliance which is now felt to have repackaged itself rather well.

Budget presentation therefore needs to have as one of its aims the neutralising of the SDP/Lib appeal which owes something to the so-called "liberal conscience".

This could best be done by a four pronged approach to Budget presentation, on the assumption that the Budget facts permit it:

1. The Government's prudent management of the economy over the last 8 years has produced six continuous years of growth, a resurgence of the economy, more jobs and at last a falling trend in unemployment.
2. This has been partly brought about by tax cuts which have encouraged enterprise, hard work etc. Consequently, I propose to reinforce this healthy development by a further modestly prudent reduction of Xp.

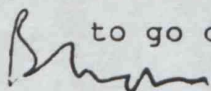
3. I could of course have cut taxes more because I have the spare cash to do so, but prudence requires a balanced approach. It is therefore right that I should use part of those resources to reduce borrowing and so help to lower the cost of interest rates to industry and home buyers, among others.
4. But there are other claims on available money - not the least of which are health, education and the social services. And here I want to make clear that the money to reduce taxes and borrowing is available, thanks to prudent management, over and above what we have already allocated to higher spending on these social priorities. This higher spending is not just taking place now in an election year; it has occurred in each of the last X years; and it will continue in the years immediately ahead as our published public expenditure plans show.

In other words, the prudent management of Britain's finances over the last 8 years is paying a treble dividend:

- in lower taxes
- in lower borrowing
- in higher spending on social priorities.

That's what a Conservative Government has been about in the 1980s. It is what a Conservative Government is about as we approach the 1990s. And it is what a Conservative Government intends to continue to be about as we approach the next century.

Such a presentation would accord with the advice coming from Young & Rubicam who are adamant that the Government needs to demonstrate that it is devoting some of the extra resources to social principles not merely now, but intends to go on doing so in the future - as its plans indicate.



BERNARD INGHAM
6 February 1987

FT 6/2/87

UK NEWS

Philip Stephens examines the options facing the Chancellor in what looks like being an election year Lawson prepares Budget of sweeteners and surprises

LOWER TAXES, lower borrowing and lower interest rates are the enviable prospect that Mr Nigel Lawson, the Chancellor, sees within his grasp as he prepares for what seems almost certain to be the last Budget before a general election.

Behind the pre-Budget secrecy surrounding the Treasury it is impossible to miss the air of optimism among the Chancellor's advisers. The talk is of an "exciting" Budget, of "surprises" on March 17.

Mr Lawson's attempts to downplay expectations have had no impact in Whitehall. There is growing confidence that he will find £3bn or £4bn to split between income tax cuts, other electoral sweeteners and, with an eye on financial markets, a cut in borrowing.

"Barring a sterling crisis he will be able to be both generous and prudent. The timing is perfect," is how one insider puts it.

The final judgment of the size of the "fiscal adjustment" (the amount of cash the Chancellor has available to reduce taxes or public borrowing or a combination of both) will not be made until perhaps the beginning of next month. Last year Mr Lawson waited until 10 days before the Budget before deciding that he could afford to cut the basic rate of tax by 1p.

It is already obvious, however, that revenues from value

added and corporate taxes are running far ahead of the Treasury's previous forecasts. The tax windfall—generated by the current consumer spending boom and high company profitability—was acknowledged in last November's Autumn Statement when the Treasury raised its forecast of non-oil revenues in 1986-87 by £2bn.

At that time the Treasury's internal forecasts were already pointing to a substantial fiscal adjustment, perhaps of about £2bn, even after the Government had added nearly £5bn to its public spending target for 1987-88.

There is growing confidence that up to £4bn will be found for tax cuts

Since then, the pace of increase in non-oil revenues has further accelerated and the Treasury expects to undershoot its £7bn target for the public sector borrowing requirement (PSBR) in this financial year.

The rise in the oil price to about \$18 a barrel has provided another unexpected windfall and will allow Mr Lawson to project a price of perhaps \$15 or \$16 a barrel for the next



Nigel Lawson: optimistic

financial year while still appearing cautious.

Finally, the likely undershoot in the PSBR has allowed Treasury officials to begin bringing forward some of the public spending which would normally fall in 1987-88 into the current year.

The decision facing Mr Lawson is how he should best use the fiscal adjustment, both in terms of maximising the Government's popularity and of ensuring that the Budget gets a vote of confidence from financial markets.

Some of the Treasury's most senior economists believe that—in the abstract—the best strategy would be to use most of the cash available to reduce next year's PSBR even further.

The argument is that the economy is growing strongly so no stimulus is needed from tax cuts. By giving an added stimulus to the consumer boom, lower taxes might also exacerbate Britain's widening trade gap, as imports account for a disproportionate share of retail sales.

A substantially lower PSBR would pave the way for lower interest rates, thus boosting prospects for investment and for more balanced growth in the economy. It might also allow a continued depreciation in the pound's value, strengthening the prospects for exports.

With an election looming, however, there are few illusions in Whitehall that Mr Lawson will opt for such a course. What does seem increasingly plausible is that he will seek the best of both worlds.

On present arithmetic the Chancellor may well be able to reduce income taxes by more than £2bn—perhaps by cutting the basic rate by 2p to 27p—and to reduce his planned borrowing target by about £1bn to £6bn.

That apparent combination of prudence and generosity might be enough for a cut in interest rates and lower mortgage rates. The latter would provide a welcome brake on the pace of

increases in retail price inflation at a time when it is likely to be heading for 5 per cent.

Of course, lower taxes may not be confined to reductions in the basic rate. Mr Lawson could seek to demonstrate the Conservative Party's commitment to the lower-paid by announcing a significant increase in income tax thresholds.

The Chancellor—again with an eye on the inflation rate and votes—could also decide against raising excise duties on tobacco, petrol and alcohol by enough to take account of past inflation.

Another relatively inexpensive option would be to cut the top rates of tax, although the Prime Minister has indicated that electoral considerations point more towards doing something for the lower paid. In that context an increase in the ceiling for the special lower-rate band of employees' National Insurance contributions might be an attractive option.

The logic of Mr Lawson's past policies would dictate the removal of stamp duty on share transactions, but what would be seen as a £1bn handout to the City would almost certainly be out of tune with Mrs Thatcher's political antennae.

The Chancellor, who is temperamentally a juggler and always anxious to spring surprises, will also be looking for taxes to reform or perhaps to abolish. The increasingly complex capital gains tax

prove a worthwhile candidate if some of its revenue can be diverted elsewhere.

Plans for the introduction of tax incentives for profit-related pay have got a lukewarm reception both within the Treasury machine and from many industrialists.

Mr Lawson, though, may well feel that he has invested too much political capital in the idea to drop the idea of even a modest move in the direction of profit-related pay.

This comfortable scenario, in which the Chancellor can afford to do most of the things he wants to do, is not, of course,

Revenues from value added and corporate taxes are running ahead of forecasts

immune to outside shocks. The pound still looks vulnerable on foreign exchange markets and another run on the currency could well force him to follow the advice of officials and drastically cut the PSBR target.

Barring a sterling crisis, though, Mr Lawson's fourth Budget looks to be the one where he will have all the pre-election opportunities he could hope for—and, of course, no ex-