

BUDGET - SECRET



4 (A-D)

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From the Private Secretary

PRIME MINISTER

BUDGET UPDATE - 10/2/89

1. As before I have had an informal briefing of what the Chancellor may say to you on Sunday evening. Please do not reveal that you have been briefed.

Latest Developments

2. Terry Burns' latest view is that the 1988-89 ~~and~~ ~~1988-89~~ and 1989-90 PSDRs will be higher than in the Treasury Forecast (Page C). On the basis of the ~~very~~ original package of net tax reductions of £1.1 billion they now believe:
- the tax and NICs / GDP ratio would rise between 88-89 and 89-90
 - although the total PSDR would stay the same between 88-89 and 89-90, the PSDR excluding privatisation proceeds would rise.

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3. So the Chancellor is now contemplating further tax reductions of about £1 1/4 billion, so that:

- tax and NICs / GDP ratio is the same in the 2 years
- PSOR excluding pensioners is the same, and total PSOR falls about £1 billion between the 2 years.

4. The Chancellor is also influenced by:

- worries that a bigger PSOR - ? £14-15 billion - will fuel demands for extra public spending.

Possible Tax Reductions

5. 5 ideas are in play for "spending" the extra £1 1/4 billion:

- (a) 1p off the basic rate
- (b) More than indexation of tax allowances ^{in view of RPI increases}
- (c) Some adjustment to the lower bands of NIC contributions. X
- (d) 2 percentage points off corporation tax
- (e) Abolish income tax on the state retirement pension, abolish age allowances and scrap the pensioners' earnings rule.

6. ● The Chancellor may not mention all of these. If not, you might reasonably be expected to think on the spur of the moment of any of (a) to (d), but for you spontaneously to suggest (e) might alert the Chancellor to the fact that you had been briefed!!
7. But if he mentions (e), it certainly sounds worth exploring. The political attractions could be considerable - and it might help to ease the Chancellor's worries of a "boring Budget".

Line to Take

8. Stress the need to err on the side of caution this year. The ~~size~~ dangers of too ^{restrictive} ~~expensive~~ a policy stance are far less - and to some extent easier to address - than the reverse.
9. Emphasise the fundamental importance of tight monetary policy. Arguably the most important thing about the state Budget is that it should not be the traditional occasion for an interest rate cut.
10. Question the forecast that the budget surplus will stay high. Have the Treasury fully allowed for how

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● quickly the surplus could fall as the economy slows down - both from slower growth of tax revenues and upward pressure on public spending? This last year shows just how sensitive the PSBR / PSBR is to variations in economic growth - and the same is true in both directions.

11. If ^{that's it,} you are satisfied on (10) give a fair hearing to the case for a slightly ~~smaller~~ ~~fixed~~ ~~change~~ bigger tax reduction. NB that the way now be proposing is roughly consistent with what Alan Walker recommended before.

12. Of the options (a) to (d) in (5), I would discount (c) and (d). And I would strongly favour (b) - tax allowances - rather than (a) - the basic rate. NB as long as earnings rise in real terms, simply indexing in line with prices implies a higher real tax take. ✓

Handling

13. Press the Chancellor to quickly to put his proposals down on paper before!

REC 6.10/2