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NOTE OF A MEETING HELD AT NO.11 DOWNING STREET ON TUESDAY, 27 JANUARY, 1981 AT 9.30 A.M.

Present:

Chancellor of the Exchequer (In the Chair)
Chief Secretary
Financial Secretary
Minister of State (C)
Sir Douglas Wass
Mr Burns
Sir Anthony Rawlinson
Mr Ryrie
Mr Middleton
Mr Unwin
Mr Ridley
Mr Cropper
Mr Walters - No.10

BUDGET STRATEGY

The short discussion focused on the agenda submitted by Mr Unwin on 26 January.

Monetary stance

2. Mr Ryrie reported that the various pieces of work were well on schedule, but that it would not be possible to complete papers about monetary targets and funding arrangements until next week. Discussions on certain aspects of monetary control, particularly concerning the money markets, were now crystallising satisfactorily with the Bank of England. The Chancellor asked that any available material - even if in a less than final form - should be submitted to him by 30 January.

Fiscal stance

Sir Douglas Wass said that officials were generally agreed that a net contraction of around £1½ billion would be sensible, on the basis of a pre-budget forecast PSBR of about £10½-11 billion.

/However, he emphasised

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However, he emphasised that this remained a provisional view of the desirable impact of the Budget, and that it could change if the forecast PSBR changed markedly. On the basis of the figure suggested, the 1981-82 PSBR would be some 4-4½ per cent of GDP, as compared with 5½ per cent during the current year. The 1981-82 figure was a central estimate, and allowed nothing for the possible need for a safety margin. Mr Ridley and Mr Cropper made clear their preference for a figure well below £10 billion; the difficulties encountered as a result of the present excessively high level of interest rates were themselves a signal of the need to reduce the PSBR. The Minister of State (C), however, thought even £10 billion might be unrealistically low; the Financial Secretary thought the markets would be very pleased with £10 billion if they could believe in it. The Chancellor thought people would only believe the PSBR forecast if robust contractionary measures were to be imposed; thus he saw a £1½ billion reduction in the PSBR as a minimum, given the need for some safety margin.

3. Discussion then turned to the means of achieving a £1½ billion PSBR reduction. Sir Anthony Rawlinson doubted whether further public expenditure reductions would be possible in advance of the Budget. The Chancellor suggested that we should be looking for short-term regulators which would reduce the costs of public expenditure, and should also study urgently possible changes in the methods of control. Sir Douglas Wass said he was arranging for further work to be done on these various ideas.

4. The Chancellor questioned whether, within the overall objective of a £1½ billion PSBR reduction, we should be aiming at some net reduction in the tax burden on the business sector. Sir Douglas Wass said the question boiled down to how much could be extracted from the personal sector: such additional revenue as could be secured

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should be obtained from the banks and the oil companies, but in one way or another the personal sector would have to carry by far the largest share of the burden. It was noted in further discussion that the personal sector would already be contributing an extra £1 billion through the increase in the employees' national insurance contribution - in effect a surrogate income tax. Even assuming something more than full revalorisation of the specific duties, a further increase in the real burden of income tax of £2 billion or more would be required to give net relief of even £½ billion to the company sector. In these circumstances any net relief to the company sector would be a clear indication of the Government's priorities. The Financial Secretary was inclined to think that the main priority was to get the PSBR down; companies had been relatively successful in protecting their financial position, and any fall in the exchange rate would tend to ease the pressure on them.

5. Mr Burns and Mr Middleton emphasised the extent to which this year's difficulties with the PSBR had arisen as a result of the pressure which had been put on the company sector - so bringing about the earlier presentation of bills, the more rapid execution of Government contracts, the laying off of workers, etc. These considerations suggested that there might be a case for accepting a higher PSBR as the price of giving some relief to the company sector. On the other hand, it was recognised that companies were now making substantial progress in adjusting to the sudden deterioration in competitiveness, and that there was now perhaps less of a case for very substantial relief for companies than there had been last year.

6. In discussion of the scope for increasing the specific duties, two problems were noted: the diminishing returns on duty increases on spirits and perhaps also beer, and the constraint imposed by

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the need not to push up the general price level too sharply. The Chancellor suggested that the maximum tolerable increases overall were unlikely to exceed $1\frac{1}{2}$ times revalorisation - although the Government might look for more on tobacco and perhaps on petrol (but the decision on the latter would depend on what was done about "blocking"). It was generally agreed that, with the improved outlook for inflation, there was perhaps a little more room for increasing the specific duties than there had been in 1980; but the inflation prospect remained fragile, and it would be important to do nothing which could contribute to a reacceleration in the inflation rate in 1982-83. The Financial Secretary urged that the option of increases in the specific duties of up to twice full revalorisation should be kept open for the time being.

7. The Chancellor suggested that total tax reliefs for the business sector should not amount to more than a 1 per cent reduction in the employers' national insurance surcharge, together with perhaps £$\frac{1}{4}$-$\frac{1}{2}$ billion in various capital tax concessions. Even this could prove extremely difficult to finance, particularly since it appeared that income tax allowances would need to be revalorised by at least $6\frac{1}{2}$ per cent so as to keep tax thresholds above social security benefit levels. Given this constraint, it could well turn out that the only available means of securing additional revenue from the personal sector would be by means of a further increase in employees' national insurance contributions. However, it was recognised that there would be great difficulties in going for this - not least that the Government would give the impression of inadequate planning if contribution rates were to be changed yet again so soon after the increase currently under consideration in Parliament.

JW

A J WIGGINS
28 January 1981