

Prime Minister

BUDGET SECRET

Ref. A09625

PRIME MINISTER

* which I have mentioned to the Treasury.

You should read this before your meeting with the Chancellor at 6 pm tomorrow. It raises some important questions. The Chancellor will be sending you his own promised paper first tomorrow. JL 22/5

The Budget

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I have seen Mr. Lankester's account, in his letter of 22nd May to the Chancellor's office, of the discussion you had on Tuesday with the Chancellor about the Budget. I understand that your talk with the Chancellor is to be resumed tomorrow evening and I should like to offer these comments.

2. Your objectives are clear. You want to reduce the PSBR and the rate of growth in money supply to restrain inflation; you want to reduce the share of national income absorbed by the public sector, and thus release more for the private sector; you want to shift the burden of taxation from direct to indirect taxes in order to provide the economy with a new dynamic; and you want to do these things without putting up the RPI, through tax changes, more than is necessary.

3. My worry is that the Treasury, in its approach to these objectives, is in danger of getting too boxed in between the conflicting desiderata, in the light of their latest forecasts, and that the casualty is likely to be the cuts in direct taxation on which your broad economic strategy fundamentally depends. Whatever the economists may say, a Budget largely confined to cutting public expenditure and the PSBR and raising VAT would not only be a great disappointment to the voters (who don't understand PSBR and the money supply anyway) but would wrong foot your basic strategy in the critical first 12 months of your Administration. Might I therefore suggest that in your talk with the Chancellor you seek to explore each of the main elements in the equation and probe whether the Treasury could not be more inventive. Thus:-

- (a) The PSBR: Of course the level of the PSBR is important and of course you want to get it below Mr. Healey's target if you can. But the Treasury forecast is not inscribed on tablets of stone. It is a forecast and there is a wholly legitimate area of uncertainty about the figures. How far has the Chancellor probed the arithmetic and what probabilities