

Secret & Personal

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8 March

The Budget

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This morning we reviewed the oil price possibilities and the effect on the budget and PSBR etc. The PSBR results are as follows: -

World Oil Price	Increase of PSBR (£bn)	
	1983/4	1984/5
\$27 a barrel	0.5	0.7
<u>\$26</u>	<u>0.9</u>	1.2
\$25	1.3	<u>1.8</u>

[These allow for a depreciation of sterling by 2% for every 10% reduction in oil price.]

Oil is trading now on the Rotterdam spot market at about \$26-27 a barrel and there are many transactions below those values.

Oil price reductions are very similar to reductions in specific excise taxes - except that we do not control them but must make guesses about their magnitude. [My personal guess has, since end 1981, been that the oil price would go below \$25 before the end of 1983 - but it may well be sensible to envisage an average value of \$26 in 1983/4 with contingency plans for a fall to the low 20's]

The certainty of a substantial fall in the oil price reinforces the Chancellor's view that we hold the PSBR (assuming oil prices at about \$29 a barrel) to £8 Bn. If the oil price falls to \$26, then the PSBR will rise to £9 Bn.

I think it would be prudent to plan to absorb about half the increase in PSBR. Thus we should plan for a £7½ Bn PSBR (assumed oil price \$29). The effect would be roughly the same as an £8½ Bn PSBR if the oil price falls as expected to \$26. The extra billion is the indirect-tax-reduction-equivalent to the fall in the oil price.

The Chancellor has a good case for holding the thresholds to inflation + 8½%. There are also compelling reasons for dropping the NIS reduction but he may well want to keep that card up his sleeve for the time being.

I would urge you to think about the consequences of any substantial reductions in tax when there is such a high likelihood of substantial reductions in the oil price.

This year above all we do not want to have to introduce July-measures to increase taxes to offset falls in oil revenue and to calm fevered markets.

I doubt if you will find this at all palatable but there it is!

Alan Watkins