

cc. Econ. Pol.  
Budget. Pt 14. *mb*

PRIME MINISTER

You have a two hour bilateral with the Chancellor tomorrow afternoon. There are three major topics for discussion:

- the markets
- the Budget
- the Green Paper on Personal Taxation

I suggest you start with the markets (see my separate note about base rates). This will set the right flavour for discussion of the Budget.

In this context you might also raise with him the extent of intervention in the foreign exchange markets, whether directly or by meeting departments' needs from the reserves - over \$400 million down last month, and a fall every month since August, the floating rate note aside. This surely cannot be allowed to go on, nor should the Chancellor agree at the G5 this month to further intervention by the UK. (You might ask the Chancellor what the agenda is to be for this meeting and what he thinks is likely to come out of it.)

On the Budget, the Chancellor intends to give you some first thoughts about the overall fiscal and monetary framework. The Treasury say the monetary discussion is not very advanced. On fiscal policy, the Treasury say public comment has an exaggerated idea of the Chancellor's intentions. I am told privately that the Chancellor has no present intention of increasing the PSBR for 1986-87 beyond the £7½ billion envisaged in the 1985 MTFs. The question is rather how much below that figure he should aim. The £2½ billion higher asset sales point in one direction; lower oil revenues may point in the other.

The flavour of the public comment is given in the notes by Phillips & Drew below. Though these papers do not show it, some people are saying that the Chancellor intends to increase the PSBR. On the other hand, see the tables on pages 13 and

14 of the Phillips & Drew pamphlet.

You might also like to look at the record (dictated from memory) of your dinner with the Chancellor last month.

I suggest that at this stage you should not get into a discussion of detailed numbers for the PSBR even if the Chancellor wished to do so.

The next area for discussion is the main blocks of the Budget.

On direct taxation, should priority be given to reducing the basic rate or increasing allowances? (Note that reductions in the basic rate reduce the cost of transferable allowances.) Do you want to argue for simplifying the higher rate band? (You noted this morning that one of them is rather narrow - see the table attached.)

On indirect taxation, the blip downwards in inflation in the middle of this year would ease the pain of more than revalorisation. One possibility, as always, would be to raise VAT. Politically difficult perhaps, but it has a relatively low RPI effect for the revenue it raises. On specific duties, the uncertainty about oil prices may mean that the Chancellor should say, as Sir Geoffrey Howe did in 1982 and 1983, that if oil prices fall he would be prepared to raise specific duties to compensate for the effect on the PSBR.

Thirdly, employment measures. The Chancellor will not want to reinforce the tradition of increasing public expenditure at Budget time. To do so is bad for Survey discipline, partly because it looks as though the Chancellor is reserving goodies for himself. But I am told that Lord Young's ideas, discussed at the time of the Autumn Statement, are regarded as imaginative and that they could be reasonably cheap. An increase in the community programme, as favoured by the CBI, would be worth keeping up the sleeve in case the unemployment figures began to rise again.

Fourthly, the Chancellor may broach a miscellany of ideas about, eg, pension fund surpluses and charities. On charities, there has in the last few months been some correspondence stemming from a report by Sir Adam Ridley which proposed greater tax deductability for charity giving, among other things.

The discussion on the Green Paper on Personal Taxation has been postponed. But the discussion tomorrow could be used to steer the Chancellor in a way which would head off a row. You could perhaps make the following points to him:

- (i) recognise that he is committed to publishing a Green Paper and agree that we should work towards publishing it on Budget Day;
- (ii) the Green Paper as at present drafted is almost white on the main issue and sets out only one side of the case; it also risks looking imprudent (£5.3 billion);
- (iii) you will need to see what colleagues think, but in any case the Green Paper will need to be redrafted to make it more green and recognise that there are arguments against the proposal;
- (iv) the Green Paper should also acknowledge that £5.3 billion may not be available: it could show the benefits of the proposal on several different bases, eg revenue neutral, £2½ billion available and no losers;

(v) you will want to look very carefully at some of the more minor proposals as well, eg why should not mortgage interest relief be split and transferable between husband and wife at £15,000 or some higher level? [I am not clear what in fact this would achieve: would the idea be to allow the split relief to be used against different houses?]

*Hamilton (Duty Clerk)*

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DAVID NORNGROVE

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## BANDS OF TAXABLE INCOME

£	Per cent
0 - 16,200	30
16,201 - 19,200	40
19,201 - 24,400	45
24,401 - 32,300	50
32,301 - 40,200	55
over 40,200	60