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*This incorporates
Alan's views**AT 27/1*

PRIME MINISTER

Budget Stance*ms*

Retail demand is strong, bank lending is growing quickly, corporate profits are rising rapidly and monetary policy is lax.

A so-called "neutral" budget (PSBR £8bn + asset sales) is too generous in these conditions. A PSBR of £6½-7bn should be the maximum permitted.

If the PSBR is not reduced this far it will be difficult to tighten the monetary position as much as is needed without interest rate rises. Markets will doubt the seriousness of intent behind the counter-inflation strategy and commentators will attack the policy as directionless. A lower PSBR is also the best protection against US problems.

A PSBR of £6½-7bn is attainable through a combination of expenditure reductions and imaginative changes to the tax base (as below). Expenditure could be reduced by £½bn as a result of the Treasury reviews underway if the work is seen as urgent.

Taxation Policy

This is the budget to be bold. It should stake out the radical tax measures of this Parliament.

The Chancellor's radical proposals for Corporation Tax are to be welcomed. Companies can afford to pay more, allowances should be phased out and the rate can still be lowered substantially. The idea of licensing credit companies should be welcomed.

Equally urgent is the need to encourage wider capital ownership. Individuals should retain more of their own money whilst the

cossetted life of the savings institutions based on tax breaks should be challenged. The abolition of insurance premium relief on new contracts is a good measure. The Investment Income Surcharge should be abolished (cost £140m). Stamp duty on houses and shares should be at least halved (cost £500m). Capital Gains Tax should be abolished (cost £630m). Gains realised in under one year could be taxed as income to counter the most obvious criticisms. By bringing pension fund investment income into the tax net (with suitable restrictions on bond washing) around £2,000m extra could be raised to pay for the other changes.

Development Land Tax should be abolished (cost £65m) and the top rate of CTT reduced to 50 per cent.

These measures would be attacked as a "help the rich" budget. The abolition of the investment income surcharge will, however, help widows, disabled and others living on insurance monies or modest inheritances. The stamp duty charges can be presented as a major bonus for homebuyers and will assist young people trying to climb on the first rung of the housing ladder. By taxing short-term gains, the CGT measure is more difficult to oppose.

The 1979-83 government promised a major review of capital taxes but little came of it. This budget could do much in this area whilst reducing the PSBR at the same time. I have discussed these views with Alan Walters and he wishes to be associated with them. Such a budget would reaffirm the major planks of your economic strategy: honest money, taking the problem of inflation seriously and removing tax impediments to individual enterprise and initiative. It would not impede recovery.



JOHN REDWOOD
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