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PRIME MINISTER

The Budget

You are discussing the budget with the Chancellor again tomorrow morning. In particular, you will be looking at the package on the reform of taxation on income, expenditure and savings.

Looking at the package as a whole, my reaction is that it is an economist's budget. Much of what it seeks to do will represent a major step to a more efficient, competitive and flexible economy ~~budget~~. It makes a significant contribution in a number of areas:

(i) It continues the progress towards lower borrowing, lower monetary growth and lower inflation.

(ii) It widens the base for indirect taxes, including securing a proper contribution from the financial sector, thereby permitting a substantial increase in tax thresholds which will alleviate the poverty trap.

(iii) In conjunction with the change to regional grants with a cost-per-job ceiling, it brings about a major shift from taxing jobs/subsidising capital towards a more neutral stance. This should contribute to the generation of more employment.

(iv) It begins to reverse the trend towards institutionalised saving, encouraging a swing towards direct ownership of shares and a stake in one's company.

(v) It lowers transactions costs in capital markets and the housing market.

All this should appeal to serious commentators. The weakness of the budget is that by creating a host of losers, as well as gainers, it is vulnerable to having the unpleasant

/ bits

bits picked off, leaving only the give-aways. The aim must be to hold the high ground represented by the major themes, and not allow the budget debate/Finance Bill to degenerate into skirmishing with vested interests.

The list of those who lose in some way is substantial, though almost all of them receive compensating gains:

- newspaper proprietors
- the building industry
- banks (probably the biggest losers in the budget)
- some manufacturing companies
- importers
- beer drinkers in comparison with wine drinkers
- Life offices
- building societies (though on balance they probably gain)
- drivers of company cars
- the poverty lobby who will resent removal of the Investment Income Surcharge.

You should also be aware of what is not included. Very little is admitted on capital taxes or on the tax treatment of pensions, though I think the explanation given in the case of the latter is convincing. On capital taxes, one has to ask whether action here is really a higher priority than on the items included.

Another factor is that the relief of taxes for business is substantial, particularly in 1985/86 when the once-off effect of VAT on imports has passed. In that year, the reliefs total £2.1 billion, the losses only £750 million. Does it make sense to commit so much in advance to companies rather than leave more room for raising thresholds? Or is this the necessary price for achieving a major change in the structure of tax?

/ Specific points

Specific points you might want to raise:

(i) Is it worth taking on Fleet Street over VAT on newspapers? The logical argument for this is strong and there is significant revenue at stake, most of the £340 million coming from newspapers rather than magazines. Furthermore, it would be difficult to establish a dividing line between newspapers and magazines though learned journals e.g. the Lancet, Law Society Gazette, might represent a pressure point.

(ii) What is the combined impact on building societies? The components are set out in the annex. The net position should be favourable.

(iii) Is the combined impact on banks acceptable? Undoubtedly they will be major losers but the argument for this is that they have been very profitable (the figures are in the annex). They will be large gainers from the abolition of NIS and the impact on their leasing business is not immediate but is phased over two or three years.

(iv) Are you content to apply credit licence duty to non-qualifying mortgages? The case for keeping the definitions of mortgage interest relief and exemption from credit licence duty the same seems to be very strong.

AT

22 February 1984

ANNEX

BUILDING SOCIETIES

+ ve	- ve
(i) Composite rate for banks	(i) Tax on gilts
(ii) Removal of life assurance premium relief (making BS's more competitive against life offices)	(ii) Credit licence duty on non-qualifying mortgages
	(iii) Loss of commission on endowment policies

BANKS

+ ve	- ve
(i) Lower CT rate	(i) Credit licence duty on consumer lending
(ii) NIS abolished	(ii) Loss of capital allowances for leasing
	(iii) Composite rate

Clearing bank profits: £ billion

1979	1.7
1980	1.6
1981	1.9
1982	1.8
1983	to be announced shortly

MANUFACTURING COMPANIES

+ ve	- ve
(i) NIS abolished	(i) Lower capital allowances
(ii) Lower CT rate	(ii) Less of stock relief
(iii) lower stamp duty on shares	

VAT on imports advantageous for some, disadvantageous for others