

NOTE FOR THE RECORD

The Prime Minister discussed with the Chancellor last night the prospects for the budget. The following points emerged.

(i) PSBR in 1984-85 was expected to be about £10<sup>3</sup>/<sub>4</sub> billion. Of the overrun of £3½ billion, £2½ billion was due to the coal strike.

(ii) In the medium term, the fiscal position had deteriorated. Public expenditure was higher, reflecting higher debt interest, the difficulties of controlling local authority expenditure, difficulties of continuing to hold public sector pay below that in the private sector, and the continued rise in the take-up of social security benefits. Oil revenues were likely to start tailing off around 1987-88. The cumulative fiscal adjustment over the next three years looked like being £6 billion rather than £10 billion. As a result, 1987-88 could be a particularly difficult year.

(iii) If the PSBR in 1985-86 were, as originally projected, set at £7 billion there might be scope for reducing taxes net by £1<sup>3</sup>/<sub>4</sub> billion. The Chancellor wanted to give away no more than £1 billion, keeping the rest as an additional cushion against contingencies. This could be achieved either by setting the PSBR at £6-6½ billion or by setting it at £7 billion, with a margin built into the component figures. It was agreed that the latter was preferable.

(iv) The Chancellor said he wanted to increase the scope for cuts in direct and capital taxes by boosting the yield of indirect taxes by £250 million, over and above the increases required to match inflation. This could be done by over-indexing the specific duties (with the exception of whisky) and VED. This would add 0.1% to the RPI in addition to the 0.3% coming from revalorisation. On VAT he proposed only one extension, to newspaper advertising, and one

relief, for bad debts. He proposed to give assurances that the only extensions to the coverage of VAT for the rest of the Parliament would be those necessary to comply with our Community obligations. The Prime Minister raised no objections to these proposals.

(v) On capital taxes, the Chancellor proposed a simplification of stamp duty, with the abolition of a number of minor duties. On CGT he hoped to simplify the indexation mechanism, allowing it to run from the date of purchase. This would also permit the re-introduction of pooling. He would also be introducing measures to deal with bond washing. On CTT he proposed to raise the business relief to 100%. DLT would be abolished. The Prime Minister raised no objections to these proposals.

(vi) On NIC, the Chancellor proposed to allow the self-employed to set half of their contributions against tax. This would provide some compensation to the unincorporated sector which had been disadvantaged by the CT/allowances reconstruction. The Prime Minister agreed.

(vii) The Chancellor also proposed to restructure employers NIC to a payroll basis by abolishing the upper earnings limit. This would raise £700 million which could be used:

- (a) to reduce the rate all along the income scale;
- (b) to raise the lower earnings limit;
- (c) to introduce a taper with the rate increasing with income.

There was some discussion of the merits of each: (a) was least favoured as it would spread any reduction too thinly to have any effect on employment; (b) would have a sharp effect at very low income levels, especially for part-time workers; (c) would extend the effect a bit further up the income scale, but would be more complex. No final view was taken though the Prime Minister lent towards (b).

(viii) The Chancellor said that jobs would be one of the main themes of the budget and that this would require inclusion of an employment package. Of the possibilities, he favoured extension of YTS to two years for those leaving school at 16, with one year only for those leaving at 17. The Prime Minister also favoured the extension of YTS but hoped that industry would be prepared to meet a large part of the additional cost. She also favoured the withdrawal of supplementary benefit for under 18s. The Government would thereby be able to claim that unemployment was not an option for this group. The Chancellor pointed out that the withdrawal of SB added to the costs by forcing more youngsters on to YTS. He doubted whether there was much merit in pushing the last 10% on to the Scheme.

(ix) The Chancellor doubted whether a major expansion of CP could be afforded. The Prime Minister agreed. It might be possible to proceed with a smaller increase than that envisaged by Mr. King, eg provision of 50,000 extra places through a charity based scheme. The Prime Minister hoped it would be possible to break away from the constraint of union rates of pay.

(x) The Chancellor suggested that the eligibility for enterprise allowance should be extended so that those who had made a start on setting up a business would not necessarily be disqualified.

(xi) It was agreed that the Chancellor would talk to Mr. King, Mr. Fowler and Lord Young on the employment package and the restructuring of NIC with the aim of putting agreed proposals to the Prime Minister.

(xii) On personal taxes, the Chancellor proposed double indexation of the basic threshold with simple indexation for the high rate band and age allowance.

(xiii) The Chancellor suggested an announcement in the

budget of the publication of a Green Paper later in the year on the longer-term possibilities for personal tax. The aim would be to open up the debate on the options in the next Parliament when computerisation would have been completed. One possibility would be a non-cumulative PAYE. The Chancellor also suggested that the Green Paper might float the idea of transferable allowances. This would enable the threshold for single people to be raised, give greater support for married women at home and would ensure that married women and younger women competed for jobs on a fairer basis. The Prime Minister expressed strong reservations about this, pointing out that, in effect, wives going out to work would start to pay 30% immediately on any earnings. This would be bound to cause sharp protests. It was agreed that the Chancellor would set out for the Prime Minister the ground such a Green Paper might cover.

(xiv) There was a discussion of EMS which has been recorded separately.

4 February 1985