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RECORD OF A MEETING BETWEEN THE PRIME MINISTER AND THE CHANCELLOR OF THE EXCHEQUER TO DISCUSS THE 1985 BUDGET: CHEQUERS, SUNDAY, 24 FEBRUARY AT 1630 HRS

United States Visit

The Prime Minister said she did not feel that the President's statement at his press conference had undermined her position on the dollar. It was clear that at all levels in the US Administation there was a strong feeling that intervention did not work. Intervention produced only a temporary impact and the upward pressures resumed immediately it was discontinued. Nevertheless the US Administration was worried both about the high level of the dollar and about the implications of a sudden collapse. She did not, however, agree with the view that the strength of the dollar was the result of the weakness of other economies. One could not categorise the economies of Germany, Switzerland and Japan as weak.

Social Security Reviews

The Chancellor said that the Government should seek savings of £2 billion from the reviews. This would require not only the savings of £½-$^3/_4$ billion envisaged as the outcome of MISC 111 but further savings e.g. from skipping an uprating of unpledged benefits, moving to biennial upratings or means-testing child benefit. The Prime Minister agreed that substantial savings should be sought. She had noted the proposal in the Chief Secretary's minute for Income Related Child Support, though the effect of this proposal would be to remove all recognition of family circumstances from the tax/benefit position of those over average earnings and it would transfer cash from wives to husbands.

The Prime Minister and the Chancellor discussed whether to seek agreement to a package of savings before the budget. The Chancellor felt he could not be sure of securing agreement and it would therefore be unwise to base his budget arithmetic on it. It would be easier to secure reductions in the social

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security base line in the public expenditure round, having prepared the ground in the Green Paper. Furthermore a reduction in social security benefits in the budget would make it difficult to introduce various enterprise measures at the same time. It was agreed that savings should be pursued outside the budget context.

Budget

It was agreed that the option of no uprating of the unpledged social security benefits, matched by no uprating of tax thresholds and the elimination of the enterprise measures should be rejected as being entirely negative. The Chancellor said he proposed to raise the planning totals. The Prime Minister asked whether he could hold the figures by promising corrective action later. The Chancellor doubted whether this would be credible and the Prime Minister therefore reluctantly agreed to his proposed course.

The Chancellor said he would set the PSBR in 1985/86 at £7 billion. This would allow a fiscal adjustment of £1$^{3}/_{4}$ billion but he proposed to use only £$^{3}/_{4}$ billion with the remaining £1 billion being built into the figures as a safety margin. This was agreed. The Chancellor said he would increase the tax from indirect taxes, over and above revalorization which would raise the course total for tax cuts to just over £1 billion. There was no discussion of the details of the indirect tax changes. The Chancellor reported that the outcome for the 1984/85 PSBR could be very close to £11 billion.

The Chancellor then set out the specific components of the budget:

(i) He proposed to double index the basic tax threshold.

(ii) He would announce the extension of YTS which was being discussed in E(A). This allowed the Government to claim that unemployment for under 18s need not be an option. The

Government should avoid presenting this as a guarantee as this weakened its bargaining position with the employers who were being asked to find a significant proportion of the cost of training allowances. The Prime Minister argued strongly for the removal of entitlement of under 18s to supplementary benefit. They should receive no more than the value of child benefit. This would allow the Government to claim that unemployment for under 18s was not an option. In effect, children would have to stay in the education system unless they could get a job or a training place. There was substantial spare capacity in technical colleges which could be used. The Chancellor argued that this would add substantially to the cost of the scheme; reduce its attractiveness to employers and bring in by compulsion the least motivated young people. The Prime Minister maintained her opposition to his proposals.

(iii) The employers NIC would be restructured. The upper earnings limit would be abolished and the revenue so raised would be used to produce a tapered scale, rising from 5 per cent at the lower earnings limit to 10.45 per cent at around £140 per week.

(iv) The self-employed would be allowed to set half their NIC's against tax.

(v) The Community Programme would be expanded by about 100,000 places.

(vi) Business relief under CTT would be expanded substantially. It could be raised from 50 per cent to 100 per cent though the Chancellor had not made up his mind whether to go this far. Farms would also be included in the improved relief.

(vii) The Chancellor did not report on his proposals for CGT.

(viii) DLT would be completely abolished. This tax required 200 people and cost £5 million to collect and required 200 pages of legislation. The loss in revenue would be small as a significant part of the gain would be caught by CGT. There was, however, a political risk that a particularly outrageous case would arise immediately after abolition. The Chancellor felt that, with inflation low, the circumstances were nevertheless right for abolition.

With the exception of (ii) above, these proposals were agreed.

Tax Reform

The Chancellor said he wished to announce his intention to introduce a Green Paper later in the year which would discuss the opportunities for reform of personal taxation in the next Parliament when computerisation had been introduced. The Green Paper would rule out two options, the merger of NIC and IT and a tax credit scheme. It would canvass opinion on transferable allowances. This would give all taxpayers the same allowance and non-working spouses could transfer it to the working spouse . The Chancellor saw a number of advantages in this. It was fairer between married and non-married women and it would produce a significant alleviation of the poverty and unemployment traps. The Prime Minister set out a number of objections which would be raised; many working wives would oppose it as, in effect, they would be paying tax immediately they went out to work. The Chancellor explained that professional women would not be affected as they were likely to have opted for separate taxation. The Prime Minister suggested that investment income could also be taxed separately. The Chancellor agreed to this.

The Chancellor said he was considering a proposal for a levy on companies whose pay per employee rose faster than the average. This would not be based on a norm but on the average ex-post. Companies increasing pay faster would bear the levy while companies increasing pay more slowly would be net recipients. This would provide companies with an incentive to keep pay down. He envisaged such an arrangement as temporary. The Prime Minister saw serious objections to this idea. It would require a large bureaucratic apparatus and would penalise companies where productivity was rising or where higher pay increases were needed to retain key staff. In effect it would be a tax on success. The Chancellor agreed to take this no further for the time being.

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25 February 1985