PRIME MINISTER

CONFIDENTIAL

~~BUDGET - SECRET~~

Selling this Budget is going to be difficult. The overrun on public spending could lead to headlines of "Government gives up battle to control state costs" or "Chancellor abandons his tax/spending strategy". Tax reforms in 1990 are too distant a prospect to excite enthusiasm.

Public Expenditure

Accepting £2 bn more on the Reserve will give the wrong signals to spending departments, knock confidence and delay bigger tax cuts.

We are past the point of no return on this.

By all means tell people there are strong pressures on spending - they know that - but say the ending of the strike, renewed enthusiasm for asset sales and the continuing search for economies (e.g. the welfare reviews) mean the targets can be hit.

Annex A shows City opinion is totally unprepared for a major spending overrun. Markets do not like unpleasant surprises.

Income Tax Reform

Transferable allowances between husband and wife have their attractions. But any reform that gives away £4.5 bn can look exciting. The bad news is that the Inland Revenue have ruled out any manual scheme and so 1990 is the first date for change.

A more immediate option is to consider how best to spend the £2 bn to be spent on the higher general thresholds and whether some of the £4 bn currently spent on Child Benefit can and should be routed through the tax system instead.

Options include the family tax allowance to parent or parents with children under 16, a higher married man's allowance or the creation of child allowances.

The Budget judgement on personal tax cannot ignore the likely outcome of the Fowler review of Child Benefit or the possible introduction of Family Credit.

How does Nigel see these parts of the jigsaw fitting together? Annex B sets out the position.

Pensions

The Budget has to say something about pensions tax and policy in view of the media comment.

Here is a unique opportunity to make it an exciting, radical and popular event.

Pension funds are overfunded. Gomme Holdings - a small company - recently wound up its pension fund, created a new one to meet the obligations and pocketed £3 m in the process! The Evening Standard reckons the Midland Bank fund is overfunded by more than £200 m. Barclays cut its funding rate by £50 m a year as the asset had gone up so much.

Taxing the funds would be unpopular - although it could bring in substantial money if their income was taxed which could help raise tax thresholds.

But, better still, to stop companies cheating their pension fund members by winding up funds and pocketing surpluses, or slashing their contributions, we could announce that all funds are to be "given" to their members - everyone would be told the value of his share or unit holding in the fund and could take it with him on transfer to another fund.

You would then create a nation of 11m wealth owners, ease the transfer problem further, prevent any future government controlling pension funds and solve the question of companies exploiting pension funds for their own ends.

Then you would have a bold and exciting Budget. The actuaries and fund managers who would make difficulties would lose the argument as you mobilise the 11 million. The Budget would become a Budget for wider wealth ownership as well as one for jobs.

John Redwood

(JOHN REDWOOD)

7 March 1985

ANNEX A

Simon & Coates: "Assuming that the miners' strike will be over early in the new financial year, there seems a reasonable chance that the public expenditure target for 1985/86 will in fact be hit, since an initial contingency reserve of £3 billion should be enough to offset continuing problems in other areas."

Hoare Govett: Expect a tighter fiscal and monetary stance and no deviation from White Paper on PE or MTFS.

Wood Mackenzie: "It is important this year that the Chancellor is seen to be keeping to the spirit of his financial strategy. . ." The Treasury cannot assume its PE targets will be overrun.

Lloyds Bank: Budget review assumes government will carry out plans to cut back excess public spending.

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ANNEX B

TRANSFERABLE TAX ALLOWANCES

The Chancellor's Green Paper has a way of leaving the two-earner couple no worse off and the single earner couple better off:

Year 1 Reduce married man's allowance from £3,155 to £2,855

Raise single man's allowance from £2,005 to £2,305
£1,200 of wife's allowance is transferable to husband

Year 2 Reduce married man's allowance to £2,580
Raise single allowance to £2,580.
Wife's allowance fully transferable

This costs £4.5 bn. There are 4.4m one-earner couples who gain £11.57 a week and 7.8m single earners who gain £3.32 a week.

NB. There are now 5.5m couples with both working and only 4.4m with one working. The Transferable Tax Allowance scheme helps the 4.4m relative to the 5.5m. Of those 4.4m, 1.5m have no children. The idea behind the scheme is to end special tax benefits for two-earner couples without any of them losing in cash terms.

Additional Options (Abolition of Child benefit)

Take £3bn out of Child Benefit and give it back as a Family Tax Allowance. This is a flat rate tax allowance for all families and would work out at about £1600 a family of tax free earnings. Thus the married man with children would see his tax threshold rise from £3,155 to c£4,700. It would be worth £9+ a week for all tax paying families with children but would redistribute to single child families. In many cases payment ~~would go to the husband rather~~ than wife.

Or, Take £3bn of Child Benefit and give it as Child Tax Allowances.

Both these options assume the other £1bn of Child Benefit is spent on means tested benefits for poor working and non working families.

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TRANSFERABLE TAX ALLOWANCES

		cost of £100 increase
Single person's allowance) Wife's earned income allowance)	£2,005	£360m
Married man's allowance	£3,155	£325m

A two-earner couple gets a total tax allowance of £5,160. It now costs £1.5 billion to give two-earner couples more than two single allowances.

Chancellor's proposal is to divide total tax allowance for married couple into a fully transferable personal allowance of £2,580. So for a one-earner couple, tax allowance rises to £5,160 from £3,155. Cost is £4.5 billion.

Two-stage implementation

In year 1, reduce married man's allowance to £2,855 and raise single man's allowance to £2,305. £1,200 of wife's allowance is transferable, so for a one-earner couple, total tax allowance rises to £4,055. Do the rest in year 2. This divides up cost roughly evenly between 2 years.

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Distributional effects

4.4 million non-elderly one-earner couples gain a maximum of £11.57 per week if on basic rate tax (81% are). 620,000 (14%) are taken out of tax altogether.

7.8 million single people under 65 gain up to £3.32 per week if on basic rate tax (90% are).

5.5 million two-earner couples have no change in their tax position.

The elderly

Allowance for married man over 65	£3,955
Allowance for single people over 65	£2,490

Cost of avoiding elderly losses from £5,160 total allowance is £0.5 billion.

Timing

Introduction envisaged in 1990.

Currently, tax system need not know who is married to whom. IR need information on married couples (approximately 20 million) so they can transfer allowances. This additional information can only be held efficiently and economically on a computerised network, which will not be in place until early 1988.

An interim manual scheme?

Investigated and rejected by Chancellor because of risk of bureaucratic shambles. Mrs Smith works till July and then transfers unused remainder of her allowance to husband. IR advise current manual system and current staff levels cannot change codings frequently and accurately.

David Willetts
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