STARTS 12-10-82
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PART A

FINANCIAL STATEMENT
BUDGET REPORT 1983

DD 25 years N.A[illegible] 15/7/94

PO -CH /GH/0013
PART A

DEPARTMENT OF THE ENVIRONMENT
2 MARSHAM STREET
LONDON SW1P 3EB
01-212 7601

Mr Gosden
CST | Mr Kitcatt
FST | Mr Kemp
| Mr Monck

MINISTER FOR HOUSING AND CONSTRUCTION

EST | Mr Moore
MST(R) | Mr Ridley
MST(C)
Sir D Wass
Sir A Rawlinson
Mr Widdring
PS/IR

B 1983
and for on list

My Ref: ST/PSO/43934/82

12 October 1982

Dear Geoffrey

The Centre for Policy Studies has been examining ways of reviving the private rented sector, and I attach a copy of the very useful paper they have now prepared. I also attach a copy of my reply, which asks them to elaborate on a number of points.

You will see that most of the CPS's proposals impinge on Treasury responsibilities, and I should be grateful for your comments. I agree in particular with the emphasis the CPS place on the need for further fiscal help for the private rented sector. Your excellent initiative in introducing capital allowances for assured tenancies is looking as though it has produced the desired impact. Although the Select Committee on the Environment in producing their recent report on the private rented sector curiously failed to note that we have already introduced these capital allowances, it is encouraging that the Committee went on to advocate that they be made available for assured tenancies! 30 bodies have now been approved and interest remains high with 17 further applications currently under consideration. The potential however would be far wider if we further extend the possibilities of fiscal incentives for private sector landlords. We need in particular to attract the volume housebuilders. Although two have so far been approved under the assured tenancy scheme (Wates Ltd and Barratt Developments PLC), there remain deterrents to them actually going ahead with construction.

Section 1.4 of the CPS paper deals with this. They propose that capital allowances, or benefits similar to capital allowance, should apply to building which the Inland Revenue would currently regard as stock in trade rather than fixed assets. This would be of great benefit to volume builders who do not wish to tie up capital for too long a period in rented homes. It would - even more importantly - solve the problem created by the Revenue's view that shared ownership would normally count as trading rather than investment. The rented share of shared ownership would therefore be able to attract capital allowance. Your letter of 28 September to Michael Heseltine on

h .sing and labour mobility says that capital allowances should be used only to encourage building for rent and would not be appropriate for shared ownership schemes in the private sector. But the purchaser of a shared ownership lease is under no compulsion to buy up the rented share under the lease. Indeed the results of a recent research project into local authority schemes showed that about 95% of the purchasers paid at least 50% in rent and that about 20% of the purchasers had no intention of ever buying this rented share; many others did not intend to do so for some years. The situation is unlikely to differ under private sector schemes, so it could be some substantial time before a developer would recover his heavy capital outlay. I would urge you to reconsider your decision not to extend capital allowances to them. I should perhaps stress that shared ownership is a form of leasehold (that is why it is possible under assured tenancies), and that it is only on the rented element of shared ownership that we are seeking capital allowance.

I hope you will be able also to give sympathetic consideration to the CPS's other proposals on tax and depreciation allowances. Although it has been necessary for administrative reasons to limit allowances in the first place to assured tenancies, it would certainly be desirable for them to apply more generally to all private renting as proposed by the CPS.

As you will see, the CPS also suggest that the building societies offer the best foundation on which to build an improved image of the landlord. This accords very much with my own views, and with those Michael Heseltine put to you in his letter of 24 September about building society powers. As Michael said we hope that you will find it possible to announce proposals on at least this aspect of building society powers before the end of this Parliament.

Yours ever
John.

JOHN STANLEY

The Rt Hon Sir Geoffrey Howe QC MP

DEPARTMENT OF THE ENVIRONMENT
2 MARSHAM STREET
LONDON SW1P 3EB
01-212 7601

MINISTER FOR HOUSING AND CONSTRUCTION

My Ref: ST/PSO/43934/82

11 October 1982

Dear Jimmy,

I have now had time to examine in detail the paper on the private rented sector which you sent me at the end of July. I am extremely grateful for the work which the Urban Land and Housing Group has put in on this. The proposals in the paper I found both valuable and constructive, and I have sent a copy to the Chancellor for him to study. You will appreciate that I cannot anticipate his reaction on matters of taxation or other fiscal policy, which are raised in many of your proposals. In the meantime there are some particular points in the paper on which I should be grateful for your further views.

I was interested in your sinking fund proposal. As I understand it, it is aimed not at repairs but at complete new-building. Would landlords be prepared to tie up substantial resources over a long period by making payments into such a fund when they have the alternative of borrowing and receiving tax relief on their interest payments? Also, is it necessary to introduce a further means of assisting new build by private landlords over and above the capital allowances now available for approved landlords letting on assured tenancies?

This point also arises on your proposal for 'The Housing Agency' (THA). In practice this would seem to be a means of financing and subsidising landlords building to let under assured tenancies (as other landlords would not be able to charge sufficient rent to give an attractive return on investment). Since the introduction of capital allowances there has been considerable interest in the assured tenancy scheme, and 30 bodies have now been approved. Is it really necessary to have a special agency to channel finance, or to provide an additional element of subsidy?

In your description, you suggest that the Government should guarantee the institutions' return on their investments in THA. If the guarantee were for as good a return (or better) than they could obtain by lending to Government in the normal way, it would seem better for Government to finance THA directly. Perhaps you had in mind that the guaranteed return might be less than that available on government borrowing generally, in view of the suggested possibility of an extra return. If so, I should be interested to know whether any soundings with the institutions indicate how much less the guaranteed return might be.

There seems to be a possible link between the need for an extent of subsidy involved in THA and your thoughts on depreciation and capital allowances. To what extent does the availability of allowances overtake the need for a THA?

There is a particular point on capital allowances for assured tenancies that I want to raise. You make the point that builders who build homes for letting under assured tenancies, but do not retain them for a sufficient period to count as capital expenditure, will not be able to benefit from capital allowance. How widespread a problem is this? Most of the builders who have so far been approved under the assured tenancy scheme seem prepared to retain the property themselves, and in some cases we have approved investment subsidiaries. Sales between subsidiaries may be made without a balancing change.

Turning to the general comments on the British construction industry in paragraph 1.5, I was surprised to read the statement that our construction costs are "three to five times" higher than those in North America. Reliable information on relative construction costs is notoriously difficult to obtain, owing to the problems of making like-with-like comparisons of different countries with different practices and requirements. Comparisons are also confined by changing exchange and inflation rates. But to my knowledge, no-one has produced estimates of British costs as being more than about twice those prevalent in North America. And I regard even these estimates as open to question when a number of reputable authorities - such as the RICS and Slough Estates - have quoted our costs as being directly comparable with those in the US and other leading Western countries. It would be helpful to know on what sources your estimates were based.

Nonetheless, the relative performance of the British construction industry is a subject which I regard as being of considerable importance, as indeed do many senior people in the industry itself, and increasing efforts are now going into research into the scope for improving the British performance. For example we have instigated - through the Building EDC - a study into construction times in Britain, which is now being carried out by Kenchington Little and the BRE, while within the industry the British Property Federation have commissioned Professor Honeyman

to carry out a study into the cost and efficiency of construction in this country. I believe both these examples will give us valuable insights into ways in which we can improve the performance British construction firms can offer their clients.

I was interested in your comment that the building societies might provide a base on which a new and more acceptable concept of the landlord could be built. In addition to the qualifications you make in paragraph 2.2, it would, of course, be necessary to consider how the security of savings in building societies could be maintained. You may have seen that the Chancellor has mentioned the possibility of new building society legislation, although not in this Parliament.

Your proposals on shared ownership are, in their fundamentals, very similar to suggestions which the Financial Institutions Group, set up by Michael Heseltine, have made for the marketing of a "Housing Bond" to up pension fund finance for shared ownership. These are still under discussion within the Department and with Treasury and Inland Revenue. We shall certainly examine your version very carefully, to see to what extent it might augment that put forward by FIG.

When you have been able to respond to my points in this reply I should value a further meeting with you and your Group.

Thank you once again for a most useful contribution to policy thinking.

With kind regards.

Yours sincerely,

John.

JOHN STANLEY

J N C James Esq

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CENTRE FOR POLICY STUDIES

URBAN LAND AND HOUSING GROUP

1. The improvement in net returns from rented property

With the ultimate objective of a free market in rented residential accommodation, the need for fiscal incentives for private and corporate landlords in order to stimulate activity through the improvement of net returns forms the basis of this section. We believe that the Housing Act 1980 and the Finance Bill 1982 provided a number of useful leads upon which an expanded scheme could be based. In addition, we summarise below three methods of achieving the objective, all of which require to be worked up in greater detail before a fair evaluation of their potential can be made.

1.1 Sinking Fund Tax Relief

1.1.1 Based upon the depreciation of allowances available to landlords in North America, the provision of tax relief for landlords upon bona fide sinking fund deposits would be a practical incentive to hard-pressed landlords of residential accommodation.

1.1.2 The technical way of evaluating a leasehold, by definition a wasting asset, allows for the decline in value of property over a period of time by a sinking fund. Although in practice the sinking fund is rarely, if ever, established and credited with regular payments, it has been widely seen as an omission that tax relief is not available on monies placed in such a fund. In the wider context of the material decay of premises, with virtual reconstruction of many buildings being necessary after a finite period of time, such an allowance would be a practical method of allowing for rectifying such decay in a way which allowances for running repairs never achieve. The arrangements would be similar in character

to those required by the Charity Commissioners for developments by charitable organisations where taxation is not involved. There would clearly need to be some limit which could be a proportion of the net rents. The arrangements would not apply to freeholders under long leasehold arrangements.

1.2 The Housing Agency Assistance Scheme

1.2.1 This scheme is designed to develop still further the concept contained in the Housing Act 1980 and Finance Bill 1982 to provide private sector funding for new rented property.

1.2.2 It is proposed that a new body is created for the purposes of this paper to be called The Housing Agency (THA) with Exempt Unit Trust status to act as the controller of the receipt of funds from the investing institution and the distribution of funds to developers of residential accommodation for rent.

1.2.3 If the basis were adopted, the method of operation could be analogous to the role of the Central Mortgage and Housing Corporation in Canada to provide incentives to developers through the Assisted Rental Programme. With an element of adaptation, the principles of its schemes have been used in the proposals outlined below.

(a) To qualify for THA assistance the developer must be an Approved Landlord as defined by the Housing Act 1980. Each scheme would have to be approved by the THA before commencement.

(b) The THA assistance would take the form of a low interest loan to a maximum of say 75% of total costs repayable within the 10 years of the date of receipt by equal instalments.

(c) The repayment rate would be increased if the cash flow from the property achieved certain levels.

(d) The THA assistance would be secured by a second mortgage on the property and would be repayable in full if the property was sold or refinanced. Otherwise, after 12 months from receipt of the loan, the capital will be repaid by equal instalments over the term of the loan.

(e) Where there is a bona fide sale at market price, the borrower will be permitted to deduct his original equity and sales costs from the proceeds prior to the second mortgage. If cash proceeds are insufficient to pay the second mortgage in full, it will be written off in whole or in part. However, by balancing good schemes with bad and offsetting losses against profits, the subsidy element should be minimal.

(f) The scheme would only apply to Housing within the rateable value limits applicable to protected tenancies under the Housing Act 1980 (i.e. £1,500 in London, £750 elsewhere).

(g) The borrower would be permitted a realistic rate of return (both capital and income) on his equity employed, to be negotiated with the THA, having regard to other comparable forms of investment available, based upon market rents.

(h) Any excess returns over the rate agreed in (g) above are to be divided between the THA and the borrower in proportion to the capital invested by each party.

(j) The borrower must be the beneficial owner of a substantial interest in the land or building, i.e. in excess of a 60 year lease or freehold.

(k) The borrower would be required to enter into a management contract for the period of the loan.

(l) The THA would be funded by Pension Fund and Institutional investors.

(m) The return on funds invested would be from the proceeds of the lending arrangements between the THA and the developer. Any shortfall on a guaranteed return being made good by Central Government Funds.

(n) The THA would be a Tax Exempt Unit Trust under the control of the DOE, using private sector advisers on a number of local panels to assess the commercial viability of individual schemes submitted by approved developers. Whilst an element of subsidy is necessary if the Government's objective of boosting the private rented sector is to be achieved, it is important that all schemes are assessed against commercial criteria.

1.3 Depreciation Allowances

1.3.1 Using the North American practice as a basis, we believe that depreciation allowances for all types of rented accommodation are the only real way of significantly improving net returns to landlords. The stimulus injected into the market by such proposals would have a far-reaching effect in the provision of additional rented accommodation.

1.3.2 In bringing forward a basis of depreciation allowances for both existing and new rented accommodation, it would be necessary to define the cost/value capital sum to be depreciated. So far as new accommodation is concerned, there is no difficulty in establishing a cost basis.

For existing rented property, current cost is clearly inappropriate. One method of arriving at a suitable figure would be the capitalisation of market rents in accordance with a prescribed formula. Whilst artificial in concept, it would produce consistency on a comparative basis.

1.3.3 Depreciation is an allowance against income received from property for the exhaustion, wear and tear, and obsolescence of tangible property. Assets such as land are not subject to depreciation. The periodic deduction for depreciation is the amount that will recover, over the useful life of the asset, its original cost. The amount of depreciation claimed in total cannot exceed the assets cost - less salvage - and the method adopted must be continued for the useful life of the asset. There is the ability to change this method but only by agreement with the tax authorities.

1.3.4 Methods of Computation
There are two methods of computation applicable to 'Used Residential Rental Property', namely the straight line method or the declining balance method.
Guidelines would be established in the calculation of the useful life of tangible assets and an asset of the type under discussion is considered to have a useful life of at least 20 years.

1.3.5 The straight line method is self-explanatory in that an asset having a cost of £100,000 (excluding land) can be depreciated at the rate of £5,000 per annum. The declining method ensures faster depreciation through a rate being applied each year to the unrecovered cost of the asset. The rate is determined by multiplying 125% by the rate that would be applicable for use in the straight line method. Thus, in the case above, our £100,000 asset can be depreciated at 6.25% i.e. £6,250 per annum.

1.3.6 New Residential Property for Rental
The same methods of computation would be available for new residential property for rental, but there are - in addition - three further alternatives:-

(i) Under the declining balance method the initial rate for multiplication by the straight line rate can be 150% in substitution for 125% i.e. 7.5% per annum.

(ii) As in (i) above, but 200% instead of 125% i.e. 10% per annum.

(iii) A new method is available called the 'sum-of-the-years'-digits method (SYD). The rate is based on a declining fraction based on the assets original useful life. The denominator, which remains constant, is the sum of the useful life of the asset i.e. 210 (1+2+3+4...+19+20). The numerator is the number of useful years remaining. Thus, from our example, in the first year the rate would be 20/210 or 9.5238%, in the second 19/210 or 9.0476% and so on until the final year when the rate would be 1/210 or 0.00476%.

1.3.7 Sale of a Depreciated Asset
Where a sale occurs resulting in the recovery of past depreciation, part or all of such gain will be taxed as ordinary income by way of depreciation recapture.

1.4 Assured Tenancies and Approved Landlords

1.4.1 The assured tenancy legislation is an experimental system introduced by the Government to see if it proves to be an appropriate method of stimulating investment in the

rented residential property market. Because of the experimental nature of the scheme, the legislation was directed at the institutional investor, such as pension funds, insurance companies and building societies, as these were considered to be a specific group of investors who were both reputable and sufficiently few in number for the scheme to be monitored.

1.4.2 Housebuilders are, of course, key bodies in expanding the rented property market, and, if it is the intention for them to be approved landlords and to benefit from capital allowances, then the Inland Revenue must allow them to show properties designated for assured tenancies as fixed assets. This would, however, involve a major revision to Sect. 488 of the Income Tax Act 1970. Alternatively, the Inland Revenue should make appropriate amendments to the stock relief provisions to make them comparable to capital allowances.

1.4.3 It is important to note that in order to benefit from tax allowances, the approved landlord must have taxable profits against which to offset the allowances. It should be noted that Pension Funds are exempt from tax and Building Societies have a preferential tax status and therefore tax allowances are of nil or limited value.

1.4.4 Tax incentives, in the form of capital allowances, will improve the yields of investments on assured tenancies, primarily for the house-builder/developer, who has taxable profits against which to offset the allowances.

1.4.5 If housebuilders, as opposed to property investors, are to be attracted to the scheme, then an adjustment will be necessary to the existing stock relief that will allow them to receive a similar tax benefit to the property investor.

1.4.6 Institutions with exempt tax status, such as pension funds, or those with preferential tax status, such as building societies, will not be attracted, because they cannot take proper advantage of the tax allowances.

1.4.7 The major problem with investing in assured tenancies would appear to be the protection of the capital value of a property with a sitting tenant. A property needs to be let at a market rent which provides a yield equal to or greater than open market yield, otherwise there will be an erosion of the capital value. This will have a detrimental effect in the final investment yield.

1.4.8 Achieving this could be assisted by exempting the seller of a tenanted property to another approved landlord from any clawback of allowances at the time of the sale.

1.4.9 Provided that the investor can attain an equivalent yield, he can take comfort from the fact that he should be able to dispose of the property at any time without suffering a discount and therefore, provided the yields are acceptable, he will continue to be attracted to rented property rather than selling with vacant possession.

1.4.10 On the same basis, approved institutions will be attracted to purchasing assured tenancies already established without the need for tax incentives and obviating the need to have specialist knowledge in creating the property. This secondary purchasing will strengthen the market for rented properties as a whole. It must be remembered that unless a tenanted property is sold to another approved landlord, it will revert to being a protected tenancy.

1.4.11 The yields derived from the lower yielding properties, although acceptable in isolation, will not be attractive whilst there are better properties elsewhere.

Those that are created will be more susceptible to being sold with vacant possession.

1.4.12 Finally, any scheme designed to attract an investor towards rented residential property must have the approval of all political parties. The mere possibility of being forced back to a protected tenancy will be sufficient to deter any investor.

1.5 Generally

1.5.1 Against the background of an objective of a free market in rented residential accommodation, the high level of building construction costs is clearly a major factor in the UK equation. As a result of the high building costs at three to five times those applying in North America, the possibility of showing a reasonable return is significantly reduced. Further research into ways of reducing UK building costs through more efficient working practices, reduction in planning delays and revision of statutory requirements could lead ultimately to a significant improvement in the returns available in the private rented sector.

2. The Landlords' Image

2.1 We have found this the most difficult of the tasks given us to study and our thoughts have not progressed beyond some tentative ideas. The building society undoubtedly provides a platform for respectability and public acceptance upon which it should be possible to build a new concept of the landlord. At the present time, the building society movement is undoubtedly going through a 'sea change' and it is an appropriate time therefore to consider a redefined or extended role.

2.2 Informal discussion with individual building society executives would indicate the following reaction.

1. Legislation would be necessary to permit building societies to hold land. This can be overcome in the short-term through the use of wholly-owned subsidiary companies or partnerships.

2. Each society would wish to take its own line but many/majority have a strong social conscience believing that they should do more than act as money lenders.

3. Profitability i.e. return over cost of money will be a critical factor with some assurance that future legislation will not reverse these proposals.

4. Lack of experience at present in this field, which can be overcome.

2.3 There could be resistance from some societies who would wish to see clearing banks similarly respond to social obligations rather than merely pick and choose the most profitable business opportunities.

2.4 With their favourable tax status and ability to accept minimum profit margins, we believe building societies would play an important role in the provision of additional rental accommodation at market rents.

3. Shared Ownership

3.1 Under the present shared ownership schemes, the local authorities are left holding a declining residual equity interest. We have been invited to consider as to how the Pension ~~Funds and other financial institutions~~ might be introduced in order to fund this 'landlord' element.

It has to be recognised that fundamentally this is an unattractive interest for a pension fund and in our discussions with their representatives it was quite clear that, short of direction of funds, they would not voluntarily invest in the housing field in general and this kind of situation in particular, bearing in mind their primary responsibility to their pensioners or policy holders.

3.2 On the assumption that direction of funds would not be an acceptable solution to the present Government, we believe that an intermediary guaranteed by Government would provide the necessary incentive and assurance to encourage funds to invest. Assuming that the Housing Corporation or similar was the chosen vehicle, we envisage that bonds would be issued to the pension funds and institutions yielding a market rate of interest. The Housing Corporation would then take over at face value the residual equity interest upon terms which would in due course yield a form of profit participation for the Housing Corporation in the proportion of the original equity holdings. The interest rate payable on the bonds would have to compare with the yield on government stocks and, to this extent, the operation would require Government support until at least participation in future sales had been reached. At this point, a proportion of the uplift in value from original purchase day would pass to the Housing Corporation or equivalent. The capital requirements for such a scheme would come from the private sector through pension funds and insurance companies.

3.3 As an alternative to Housing Corporation bonds being available to pension funds, insurance companies and other financial institutions, we believe that there would be considerable interest in tax-free bonds for individuals. Such an investment would be particularly attractive to high rate tax payers with the element of equity participation.

From the Secretary of State

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

EXCHEQUER
29 OCT 1982
Mr Moore
CST
FST
EST
MST(C)
MST(R)

Sir D Wass
Mr Burns
Mr Quinlan
Mr Middleton
Mr Kemp
Mr Evans
Mr Lovell
Mr Ridley
Mr Fellows
Mr Hall

cc Mr Chivers

Mr Robson c Mr Griffiths
Fraction pl.
1/11

P/Sec
P/CEE

29 October 1982

Dear Geoffrey,

As in previous years, the tourism industry and particularly the holiday resorts will be looking for some encouragement in your 1983 Budget, all the more so because the money available for direct grant assistance is so very limited. I believe that it would be right, now, to consider their case. I am concerned that unless the Government pays heed to the tourism industry's call for more equitable treatment as between manufacturing and services (of which tourism is a major component) we shall lose goodwill in many tourism constituencies which it may be difficult to recover, even though the broad thrust of our policies can be seen to be succeeding.

You have over the years introduced a number of "packages" in your successive Budgets which have done a great deal at comparatively little cost. I will suggest that this coming year there would be real merit in the inclusion of a "holiday package" to help our holiday resorts and the tourist industry generally. Such a package would also be of help to the construction industry.

The industry has a strong claim to fiscal encouragement. Tourism is of growing importance as a long-term viable sector of the economy. It is an area to which we shall be looking increasingly for new jobs, including jobs for the young and the low skilled. The industry in this country is not, however, without its problems. Like other sectors, it is finding it hard to compete for business in a highly efficient international market. This situation is reflected all too clearly in the figures. Earnings from overseas visitors have dropped in real terms every year since 1977. In the same period there have also been substantial increases each year in the number and expenditure of UK residents going abroad. It cannot be right that an industry which will pay such a large role in our future economy should, on top of these

9/128

From the Secretary of State

considerable difficulties, be further handicapped by discriminating government policies. Indeed there would seem to be a case for a slight tipping of the balance in the other direction.

While the industry has argued strongly for a wide range of concessions, I concentrate in this letter on building allowances.

BUILDING ALLOWANCES

Various proposals have been put to you for improving the existing 20% initial allowance for hotels and extending allowances to other buildings where tourist or tourist-related activity takes place. For the accommodation sector these include lowering the 10 bedroom minimum requirement, removing the evening meal requirement and extending coverage to the self catering sector. All of these I commend for your consideration.

The primary case is for an increase in the initial allowance for hotels from the present 20%. Last year you increased the initial allowance for industrial buildings from 50% to 75%. But no corresponding increase was made for hotels. This not unnaturally has added to the grievance which already existed. Moreover it negated the stock answer that all these matters would have to await consideration of the Green Paper. If allowances for industrial buildings can be increased ad interim, there is no logical reason why allowances for hotels should not also be increased. An increase to 50% for new construction and developments - which would not be very expensive - would be the clearest indication of our concern for the tourist industry and for the holiday resorts in this country.

Extension of allowances to smaller establishments than 10 bedroom hotels would underline our support for smaller firms without adding significantly to the cost. I appreciate that this raises questions of definition and I would suggest that officials should consider where the line should be drawn.

While making these changes it would be anomalous not to widen coverage to fixed structure self catering establishments (at present the fastest growing segment of the market). Here again I would suggest that officials should consider the range of buildings which house or constitute tourist attractions which might be brought within the scope of the allowances.

From the Secretary of State

VAT

I realise that singling out one sector for VAT relief poses singularly difficult problems. It is for this reason I make no specific recommendations to you despite the fact that this is an area in which the tourist industry, and hotels in particular, have very strong feelings. I would only say that if at any time you would be disposed to make VAT concessions, you should keep the tourist industry and the related activities very much in mind.

These matters are of course also of particular interest to George Younger and Nicholas Edwards, in view of their tourism responsibilities and of the economic importance of tourism in Scotland and Wales. I am copying this letter to the Prime Minister, the Secretaries of State for Industry, the Environment, Scotland, Wales, Education, Employment, to the Minister of Agriculture, Fisheries and Food and to Sir Robert Armstrong.

Yours,

Arthur.

LORD COCKFIELD

From the Secretary of State

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
London
SW1P 3AG

EXCHEQUER
29 OCT 1982
Mr Moore
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Sir ? Burns
Mr Burns
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Mr Folkes
Mr Harris

Mr Robson c Mr Griffiths
Pre-Budget
1/11
PS/IR
PS/C&E

cc R Chivers

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From the Secretary of State

VAT

I realise that singling out one sector for VAT relief poses singularly difficult problems. It is for this reason I make no specific recommendations to you despite the fact that this is an area in which the tourist industry, and hotels in particular, have very strong feelings. I would only say that if at any time you would be disposed to make VAT concessions, you should keep the tourist industry and the related activities very much in mind.

These matters are of course also of particular interest to George Younger and Nicholas Edwards, in view of their tourism responsibilities and of the economic importance of tourism in Scotland and Wales. I am copying this letter to the Prime Minister, the Secretaries of State for Industry, the Environment, Scotland, Wales, Education, Employment, to the Minister of Agriculture, Fisheries and Food and to Sir Robert Armstrong.

Yours,
Arthur.

LORD COCKFIELD

4

PMW

10 DEC 1982

Chancellor

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01-211-6402

Peter Michael Esq
Private Secretary to the
Minister of State
Treasury Chambers
Whitehall
London SW1

9 December 1982

Dear Peter,

My Secretary of State has asked me to copy to Mr Wakeham the enclosed letter from Geoffrey Searle, the Chairman of BRINDEX, on North Sea taxation.

Mr Lawson was a guest at the annual dinner of BRINDEX on 11 November. Searle raised the question of taxation and Mr Lawson invited him to write.

Yours ever,

JULIAN WEST
Private Secretary

MINISTER OF STATE (R)	
REC.	10 DEC 1982
ACTION	Mr J M Crawley CIR)
CC	PJ Chancellor
	PJ Chief Sec
	PJ Fin Sec
	PJ Econ Sec

PJ Min of State (C)

Mr French
PJ Inland Rev

Mr Middleton
Mr Byatt
Mr D Moore
Mr Burgner
Mr Robson
Mr Wicks
Mr Barber

BRINDEX

The Association of British Independent Oil Exploration Companies

MR DORKEN PS/MOS
PS/PUS
MR T P JONES
MR WIGGINS
MR E PRICE
MR ROSS
8/12/82

Please reply to:
G. W. Searle,
Chairman, BRINDEX,
c/o London & Scottish Marine Oil PLC,
Bastion House, 140 London Wall,
London EC2Y 5DN
Tel: 01-600 8021

26th November, 1982.

The Rt. Hon. Nigel Lawson MP
Secretary of State for Energy,
Department of Energy
Thames House South
Millbank
LONDON SW1P 4QJ

Dear Secretary of State,

I undertook to send you as a matter of urgency a note of certain points which Brindex would like to see introduced in the 1983 Budget to the existing oil taxation regime. In making these points we have restricted ourselves to matters which involve relatively minor amendments to the existing system on the grounds that such amendments could without too much difficulty be introduced into the next Budget.

On this basis, therefore, I would ask you to give consideration to the following:

1. PRT OIL ALLOWANCE

The oil allowance has increased in importance following the 1981 Finance Act, forming the only remaining protection from high taxation rates for the greater part of field life. However, since the cumulative limit of 5 million tonnes is still in operation, in many cases the oil allowance will be exhausted and PRT will be payable towards the end of field life. This is a period when production is declining but operating costs normally increase. Protection from very high tax rates, in the form of a PRT free cushion of income, is needed at that time in order to avoid a situation where fields may close down prematurely. It is desireable therefore that the oil allowance of 250,000 tonnes per chargeable period should be given for the life of the field, and not be restricted to a maximum allowance of 5 million tonnes.

(continued..../2)

2 W2
30/11

26th November, 1982.

As a separate point it is also the case that some smaller and marginal fields might not use their maximum oil allowance of 5 million tonnes because the allowance is restricted to 250,000 tonnes per chargeable period, but some of these fields will still be liable to PRT. It is suggested therefore that this inequity should be considered as part of a wider study on the taxation of marginal fields.

2. CAPITAL GAINS TAX:FARM OUTS

There are no special tax provisions covering farm outs and difficulties arise in trying to fit them into existing capital gains tax law and practice. The current position appears to be that there are cases in dispute with the Inland Revenue on the capital gains tax treatment of farm outs. The delay in clarifying the law is in some cases acting as a disincentive for further exploration drilling in the North Sea. A small company finding it financially impossible to meet continued drilling expenditure and wishing to reduce its obligations and costs by means of a farm out may be prevented from doing so if it faces a charge to capital gains tax which it has not the cash to meet. It is suggested therefore that this situation should be met either by a statement of practice or legislation which will effectively exempt from a charge to capital gains tax the theoretical benefit rising for the value of work to be performed on the licence in question by a company acquiring an interest in that licence. The concept of this type of sharing arrangement in which there is a contribution to the value of property or "pool of capital" is recognised in the U.S.A. and Canada where such transactions are non taxable. It is recommended that a comparative study of the applicable law needs to be undertaken.

An inequity also arises in cases where a licence might be disposed of for cash or other consideration due to the fact that North Sea licence interests are not covered by the classes of assets which qualify for capital gains roll over relief, thus the disposal of, say, a factory or goodwill will be able to be rolled over against the purchase of other business assets, but this does not apply to a licence interest. It is therefore suggested that North Sea licence interests be made one of the "relevant classes of assets" in Section 118 CGTA 1979.

It is felt that the above measures would stimulate further North Sea activity at little significant cost to Government tax revenues.

3. ADVANCE PETROLEUM REVENUE TAX

(i) In 1981 Supplementary Petroleum Duty was introduced

(continued..../3)

26th November, 1982.

as a short term measure to advance the Government's receipt of North Sea revenues. SPD will be replaced by APRT at the end of 1982 and therefore the short term measure will become a permanent feature of the oil taxation system.

Although in the long term it becomes part of PRT (if payable) in the short term it is a non-profit related levy.

For smaller fields which will not be liable to PRT or will pay little PRT, APRT will represent a severe drain of cash flows. Although unutilised APRT will be repaid (without interest) after five years, companies should not have to bear this burden during the five year period. It is proposed therefore that APRT should start in 1983 either at a lower rate than the presently indicated 20% or with a higher tax free volume allowance, and should be phased out gradually.

The tax take in the long term will not be affected by such changes which only have an effect on the timing of tax collection and tax repayment which at present appear to lead to the possibility of large over payments by the companies and large repayment obligations by the Oil Taxation Office.

(ii) APRT has, however, been treated as a payment which is effective to increase to some extent the pay-back period which remains as a major point in the representations relating to uplift and safeguard reliefs.

The reduction and eventual abolition of APRT, as proposed above, (and which we believe to be in principle a necessary step) will have the effect of increasing the tax burden on fields with a high cost of development and are marginal for that reason. To correct this detrimental effect arising in a situation where separate and more detailed representations are continuing on marginal and high cost fields, we believe that the extension of uplift and safeguard should be increased to twice the payback period rather than the current factor of 1.5.

4. EXPLORATION COSTS

Although corporation tax relief is given for exploration costs within the ring fence, no relief is given for PRT unless the expenditure is abortive or until a field is determined and production has commenced.

(continued...../4)

26th November, 1982.

Difficulties arise in the case of non-abortive expenditure e.g. appraisal costs, which may nevertheless be lying fallow for some time. Time limits may expire and the value of theoretical tax reliefs evaporate with the passage of time before a decision is made to develop or relinquish.

It is suggested therefore that to remedy this situation the tax payer should have the ability to claim immediate PRT relief for all UKCS exploration costs regardless of whether they have been proven to be abortive and regardless of whether the field is in safeguard.

5. COMMENCEMENT OF TRADE

You may be aware that for taxation purposes the Inland Revenue do not treat an oil production company as having commenced to trade until it has made a successful discovery and taken the decision to develop a field. The effect of this is that expenditure incurred during the exploration and appraisal stages is not immediately deductible from other sources of income for corporation tax purposes, and will never be deductible if a commercial development is not undertaken. In practice this hurdle can be overcome by purchasing an interest in an existing oil development (usually overseas) and thus triggering off commencement of trade. In many instances valuable management time is spent on monitoring and managing such investments for relatively little return. It is suggested therefore that if the tax law was such that a trade would be deemed to commence when an exploration or production licence was granted, management would be able to devote its attention to finding and producing oil in the UKCS, rather than directing its time and money to existing production overseas in order to obtain UK tax allowances.

I am sure you will appreciate that the points mentioned above have been restricted to matters on which action may be possible in the short time before the next Budget. They are not intended to detract in any way from the wider and more important considerations relating to the level of oil taxation having regard to current oil prices and costs.

Representatives from Brindex will of course be pleased to discuss our suggestions in more detail if you so wish.

Yours sincerely,

Geoffrey Searle

G.W. Searle

PERSONAL AND CONFIDENTIAL

SECRETARY OF STATE FOR ENERGY
THAMES HOUSE SOUTH
MILLBANK LONDON SW1P 4QJ
01-211 6402

EXCHEQUER
12 JAN 1983
CST FST EST
MST C MST R
SIR D WASS.
MR MIDDLETON
MR KEMP.
MR RIDLEY

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Parliament Street
London
SW1P 3AG

10th January 1983

Dear Geoffrey

You wrote to me on 10 December about the next Budget.

Let me start where you, presumably, will start - with the appropriate size of the 1983-84 PSBR. I hope you will cleave firmly - and explicitly - to the MTFS. Last year's Red Book indicated a PSBR for 1983-84 of 2¾ per cent of GDP. However, it is now clear that the level of activity next year will be lower than was envisaged at the time of your last Budget, which implies a consequential upward adjustment of the PSBR. In the circumstances, a 'target' PSBR of 3 per cent of GDP would be perfectly acceptable. Assuming (in line with Table 1.8 of the Autumn Statement) a 1983-84 GDP of £294 billion, this translates into a PSBR of some £8.8 billion. The markets will be well content with any figure that begins with an 8, even up to £8.9 billion. I realise that what I am suggesting implies a PSBR larger than this year's likely outturn, perhaps by a sizeable margin; but there is no reason whatever why an unplanned shortfall this year should oblige you to abjure the perfectly proper scope you have for much needed tax cuts in 1983-84. By any objective standard-including international comparisons, I suspect - a PSBR of 3 per cent of GDP at this stage of the cycle is pretty good going, and sufficiently austere to present no threat to the attainment of the 7%-11% monetary growth target already foreshadowed for 1983-84. (I would certainly not advocate any relaxation there).

This would seem to leave you with scope for at least £2 billion of tax cuts. But whatever the precise figure I have no doubt that the centrepiece of your Budget should be an increase in the income tax threshold to a point where it is clearly higher in real terms than it was when we took office. In other words, you should announce at least a 'double indexation' of the

LAWSON OF 10.1

PERSONAL AND CONFIDENTIAL

personal allowances (and other thresholds etc). The political and economic case for this, not least on employment grounds, is well known to you and I will not waste space by repeating it. It would also transform our overall record on income tax where at present the reduction in the real level of the tax threshold is the one serious blot. Do not be put off by fears of the money you thus put back into the pockets of the people being spent on imports: British industry is now as well placed to meet home demand as it will ever be. Our objective is to keep monetary demand under firm control: it is emphatically not to use excessive taxation to suppress real demand and to enforce austerity for its own sake (or for that of the balance of payments). In any event, there is a good chance that any further weakening of sterling against the Continental currencies will be offset by some strengthening against the dollar.

As for the rest of the Budget, I doubt if I can think of anything that you have not already thought of and studied in some depth. In general, I would offer the following guidelines:

(i) give a high priority to alleviating the burden of the North Sea tax regime;

(ii) do <u>not</u> make any further reduction in the NIS;

(iii) do <u>not</u> seek to massage the RPI by a Healeyesque cut in indirect tax;

(iv) do a large number of small things, each of which costs relatively little, but which remedy long-standing grievances or at least display imagination and understanding.

I hope all this is of some help.

Yrs ever
Nigel

NIGEL LAWSON

PS I would be happy to have a word with you at some stage about the separate but crucial question of the handling of a pre-election 'political' run on the pound.

N.

BUDGET SECRET

FROM: M E CORCORAN
DATE: 4 MARCH 1983

1. MR KEMP
2. CHANCELLOR

cc (Part 4 not copied to all)
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Littler
Mr Burns
Mr Middleton
Mr Cassell
Mr Mountfield
Mr Evans
Mr Monck (Parts 2 & 3)
Mr Moore
Mr Peretz (Parts 2 & 3)
Mrs Lomax
Mr Shields
Mr Allen
Mr Stibbard (Part 5)
Mr Collinson (Part 5)
Mr Hall
Mr Robson
Mr Norgrove
Mr Martin (Part 4)
Mr Ridley
Mr French
Mr Harris

C. See 2.16.

a) rounding up would be caught out quite soon

b) publishing the figures here would be a pity

c) we need to bring forward some expenditure: the "hole digging" charges that people talked about in the Autumn.

2. May I talk, "sua sponte", [illegible], to PSM about this on Monday morning?

1983-84 FSBR

You will be holding a meeting next Monday, 7 March, to discuss the 1983-84 FSBR. I attach a galley proof: the rest of this submission goes through, first, some general points for you to note and, then, points which are specific to each part of the FSBR.

2. You will be receiving a separate submission from Mr Stibbard on the Public Expenditure figures in Parts 2 and 5.

CST

3. Parts 2 and 3 raise special issues of which you are aware.

GENERAL

4. The format follows the Autumn Statement. Sideheadings will be put in at the next stage (page proofs). The charts we propose are interleaved. These are subject to change and so we have not had them printed yet.

5. All the figures are still subject to change, although they are consistent with last Wednesday's decision on the PSBR.

6. Apart from the change in lay-out, we propose a slight restructuring of the FSBR this year. The content is the same overall as last year but we have split last year's Part 1 into two, giving a Part 1 which sets out the Budget proposals in aggregate and a Part 4 which sets out the Budget proposals in detail. As a result, last year's Part 4 (Public Sector Transactions) becomes Part 5. The reason for this change is that the detailed list of Budget measures separated the overview of the Budget in Part 1 from the context set out in the MTFS. It would read more smoothly to have these closer together.

Say so in text?

PART 1: The Budget Proposals

7. This part covers the same ground as the first five paragraphs and table 1 of last year's FSBR.

8. The present draft takes credit for the Autumn measures in the text (paragraph 1.05). But it would also be possible to include them in table 1.1. The argument for doing so would be to show decisions taken since the last Budget which take effect in 1983-84 and to be able more clearly to show what has been done for business. The difficulty of including figures in the table would be to know what to include and what to leave out. NIS is simple enough. But to include NIS without NIC and the public expenditure plans would look odd and would be very difficult to handle. So we would recommend strongly against expanding the table in this way.

?

9. The NIS reduction is shown net of recovery from the public sector in table 1.1 with the gross cost of the reduction given in a footnote. This presentation allows a simpler table in the absence of other expenditure measures.

PART 2: Medium Term Financial Strategy

No refs to money GDP? Table 2.5 Para 2.25 cf last year

10. This part reflects discussion with the Bank yesterday but is of course still liable to change in detail. There is a substantive point about the public expenditure total to be shown in the first line of table 2.3. This is in part the subject of the separate submission of today by Mr Stibbard. ?

§2.13 "No magic change" ?

11. There is one other point to note here. We have included information about the ratio of public expenditure to GDP up to 1985-86 in Part 5 (paragraph 5.17). It is arguable that it should be included in Part 2 as the MTFS projects forward to 1985-86 whereas Part 5 stops at 1983-84. But there is no obvious peg in the MTFS for this information and it would perhaps sit more comfortably in Part 5. On balance, we think that the information is better given in Part 5 as now. ?

2.24 2.20 oil prices

§2.16 £7½ bn

§2.18 GDP deflator fig

PART 3: The Economy: Recent Developments and Prospects to Mid-1983

12. Changes agreed or suggested at the meeting on February 24 have been made:

(i) export volume growth 1 per cent in 1983 (tables 3.4 and 3.7); ✓

(ii) a balance of payments surplus of £4 billion in 1982 and £1½ billion in 1983 (table 3.7). Latest estimates bythe CSO (to be published on 9 March) put the surplus for 1982 at £4 billion, over half a billion pounds lower than previously estimated. The forecast for 1983 of £1½ billion allows for the effects of this downward revision to IPD in 1982 as well as the higher export figure for 1983; ✓

(iii) RPI growth Q2 1983 to Q2 1984 6 per cent (table 3.7); ✓

(iv) discussion of PSBR outturn for 1982-83 concentrated in Part 5. ✓

13. On the exchange rate, paragraph 3.12, the text now says:

"The exchange rate will continue to be determined by market forces; for the purposes of this forecast, it is assumed that the effective exchange rate will remain around the level in Februry 1983."

??

14. References to employment and unemployment have been reduced. The main statement is in paragraph 3.38 which refers, in vague and qualified terms, to the rate of growth of output which if sustained etc etc is consistent with no great change in unemployment. This does not necessarily mean that unemployment is forecast to be unchanged over the next fifteen months or so - and we would not wish to be drawn any further.

15. Keen readers will notice a change to chart 3.4 which is now confined to exports, for reasons of data availability: inclusion of the value series for our share of world trade has the effect of providing a less gloomy picture. ✓

16. If it were to be decided that the FSBR should assume a substantially lower oil price, this would have implications for the forecast (text and tables but not charts) as well as for policy. ✓

Chart 3.6. If real u.l.c.s + effective ex. rate are now back to '77 levels, how stands the loss of competitiveness?

PART 4: The Budget proposals in detail

17. Part 4 contains the list of expenditure measures and proposed changes in taxation and the table on direct effects of changes in taxation which were previously in Part 1.

18. The table is on a non-indexed basis. The practice in previous years has been to include in a footnote to the entries on income tax, personal allowances and thresholds figures on the revenue costs of statutory indexation alone. We propose now to extend this footnote to cover the statutory indexation of CGT and CTT. We also propose to provide somewhat greater information on the income tax side. In place of the single totals of previous years there is a breakdown between the main allowances, higher rate thresholds and IIS. This detail is optional, but it presents the information clearly and more fully. ✓ ?

19. The footnote is at present confined to those taxes which are subject to statutory indexation. This is a natural and defensible breakpoint. However on the indirect tax side it is slightly awkward, in view of the "sensible presumption" and the assumption of indexation made in the Autumn Statement figuring. On the other hand, to provide figures on each specific duty would be lengthy and in many years not particularly illuminating. One possible half-way house might be an addition to the footnote which simply repeated the aggregate excise duty figures in Table 1 of Part 1. ?

20. In the text of the proposed changes on taxation section for the income tax entries, we have included figures for the amount the allowances etc have been increased above the statutory indexation requirement. This is designed to reflect the increasing emphasis in budgetary analysis placed on claims on the fiscal adjustment and to make the FSBR a more complete document of record. The potential difficulty, of course, is that it might in some future year be uncomfortable to set out how far allowances etc fell short of the indexed figures. On the other hand, in these ?

Repetition stresses the point. When in doubt, leave out?

circumstances the figures are readily available (not least from the table in the Autumn Statement), so that there is little advantage in not presenting them in the FSBR.

PART 5: Public Sector Transactions:

21. The draft incorporates several changes to the tables which appeared last year in Part 4. The details are set out in a note by Mr Stibbard attached as Annex A. In brief:

- tables 21A and 21B on the nationalised industries disappear as largely duplicating material in the PEWP but we shall be ready to answer questions to the extent that numbers may have changed since the PEWP was published;
- last year's table 19 (table 5.7 now) has been redesigned to link the planning totals through to the PSBR rather than the General Government Borowing Requirement;
- tables 5.5 and 5.6 show changes to the planning total since the PEWP, and the position on the Contingency Reserve.

22. A more substantive issue surrounds the expenditure figures in Part 5 and this along with the matter of the public expenditure total to be shown in Part 2 (paragraph 10 above) is dealt with separately in Mr Stibbard's submission.

M E Corcoran

M E CORCORAN

ANNEX A

BUDGET CONFIDENTIAL

FSBR PART 5: Note by GEP

During preparation of last year's FSBR you expressed a wish for some simplification of the material in it. A review of the content of the whole FSBR took place last summer and we reported to you on 10 June as follows on Part 4 (now Part 5):-

> "Although the tables in Part 4 were shortened and tidied for the 1982-83 version, more can be done in this way; ... we shall see what more can be done to shorten and simplify the tables yet more, and reduce overlap between the FSBR and the PEWP."

This year we propose to further simplify and shorten the tabular material as follows.

<u>Table 20 last year (now Table 5.8)</u>

"Nationalised industries" and "other public corporations" columns are to be combined to cover the public corporations sector as a whole. The split seems unnecessary given that national accounts outturn information is only published for public corporations as a whole. And the need for separating out nationalised industries is lessened now we propose to drop Tables 21A and 21B (see below). ✓

<u>Tables 21A and 21B</u> (of last year)

A bit drastic: especially re. EFLs

These to be dropped entirely. They follow the same format as, respectively, PEWP Tables 3.4B and 3.5 and appear only in the FSBR to provide an opportunity to update the PEWP. Most public and Parliamentary interest is probably in the final column on EFLs which, if we were to retain just that, would hardly amount to a table. So we will drop the table but PE Division would have information about EFLs ready to answer a Parliamentary Question, or give to the TCSC if requested, immediately after the Budget. To make up in part for the loss of Table 2~~1~~, NLF loans to each of the larger nationalised industries will be shown separately in Table 25 (now 5.12). ?

<u>Table 24</u> (now table 5.11)

The "class" analysis of supply services in the top half of the table to be dropped, as it duplicates the opening table in the Chief Secretary's Memorandum which is also issued on Budget day. ?

Other tables

We are making many minor modifications to all tables to improve their clarity and this, coupled with a switch to the "Autumn Statement" style of printing and layout, should help to make Part 5 more digestible.

Table 19 (5.7)

Although not a cut or a simplification I draw your special attention to the redesign of Table 19, which has been developed to show the relationship between the public expenditure planning total and the PSBR rather than, as last year, the CGBR. The presentation is unorthodox and new and brings together bits of three acounting systems. It should meet a need as it articulates the connection between the planning total and the PSBR, two of the most important policy numbers (the connection is also shown in the MTFS chapter - Tables 2.3 to 2.5 but the numbers are heavily rounded and not fully articulated). The redesigned Table 19 also includes, as a memo item, the numerator used to calculate the public expenditure/GDP ratio.

New Tables 5.5 and 5.6

These are text tables, both linked to Table 5.7 and cross-referenced from that table. 5.5 details the changes to the planning total since the Autumn Statement and Table 5.6 shows the latest position on the Contingency Reserve after Budget and other announced measures.

?

Yes: but it is disconcerting here if it involves showing ~~[illegible]~~ so clearly 82/3 PSBR @ £7.3 bn

For our 10.30 meeting

PWP

BUDGET SECRET

FROM: P J STIBBARD
DATE: 4 MARCH 1983

CHANCELLOR

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Littler
Mr Burns
Mr Middleton
Mr Cassell
Mr Mountfield
Mr Kemp
Mr Evans
Mr Monck
Mr Moore
Mr Peretz
Mrs Lomax
Mr Shields
Mr Allen
Mr Collinson
Mr Hall
Mr Hart
Mr Robson
Mr Norgrove
Mr Martin
Mr Ridley
Mr French
Mr Harris

C.

Clearly this is for the CST to advise on!

I should also like him to accept [illegible] for Pt. 5 of FSBR, which I've only skimmed.
(See my comments there + on Annex A to M. Corcoran's main note)

FSBR: IMPLICATIONS FOR PUBLIC EXPENDITURE TOTALS

In addition to the questions of format discussed in CU's submission on the FSBR this evening, there are several issues of substance on public expenditure to which we would like to draw your attention. These will be evident both in Part 5 for 1982-83 and 1983-84 and in Part 2 for the later years. The Chief Secretary may wish to give you his views on these before the meeting on Monday afternoon.

2. The 1983-84 forecasts in Part 5 for detailed income and expenditure items represent our best judgement of the most likely outcome for those items per se and, as a consequence, for the borrowing requirements. Expenditure figures have not been constrained to the PEWP plans where the latter were based on economic assumptions and assessments of shortfall which are now out-dated. For local authorities the figures broadly reflect a consensus reached between the relevant Treasury Divisions

and the Department of the Environment. PE have been closely involved on the nationalised industry element of the figures for public corporations.

3. Although in previous years some adjustments have been made for presentational reasons, there are strong advantages in presenting realistic figures of this kind:

a. they show the basis of the Budget decisions;

b. they greatly ease monitoring against outturn throughout the year, ensuring that the public, Parliament and ourselves are using the same set of figures against which to gauge outturn; and

c. they eliminate the need to explain away fudges within the FSBR (the counterpart of massages of certain figures show up as distortions somewhere else in the accounts, because they have to add up).

4. To an extent comparisons with the figures in Cmnd 8789 are blurred by the use of the national accounts framework in many of the Part 5 tables. But not too much should be made of this as City analysts and TCSC advisers are adept at translating from one accounting system to the other. Departures from Cmnd 8789 can reasonably be explained by the receipt of later information (although published on 1 February, Cmnd 8789 was mainly based on information to hand last Autumn). And (see table in paragraph 8) there is considerable room for arguing that we did allow for much of the longfall/shortfall in Cmnd 8789).

5. Nevertheless, I would like to highlight the following potentially controversial items.

Public Expenditure Planning Totals

6. Latest estimates for the Planning Total in 1982-83 will be shown in Part 5. These will indicate a figure of £112.1 billion, nearly £1 billion below that shown in the PEWP. The additional shortfall reflects a variety of factors, including lower current spending by LAs and lower NI borrowing.

7. For 1983-84 the Planning Total has also been brought down. Part 5 shows a figure of about £119 billion compared with the £119.6 billion of the PEWP. The total has of course been affected in part by Budget changes, but it also reflects revised economic assumptions and a later view of shortfall. These latter differences are not broken down in detail but the net effects are given as -£½ billion in Table 5.5. They

also are implicit within line 4 of Table 2.3 (although this line applies to general government expenditure rather than the planning total and includes part of the shortfall already in the White Paper).

8. The revisions to shortfall breakdown, approximately, as follows:

£ billion

	Allocation of Cmnd 8789 shortfall (unpublished) (approx)	Shortfall consistent with current FSBR figures (post Budget) (approx)
CG cash limited	-1	-1
CG demand determined	-	-
LA current	+¾ to 1	+¾
LA capital	-½	-¼
NI EFLs	-1/3 to ¾	-1½
Total	-1.2	-1.8

9. There is, of course, some embarrassment in revising the Public Expenditure Planning Totals so soon afer publication for reasons other than those connected with Budget or other policy decisions. But the lower outturn for 1982-83 is clearly something which cannot be overlooked and the lower total for 1983-84 is one explanation for a fiscal adjustment being achieved in this Budget which is larger than the £1 billion shown in the Autumn Statement.

10. We do not explicitly show a revised planning total for 1984-85 and 1985-86. But a revised view is implied in the MTFS (table 2.3). Table 2.3 starts from the PEWP planning total, but line 4 (differences dut to economic assumptions etc) includes inter alia a substantial general allowance for shortfall. The clear implication is that the PSBR projections (and those for the fiscal adjustment) assume that the planning total on the later years will be undershoot, and we may well have to admit as much to the TCSC. The scale of the shortfall reflects in part the fact that, on MTFS inflation assumptions and assuming strict ~~cost~~ cash controls, not all the Contingency Reserve shown in the PEWP will be needed. We have taken the view that we should avoid promulgating a new planning total for the later years at this stage - ~~logically~~ especially as there is a risk that inflation will turn out worse than assumed. Table 2.3 avoids this. But is is not possible

Why a disaster, it lowers p.e. % of GDP?

to sweep the problem entirely under the carpet, and there is a risk that Departments will use it as an argument for their bids in the coming PES round. But MTW objects overruled

11. It may be helpful to see a table corresponding to Table 2.3 in 1981-82 cost terms and this is attached. Although not for publication it shows what could be constructed by the advisers to the Treasury Committee from the figures provided in the FSBR.

Local authority current expenditure

12. For 1983-84 forecasts (eg in Tables 5.3 and 5.8) we show an overspend of about £¾ billion more than the plans in the PEWP (ie additional to the 'adjustment for realism' mentioned in paragraph 22 of Cmnd 8789 Part 1). Only a little information is available so far on local authority budgetary intentions but an overspend of this order is broadly in line with the information that has been gleaned so far by DOE (they will have a firmer impression in about two weeks). The forecast accords with past experience. It is also consistent with the information we have on rating intentions. There seems no good reason not to admit to an overspend now. Otherwise there is a considerable risk that information released by the local authority associations about budgets will discredit the FSBR numbers a short while after Budget day. The Government's own assessment of local authority budgets is in effect made public in May. A positive point is that if we do this the accounts in the FSBR provide an opportunity to show the Government's response to overspending; an estimate of grant 'holdback' is incorporated on the income side of the local authority account (and on the expenditure side of the central government account).

NI EFLs

13. Public corporations borrowing and investment in fixed assets is not presented on the same basis as in the PEWP (the format changes mentioned in the general submission have made comparisons rather more difficult). But under questioning eg from the TCSC it might be difficult to hide the fact that they imply nationalised industry outturn of around £1 billion less than the 1983-84 EFLs as shown in Cmnd 8789 plans and investment in fixed assets of about £½ billion less. Both PE and the forecasters agree that there is likely to be a large amount of shortfall on investment and present EFLs in 1983-84. PE would be prepared to admit to such under questioning from TCSC (although naturally qualified in terms of the general system of control being used). The divisions do differ slightly on the magnitudes involved. PE would find it easier to defend a shortfall on EFLs near to the corresponding shortfall in 1982-83 (£¾ billion). But the precise figuring will not be discernible from the tables in

the FSBR and to take the lower figures in our calculations would raise the PSBR forecast. The FSBR figures of course also assume no net call on the Contingency Reserve by nationalised industries in 1983-84.

Capital Spending

14. The above underspend on nationalised industries capital investment, with a forecast local authority capital underspend of about £¾ billion means that the planned increases in public sector capital spending of the order of 12 per cent between 1982-83 and 1983-84 mentioned in Cmnd 8789 (eg paragraphs 18 and 32 of Part 1) will be updated by the later forecast information in the FSBR. Although it is not possible to make exact comparisons of capital spending between the PEWP and the FSBR because of definitional differences, it will be difficult to hide the fact that the rise in capital spending in the FSBR is a good deal less than the PEWP figure based on plans. Given last year's outturn in this area, however, a move towards realism is more likely to gain approval than adverse comment from the TCSC.

PJS

P J STIBBARD

BUDGET
CONFIDENTIAL

Table 2a

NOT FOR PUBLICATION.

GENERAL GOVERNMENT EXPENDITURE

Cost terms

1981-82 prices

£billion, ~~cas~~

	1981-82	1982-83	1983-84	1984-85	1985-8
ublic expenditure planning total[1]	104.7	105½	106	106	106
lanning total adjustments[2]	-1.0	1½	½	0	0
eneral government expenditure[3]	103.7	107	106½	106	106
ifferences due to policy measures and economic assumptions[4]	–	-1½	-1½	-1	-½
ational accounts adjustment[5]	2.7	3	3½	4½	3½
nterest payments[6]	13.8	13	~~13~~ 12½	12	11½
eneral expenditure in national accounts terms[7]	120.2	121½	121	121½	120½

ootnotes: see over

Mr Corcoran

For urgent correction.

UR 8/3

Miss RUTTER
A few changes marked in pencil

[illegible signature] 8/3

Rosa p!

NOTE OF A MEETING ON MONDAY 7th MARCH AT 4.15 P.M. IN THE CHANCELLOR'S ROOM, H.M. TREASURY

Present:
Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Sir D Wass
Sir A Rawlinson
Mr Burns
Mr Littler
Mr Middleton
Mr Cassell
Mr Mountfield
Mr Evans
Mr Moore
Mrs Lomax
Mr Shields
Mr Kemp
Mr Stibbard
Mr Hall
Mr Norgrove
Mr Corcoran
Mr Ridley

1983-84 FSBR

X The meeting had before it Mr Corcoran's minute of 4 March. P/ 2. The Economic Secretary queried the sense of moving the Budget proposals in detail to the ~~end of the document~~ proposed position (part 4). After a brief discussion it was agreed that this did in fact make sense and the document would stand as drafted.

3 ~~2.~~ The meeting considered the point in paragraph 8 of Mr Corcoran's minute, whether the table 1.1 could be expanded to take credit for the autumn measures. It was pointed out that this could create an unwelcome precedent and would pose conceptual problems. It was agreed that the table should not be so expanded.

CHANCELLOR OF THE EXCHEQUER

4 ~~3.~~ There was some discussion of the change in definition of sterling M3 and the PSBR alluded to in a footnote in part 2. the footnotes to tables 2.2 and 2.5. It was noted that these changes would be explained in greater depth in the Bank of England quarterly bulletin article but this would not appear for two weeks after the FSBR was produced. It was agreed that there should be a technical press notice produce to accompany the FSBR to explain the change, and that the footnotes should give a Part 5 paragraph refs. The Chancellor queried the consistancy consistency of treatment of money GDP in paragraph 2.23. Mr Burns was not sure whether the figures should be highlighted. ~~Mr Burns~~ He undertook to have another look at the figures.

5 ~~4.~~ The Chancellor asked if all were agreed on the formulation "no major change" to describe the exchange rate in paragraph 2.13. Mr Middleton said that this had been accepted by the Bank of England. It was agreed that this formulation should be used. Mr Cassell agreed to have another look at the penultimate sentence of that paragraph.

6 ~~5.~~ The Chancellor asked that all references to oil prices be ~~squared~~ bracketed in the next version of the FSBR.

7 ~~6.~~ The FST noted that there was scant reference to unemployment in the FSBR. It was agreed that this was not appropriate in such a document. The treatment was consistent with the Government's insistence that it did not publish unemployment forecasts. The Chancellor noted references to unemployment should be consistent with the Budget speech.

8 ~~7.~~ The Economic Secretary was concerned about the apparent discrepancy between the text on productivity and the chart. Mr Kemp agreed to have another look at the words although Mr Burns and Mr Evans did not think there was any inconsistency. The Chancellor noted references to unemployment should be consistent with the Budget speech.

9 ~~8.~~ The Chancellor expressed concern about the picture shown on nationalised industry price increases in table 3.2 of the section on inflation. It was agreed that this table should be droped dropped. The reference to nationalised industry prices would come in the paragraph 3.22 where future performance could also be referred to.

10 ~~9.~~ There was some discussion of ~~table~~ chart 3.6 and ~~table~~ chart 3.3. It was agreed that the reference "competitiveness" in ~~table~~ chart 3.3 should be dropped and that there should be an attempt to explain more clearly the concept of real unit labour cost.

11 ~~10.~~ ~~The Chancellor agreed that the table~~ in footnote (c) ~~to~~ table 4.2 should ~~remain.~~ The Chancellor asked that the squared bracketed sections showing the ~~result of~~ difference between what was proposed and simple indexation should be left out ~~from~~ the part 4 text.

12 ~~11.~~ The Chancellor expressed concern about the zero percentage increase shown from manufacturing production in 1983. Mr Burns thought that the table should show half year figures. The Chancellor agreed that these should be included. That would put the figures on the same basis as those on the autumn statement.

13 ~~12.~~ Mr Middleton agreed to have a careful look at the PSBR outturn for 1982-83.

14 ~~13.~~ The Chief Secretary alerted the meeting to the issues raised in Mr Stibbard's minute of 4 March. It was agreed that these ~~will be~~ would be discussed subsequently.

JILL RUTTER

Distribution

Those Present
PS/Minister of State (R)
Mr Monck
Mr Peretz
Mr Allen
Mr Collison
Mr Robson
Mr Martin
Mr Harris

NOTE OF A MEETING ON MONDAY 7th MARCH AT 4.15 P.M. IN THE CHANCELLOR'S ROOM, H.M. TREASURY

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Mr Shields
Mr Kemp
Mr Stibbard
Mr Hall
Mr Norgrove
Mr Corcoran
Mr Ridley

1983-84 FSBR

The meeting had before it Mr Corcoran's minute of 4 March.

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11. The Chancellor asked that the square bracketed sections showing the difference between what was proposed and simple indexation should be left out from the part 4 text.

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14. The Chief Secretary alerted the meeting to the issues raised in Mr Stibbard's minute of 4 March. It was agreed that these would be discussed subsequently.

JKR

JILL RUTTER

Distribution

Those Present
PS/Minister of State (R)
Mr Monck
Mr Peretz
Mr Allen
Mr Collison
Mr Robson
Mr Martin
Mr Harris

CH/EX REF NO B/83/20.

COPY NO 1. OF 28. COPIES

RECORD OF THE SEVENTH BUDGET OVERVIEW MEETING AT 11.30AM ON 8 MARCH

Present:

Chancellor	Mr Burns	Mr Moore
Chief Secretary	Sir Lawrence Airey (IR)	Mr Kemp
Financial Secretary	Mr Fraser (C&E)	Mr Cassell
Economic Secretary	Professor Walters (No 10)	Mr Ridley
Minister of State (C)	Mr Bailey	Mr Kerr
Minister of State (R)	Mr Middleton	Mr Hall
Sir Douglas Wass		
Sir Anthony Rawlinson		

Papers:

i. Progress Report (Mr Kemp's minute of 8 March)

ii. Lower Oil Prices (Minutes of 4 March from Sir A Rawlinson and Mr Cassell)

ITEM 1: Decisions of Minor Measures

The following decisions on minor measures were taken:-

a. as proposed by the FST (minute of 4 March) it was agreed that the Business Expansion Scheme should be brought into effect from 1 January, rather than 1 March, 1984. The effect would be to bring forward into 1983/84 costs which would otherwise fall in 1984/85. They might be up to some £25 million.

b. It was agreed that, as suggested by the Minister of State (R) (minute of 4 March) the six year period of carry back of ACT should be introduced, as from the present date, though with no backdating. Compared to no extension of the period, there would be no additional costs in 1983-84, and a cost of some £1 million in 1984-85.

BUDGET SECRET

FROM: C D HARRISON
DATE: 7 MARCH 1983

PS/CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Littler
Mr Burns
Mr Middleton
Mr Cassell
Mr Mountfield
Mr Evans
Mr Kemp
Mr Monck
Mr Moore
Mr Peretz
Mrs Lomax
Mr Shields
Mr Allen
Mr Stibbard
Mr Collinson
Mr Hall
Mr Robson
Mr Norgrove
Mr Martin
Mr Corcoran
Mr Ridley
Mr French
Mr Harris

1983-84 FSBR

The Economic Secretary has seen the draft attached to Mr Corcoran's submission of 4 March.

2. His main comment was that he was dubious about the rationale of moving "Budget proposals in detail" to behind the MTFS. Although not a matter of great moment, he finds this messy, and, if it is thought desirable to put this section after the MTFS, then it would be best to put it right at the back, after "Public Sector Transactions".

3. I attach drafting suggestions by the Economic Secretary at an annex.

CDH

C D HARRISON

ANNEX

DRAFTING SUGGESTIONS FOR FSBR

1.05, line 1: replace "are" by "were".

1.05 Line 3: after "1½%" insert to come into effect on..."

2.05, line 5: insert a semi colon after "9%", and replace "but" by "thereafter".

2.13, line 1: replace "ensuring" by "maintaining".

2.16, line 4: replace "figure" by "of GDP".

2.26, line 7: replace "effect of lower mortgage interest rates" by "the fact that the sharp fall in mortgage rates in the autumn of 1982 will no longer be reflected in the index".

2.23: The Economic Secretary feels that the final sentence is partly repetitive and unnecessarily defensive.

3.12, line 6: replace "on" by "about".

3.14: The Economic Secretary thinks that the improvement in the UK's share of world trade in volume terms in 1981 and 1982 might be mentioned. And in 3.19, he feels that the words "a continuing tendency for UK producers to lose share" is sufficiently hypothetical to be deleted.

3.28, final sentence: insert "the" after "of", and insert "pursued" after "policies".

3.29, second sentence: revise to read "Expenditure on durables in particular rose rapidly reflecting mainly the beginning of an upturn in real take-home pay, lower mortgage rates..."

3.30, line 4: replace "becoming" by "deemed to be".

3.33, final sentence: surely council house sales are not investment?

3.38, first sentence: surely chart 3.8 actually implies losses in productivity by the end of 1982, rather than simply "more moderate gains"?

3.42, first line: replace "the present rate" by "that predicted" (?)

COPY No 1 OF 31

FROM: J M SWIFT
DATE: 7 March 1983

PUP

PRINCIPAL PRIVATE SECRETARY

c.c. Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Littler
Mr Burns
Mr Middleton
Mr Cassell
Mr Kemp
Mr Mountfield
Mr Evans
Mr Monck
Mr Moore
Mr Peretz
Mrs Lomax
Mr Shields
Mr Allen
Mr Collinson
Mr Hall
Mr Hart
Mr Robson
Mr Norgrove
Mr Martin
Mr Ridley
Mr French
Mr Harris
Mr Stibbard

FSBR: IMPLICATIONS FOR PUBLIC EXPENDITURE TOTALS

The Chief Secretary has seen Mr Stibbard's minute of 4 March.

2. The Chief Secretary finds the proposals made extremely disconcerting and does not think that they should be accepted e.g. the NI shortfall is not in accordance with the Public Expenditure view. The Chief Secretary thinks that we really cannot depart from the PEWP figures so radically and so soon. The consequences would be very damaging.

JMS

MISS J M SWIFT

BUDGET SECRET

FROM: M E CORCORAN
DATE: 9 MARCH 1983

Please note that not all the numbers are fully up to date.
G.

1. MR KEMP

2. CHANCELLOR

C.

Stimmed only

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Littler
Mr Burns
Mr Middleton
Mr Bailey
Mr Cassell
Mr Hall
Mr Moore
Mr Evans
Mr Allen
Mrs Lomax
Mr Monck
Mr Stibbard
Mr Collinson
Mr Robson
Mr Norgrove
Mr Ridley
Mr Harris
Mr French

Sir Lawrence Airey Inland Revenue
Mr Fraser Customs & Excise

FSBR

Attached is the latest version of the FSBR.

2. We have tried as far as we can to make the figures accurate and up to date. But there are no doubt changes to the numbers which still need to be made, and errors.*

3. The printers wish to receive amended page proofs during the course of tomorrow afternoon and at the latest by close. If there are to be any amendments, could I have them by 1pm please?

4. The next stage will be book proofs on Saturday morning. By then in the normal way we would aim to have to make only very minor changes to the text or numbers.

5. All this is on the basis that OPEC's decisions do not require major changes. As you know, we have been trying to make contingency plans to cope with that.

M E Corcoran

* Now overtaken: the figuring has not caught up with this afternoon's decisions. These are now being fed through to the printers.

IR 7-8

BUDGET—SECRET

Financial Statement and Budget Report 1983–84

RETURN to an Order of the House of Commons dated 15 March 1983: for

COPY of FINANCIAL STATEMENT AND BUDGET REPORT 1983-84 as laid before the House by the CHANCELLOR OF THE EXCHEQUER when opening the BUDGET

Treasury Chambers, 15 March 1983 } NICHOLAS RIDLEY

Ordered by The House of Commons *to be printed*
15 March 1983

LONDON
HER MAJESTY'S STATIONERY OFFICE
£[redacted]·[redacted] net

BUDGET—SECRET

Financial Statement and Budget Report 1983–84

RETURN to an Order of the House of Commons dated 15 March 1983: for

COPY of FINANCIAL STATEMENT AND BUDGET REPORT 1983-84 as laid before the House by the CHANCELLOR OF THE EXCHEQUER when opening the BUDGET

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15 March 1983

LONDON

HER MAJESTY'S STATIONERY OFFICE

£[redacted]·[redacted] net

Contents

SECOND PROOF—F.S.

1. The Budget proposals

The Budget

1.01 The main proposals in the Budget are summarised in Table 1.1 below and described in detail in Part 4. These figures and those presented in Part 4 are estimates of the direct effects of the measures on public sector transactions; they are not estimates of the net effects of all the changes in public sector transactions, both direct and indirect, brought about by the tax and expenditure decisions. The Budget is defined to include the tax changes announced in the Budget Speech, and policy changes to the expenditure plans set out in the White Paper (Cmnd. 8789).

Summary table

Table 1.1 Budget measures: Direct Effects(1) on Public Sector Transactions(2)

£ million at current prices

	Effect in 1983–84		Effect in a full year	
	Change from indexed base	Change from non-indexed base	Change from indexed base	Change from non-indexed base
Income tax allowances and thresholds	−1 170	−2 000	−1 490	−2 545
Other income tax and other direct taxes	−290	−310	−365	−410
National Insurance Surcharge(3)	−215	−215	−400	−400
Excise duties	10	595	10	605
Other indirect taxes	—	−5	—	−10
Total	−1 665	−1 935	−2245	−2755

(1) The direct effects of tax changes are the differences between the yields estimated by applying the new and the old tax rates and allowances to the taxable income and expenditure projected in the post-Budget forecast. A further adjustment is made to the estimates of the Customs and Excise taxes to allow for the changes in taxation resulting both from substitution by consumers between goods and the change in real incomes.

(2) +/− indicates an increase/decrease in revenue.

(3) Estimates exclude public sector payments; the gross cost of the reduction in the surcharge is £295 million in 1983–84 and £600 million in a full year.

Tax proposals

1.02 The net effect of the tax proposals in the Budget is shown on two alternative bases. The first, conventionally used in the preparation of economic forecasts, allows for the full indexation of 1982–83 excise duty rates and main income tax allowances and thresholds in line with inflation in the year to December 1982. On this basis the net effect of the tax proposals in the Budget is to reduce revenue by £1,595 million in 1983–84 and by £2,250 million in a full year. The cost in 1983–84 of the increase in the main income tax allowances and thresholds over and above full revalorisation is estimated to be £1,170 million. The second basis, which corresponds with the actual changes in tax rates and allowances to be included in the Finance Bill, measures the effects of those changes as compared with existing rates and allowances. On this basis the increase in income tax allowances and thresholds is estimated to cost £2,000 million and the increase in excise duties to yield an additional £595 million in 1983–84.

Public expenditure measures

1.03 Public expenditure measures announced in the Budget total £250 million in 1983–84. They are listed in Part 4 and in Table 5.5. Their cost will be met entirely from the Contingency Reserve. They will not therefore lead to any increase in the public expenditure planning total for 1983–84 announced in the White Paper. There will however be a reduction in planned public expenditure as a result of the further cut in the National Insurance Surcharge announced in the Budget, which will be recovered from central government and nationalised industries. In Table 1.1, the reduction in public expenditure is offset against the gross cost of the change in the Surcharge.

The effect on the PSBR

1.04 Taking the tax and expenditure changes together, and allowing for indirect, as well as direct, effects on public sector transactions, the Budget measures are expected to add about £1½ billion to the PSBR, compared with what it would have been on conventional assumptions about the indexation of tax rates and allowances. The level of the PSBR in 1983–84 is expected to be around £8 billion, or 2¾ per cent of GDP (at market prices).

The Autumn measures

1.05 Other changes affecting 1983–84 are set out in the Autumn Statement, published in November. They include the 1 percentage point reduction in the National Insurance Surcharge from 2½ per cent to 1½ per cent; changes to public expenditure plans which kept the planning total for 1983–84 within the figure given in the 1982 White Paper as modified by the 1982 Budget (£120.7 billion); and limited increases in employees' and employers' National Insurance Contributions. The tax reductions and the effect of holding the increase in National Insurance Contributions below the amount needed to balance the Fund were estimated to cost about £1 billion in 1983–84.

2. Medium-term financial strategy

Objectives

2.01 Government policies have helped to bring about a rate of inflation that is already well into single figures. The objective over the medium term is to continue reducing inflation, and to secure a lasting improvement in the performance of the UK economy, so providing the foundations for sustainable growth in output and employment. Firm financial policies are an essential means to this end. The medium term financial strategy sets out the framework within which policy is operated.

The financial framework

2.02 Control of the money supply is a central part of this strategy. In judging the rate of monetary growth needed to reduce inflation, the Government will continue to take account of structural influences on the different monetary aggregates, as well as the behaviour of other financial indicators. Fiscal policy is designed to be consistent with this monetary framework and with the overall objective of reducing inflation. Over a period of years, a reduction in public sector borrowing, as a proportion of GDP, has a key part to play in securing a fall in interest rates, in both real and nominal terms.

Need for lower costs

2.03 The extent of the recovery in real activity over the next few years depends critically on bringing down cost increases, in all sectors of the economy. Lower domestic costs will enable British industry to compete more effectively, at home and abroad, without adding to inflationary pressures. Despite recent gains, UK productivity is still low in comparison with other major industrial countries. The long term health of the economy depends on further efforts to close this gap. Moderation in pay will help to ensure that improved efficiency is reflected in higher output and employment.

Supply

2.04 The Government will continue to pursue policies to strengthen the supply performance of the economy, by providing greater incentives for work and enterprise, and by improving the working of markets. A low rate of inflation will provide the right macro-economic environment in which these policies can succeed.

Recent financial conditions

Monetary growth in 1982–83

2.05 Monetary conditions have developed broadly as intended over the past year; in the year to February, the growth of the key monetary aggregates was within the target range of 8–12 per cent. Combined with the rapid fall in inflation, this contributed to a significant fall in interest rates. By mid-November, short term rates had come down to 9 per cent but, as the exchange rate weakened, market rates, and with them base rates, rose to around 11 per cent. This compares with a peak of 16 per cent in November 1981.

Table 2.1 Monetary Growth 1982-83

	Percentage growth					
	M_0(1)	M1	M2	£M3	PSL1	PSL2
February 1982–February 1983	$3\frac{1}{2}$	11	$6\frac{1}{2}$	10	$8\frac{1}{2}$	9

(1) Monetary base, wide definition.

Broad money

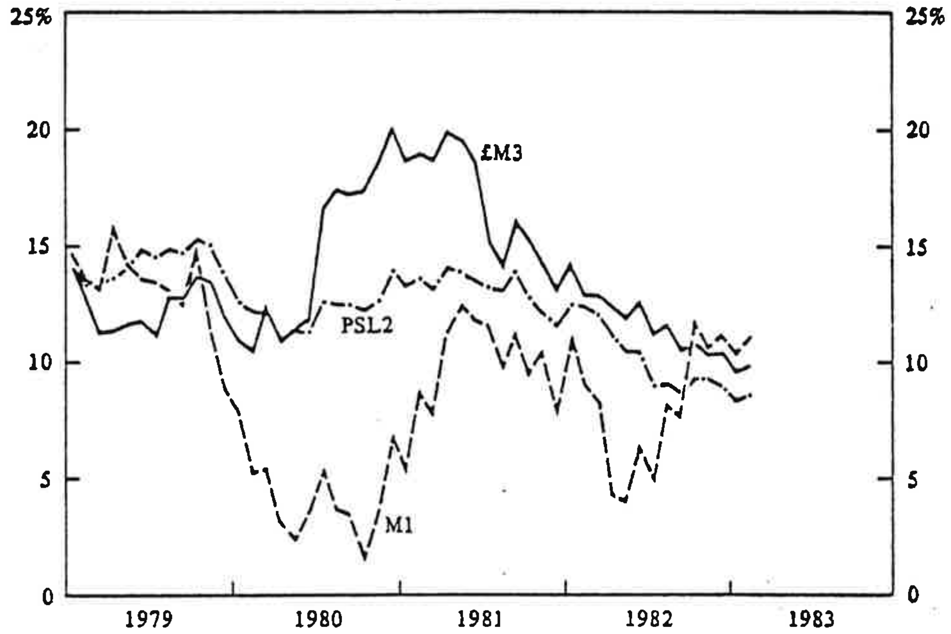
£M3 grew by 10 per cent over the first twelve months of the target period. During the spring and early summer the rate of growth was close to the bottom of the range. There was some rise in the late summer and autumn, but since November growth has again slowed down. PSL2 grew by less than £M3—9 per cent in the year to February. The growth of bank lending followed much the same profile as that of £M3. This in-year variation was attributable largely to borrowing by companies, borrowing by persons remaining high throughout the year.

'row money

2.07 M1 grew more slowly than £M3 over the period 1979–81. Last year, as expected, the growth of M1 rose to 11 per cent over the twelve months to February. Narrower measures of money continued to grow comparatively slowly. The monetary base grew by only 3½ per cent, despite lower interest rates, possibly reflecting a faster decline in the importance of notes and coins relative to other means of payment. Transactions balances, as measured by the new M2 statistics, grew by 6½ per cent, though lack of past data still makes this series difficult to interpret.

CHART 2.1

Monetary growth
Percentage change on year earlier



Notes: (1) Based on banking months
(2) Adjusted to take account of the introduction of the new monetary sector in November 1981 in place of the former banking sector

Other indicators

2.08 Other financial indicators pointed to moderately restrictive monetary conditions. As in other industrial countries real short term interest rates remained high. For most of the year the exchange rate was strong. The fall after October seems to have owed much to external factors, such as concern about oil prices and sharp movements in other currencies and, possibly, to political uncertainties.

Real money balances

2.09 Against this background, the growth in real money balances, on most measures of money, largely reflects the fall in inflation and points to a recovery in real activity. For a given growth in the nominal money supply, higher real money balances are an important mechanism by which lower inflation can help to raise the level of activity.

Monetary policy

Money ranges

2.10 In recent years the economic significance of the wider aggregates has been affected by changes in saving behaviour and by structural changes to the financial system, associated in part with the ending of direct controls. Inflation has fallen fast despite the overrun in previous years' monetary targets. These developments led to last year's decision to raise the monetary ranges. Monetary growth within the new target range set for 1982–83 has been consistent with maintaining a reasonably restrictive stance.

Target for 1983–84

2.11 As announced in the Budget Speech, the target range for 1983–84 is to be set at the 7–11 per cent indicated in last year's Financial Statement. As usual, this range applies to the annual rate over the fourteen months beginning in February 1983. A sustained reduction in monetary growth over a period of years will be needed to keep inflation on a downward trend. Illustrative ranges for the next few years are shown in table 2.2 Precise targets for 1984–85 and 1985–86 will be decided nearer the time.

Table 2.2 Ranges for Monetary Growth([1])

	1983–84	1984–85	1985–86
Percentage change during year	7–11	6–10	5–9

([1]) From 1983–84 onwards, the definition of £M3 will exclude public sector deposits. This is in line with the revised definition of the PSBR (see Part 5, para 5.04 footnote).

The growth of M1

2.12 The path shown in table 2.2 applies to both narrow and broad measures of money: M1 and £M3 (and PSL2). However, as noted in last year's FSBR, the combination of lower interest rates and lower inflation is likely to lead to a period of more rapid growth in M1 than in broader measures of money. The size and timing of these effects is uncertain, but if interest rates maintain their downward trend, and other indicators suggest that conditions remain moderately restrictive, it may be appropriate for M1 to grow more rapidly than the target range for 1983–84.

Interpretation of monetary conditions

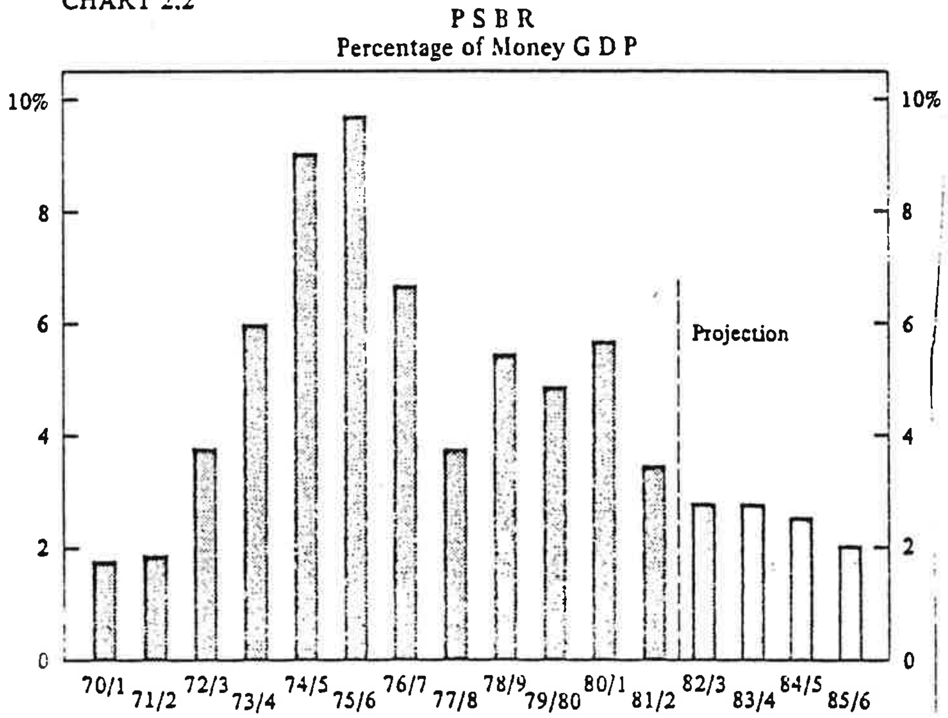
2.13 As explained in last year's Financial Statement, the interpretation of monetary conditions will continue to take account of all the available evidence, including the exchange rate, structural changes in financial markets, saving behaviour, and the level and structure of interest rates. Policy decisions will be aimed at maintaining monetary conditions that will keep inflation on a downward trend. The ranges shown in Table 2.2 have once again been constructed on the assumption that there is no major change in the exchange rate from year to year.

Fiscal policy

Past experience

2.14 Sustained progress on both inflation and interest rates requires continued fiscal restraint. During the 1950's and 1960's the PSBR averaged about 2¾ per cent of GDP. As Chart 2.2 shows, there was a strong rise in this ratio during the first half of the 1970's, peaking in 1975–76, when the PSBR reached nearly 10 per cent of GDP. High fiscal deficits over this period were associated with high inflation and interest rates.

CHART 2.2



The PSBR path

2.15 Government policies have been directed at achieving a progressive reduction in public sector borrowing over the medium term. The path that has been followed has also taken account of the depth of the recession. Two years ago the PSBR path was raised substantially for this reason, though the generally declining profile was retained. The PSBR was reduced from 5 per cent of GDP in 1979–80 to 3½ per cent (£8·7 billion) in 1981–82.

The PSBR in 1982–83

2.16 The estimated outturn for 1982–83 is [£7½ billion] equivalent to about [2¾ per cent] of GDP. This is some [£1½ billion] lower than the Autumn Statement forecast, and about [£2 billion] lower than expected at the time of the Budget, though still some way above the 2¼ per cent of GDP envisaged for the year now ending in the 1980 FSBR. Identifiable factors contributing to the lower outturn this year include unexpectedly high receipts from North Sea oil taxes, reflecting a higher sterling oil price, and underspending in some areas of public expenditure, notably local authority capital.

PSBR projections

2.17 The PSBR for 1983–84 is forecast to be [£8 billion], equivalent to about 2¾ per cent of GDP, as suggested a year ago and in the Autumn Statement. The fiscal projections summarised in table 2.5 show a further reduction in the PSBR as a proportion of GDP, to around [2½] per cent in 1984–85, and [2] per cent in 1985–86. This path should leave room within the monetary guidelines for a fall in interest rates over the next few years. The figures for 1984–85 and 1985–86 are illustrative. Decisions about the appropriate size of the PSBR in any particular year will be taken nearer the time.

Assumptions

2.18 The fiscal projections in tables 2.3–2.5 are based on the public expenditure plans shown in the Public Expenditure White Paper (Cmnd 8789), updated where necessary to take account of Budget changes and estimating changes. Further details for 1982–83 and 1983–84 are given in Part 5. Real output is assumed to grow by 2½ per cent a year on average over the three years. The general rate of inflation, as measured by the GDP deflator was 7 per cent in 1982–83.
It is forecast to fall to 5½ per cent in 1983–84. (The relationship between the forecasts for the GDP deflator and the more widely known Retail Prices Index is discussed in para 3.28. There are many reasons why the two indices may move differently over relatively short periods of time including, for example, the differing impact of changes in mortgage interest rates, seasonal food prices, oil prices and import costs.) In the later years, the GDP deflator is assumed to rise by 5½ per cent in 1984–85, and by 5 per cent in 1985–86. These assumptions imply an average growth in money GDP of about 8 per cent over the period as a whole.

Public expenditure

Public Expenditure

2.19 Table 2.3 shows the relationship between the planning total for public expenditure shown in Cmnd. 8789 and general government expenditure in national accounts terms (the definition of public expenditure lying behind the general government borrowing requirement).

Table 2.3 General Government Expenditure

£ billion, cash

	1981–82	1982–83	1983–84	1984–85	1985–86
Public expenditure planning total(1)	104·7	113	119½	126½	132½
Planning total adjustments(2)	−1·0	1½	1	—	—
General government expenditure(3)	103·7	114½	120½	126½	132½
Differences due to policy measures and economic assumptions(4)	—	−1½	−1½	−1½	−½
National accounts adjustment(5)	2·7	3	4	5½	5
Interest payments(6)	13·8	14	14	14½	14½
Total expenditure in national accounts terms(7)	**120·2**	**130**	**137**	**145**	**151½**

(1) Public expenditure planning total, see Cmnd. 8789, table 1.1, line 9.
(2) Adjustment to line 1 to exclude certain public corporations' capital expenditure, public corporations' net overseas and market borrowing and general allowance for shortfall as in Cmnd. 8789.
(3) Expenditure on programmes by central government and local authorities plus the contingency and provisional reserves and special asset sales. Broad assumptions have been made about the share of general government in the total of expenditure on programmes shown in Cmnd. 8789, table 1.1 for 1984–85 and 1985–86.
(4) Incorporates later information for 1982–83 than in Cmnd. 8789. For 1983–84 onwards includes Budget measures and estimating changes, shortfall and the net effects of different economic assumptions from those in Cmnd. 8789. Revised planning totals for 1982–83 and 1983–84 are shown in table 5.7.
(5) Adjustments to line 3 to the definitions used in National Accounts Statistics.
(6) For 1981–82 see table 2.1, Financial Statistics, February 1983. For 1982–83 and 1983–84 see table 5.8.
(7) For 1981–82 see table 2.4, Financial Statistics, February 1983. For 1982–83 and 1983–84 see table 5.8.

Revenue

Revenue

2.20 The growth of Government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as policy decisions. Revenue is projected on the conventional assumption of constant tax rates and indexed allowances and thresholds at the proposed 1983–84 levels. National Insurance contribution rates in future years are assumed to be adjusted to maintain an adequate balance in the Fund. [Projections of North Sea tax revenues assume that the North Sea fiscal regime is changed as proposed in the Budget and that oil prices remain around their present levels for the next two years and then rise broadly in line with world inflation.]

2.21 On these assumptions, general government receipts are projected to rise by nearly 22 per cent between 1982–83 and 1985–86, a little less than the growth in total money income. Government revenue from the North Sea is expected to account for about 6 per cent of total revenues throughout the period.

Table 2.4 General Government Receipts

£ billion, cash

	1981–82	1982–83	1983–84	1984–85	1985–86
Taxes on incomes expenditure and capital	85·9	92	96	103½	113
National Insurance and other contributions	16·5	18½	21	22½	24
Interest and other receipts	10·8	11	11	11½	11½
Accruals adjustment	−1·5	−½	—	−½	−½
Total	111·7	121	128	137	148
of which North Sea tax(¹)	6·3	7½	7½	8	9½

(¹) Royalties, Supplementary Petroleum Duty (in 1981–1982 and 1982–83). Petroleum Revenue Tax (including advance payments from 1983–84) and Corporation Tax from North Sea oil and gas production (before Advance Corporation Tax set off).

Public sector borrowing

Public sector borrowing

2.22 The new projections of Government receipts and expenditure are brought together in table 2.5 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment, conventionally assumed to take the form of lower personal taxes, depends critically on the estimates of revenues and expenditure. These are subject to major uncertainties about, for example, the tax yield for an assumed set of tax rates, the behaviour of oil prices, and the actual level of public spending in relation to the plans.

Table 2.5 Public Sector Borrowing

£ billion, cash

	1981–82	1982–83	1983–84	1984–85	1985–86
General government expenditure	120·2	130	137	145	151½
General government receipts	111·7	121	128	137	148
Implied fiscal adjustment(¹)	—	—	—	½	4
GGBR	8·5	~~9~~	9	8½	7½
PSBR(²)	8·7	~~7½~~ 7.8	8	8	7
as % GDP	3½	~~2¾~~ 3	2¾	2½	2
Money GDP at market prices	254	275	296	321½	346

(¹) – means lower taxes or higher expenditure than assumed in lines 1 and 2.

(²) From 1983–84 onwards, the definition of the PSBR and its components will exclude changes in public sector deposits. Other minor changes will also be made (see also part 5).

Comparison with the 1982 Revenue and Expenditure Projections

2.23 Table 2.6 shows changes in the fiscal projections since the 1982 FSBR.

Table 2.6 Revenue and Expenditure: Comparison with the 1982 projections

£ billion, cash

Changes (+ increases)	1982–83	1983–84	1984–85
General government expenditure	$-1\frac{1}{2}$	-1	-3
General government receipts	$-\frac{1}{2}$	-2	-6
Implied fiscal adjustment(¹)	—	$-\frac{1}{2}$	$-1\frac{1}{2}$
GGBR	-1	$\frac{1}{2}$	$1\frac{1}{2}$
PSBR	-2	$-\frac{1}{2}$	$1\frac{1}{2}$
Change in PSBR ratio (%)	$-\frac{3}{4}$	—	$\frac{1}{2}$

(¹) By definition the fiscal adjustment for 1983–84, in this year's projections, is eliminated by the 1983 Budget measures.

Averages in assumptions

2.24 The level of money GDP in 1982–83 is estimated to have been nearly 2 per cent lower than expected a year ago, reflecting both lower output and lower prices. The average growth in real output from now on is much the same as in last year's projections, while inflation is rather lower, implying a slower growth in money GDP than assumed a year ago. This year's Budget measures have the usual effect of taking up some of the fiscal adjustment in 1984–85. The projected PSBR is unchanged, as a percentage of money GDP, in 1983–84, and ½ per cent higher in 1984–85, compared with last year's projections.

Changes in receipts and expenditure

2.25 The main factors affecting the estimated outturn for 1982–83 are discussed in Part 5. Changes to expenditure in 1983–84 and 1984–85 reflect the decisions set out in Cmnd. 8789 and in the Budget Speech and revised economic assumptions. General government receipts are now projected at the proposed 1983–84 tax rates, which are lower than those used last year. The lower level of receipts also reflects the lower level of money GDP now assumed. In 1983–84, revenues from the North Sea are expected to be £1½ billion higher than projected a year ago, the net effect of a higher assumed level of production, particularly in tax-paying fields, a lower dollar oil price, and the fall in the dollar/sterling exchange rate that has already taken place. Projected revenues for 1984–85 are unchanged, with higher production from tax-paying fields helping to offset the effect of a lower sterling oil price than previously assumed.

Conclusions

2.26 The projections shown in tables 2.3–2.5 are no more than illustrative of one particular evolution of the economy. If the domestic and world economies develop in a different way, the projections for public finances could be substantially affected. The policy response to such changes would depend on their nature, but the intention would be to hold firmly to the strategy, by maintaining monetary conditions consistent with a continued trend to lower inflation. The key to sustained recovery lies in reducing the growth of costs and increasing the returns to investment and enterprise. Within the financial framework set out here, this would make room for a faster growth in output, without damaging the outlook for inflation.

2.27 Progress in reducing inflation over the next couple of years will be influenced to some extent, by the strength of the cyclical recovery in output, both domestically and in the rest of the world. The strategy outlined here presupposes a slow recovery in output and trade in other industrial countries. As explained in Part 3, the path of the Retail Prices Index over the next year or so may be affected by special factors, including the recent decline in the exchange rate, and the effect of the fall in mortgage interest rates last Autumn. It is not to be expected, therefore, that the path of inflation will be smooth. But the Government's policies will continue to be directed towards achieving a progressive reduction in its underlying trend.

3. The economy: Recent developments and prospects to mid-1983

Summary

World Economy

3.01 By the end of 1982 lower interest rates and lower inflation, particularly in the United States, were pointing towards some increase in world activity in 1983. The fall in oil prices in recent weeks improves the prospects for both recovery and low inflation.

The United Kingdom Economy

3.02 In the United Kingdom, the effects of lower world activity in 1982 were to a considerable extent offset by a good performance by exporters in world markets and by a rise in final domestic demand, led by consumer spending. But with some further fall in stocks, the growth in total output was probably not much more than ½ per cent, most of which was accounted for by higher oil production, and there were further rises in unemployment.

3.03 The forecasts for 1983 and the first half of 1984 are based on the fiscal and monetary policies set out in the Budget speech and in the Medium Term Financial Strategy. Recent developments and future prospects for monetary growth are described in Part 2 of this Report; details of the PSBR and public sector transactions will be found in Part 5.

Trade and the Current Account

3.04 The recovery in world trade should lead to a renewed rise in exports, helped by better cost competitiveness, from the first half of this year. With imports likely to increase rather faster as domestic demand continues to rise and as the rundown in stocks comes to an end, the surplus on the current account of the balance of payments is forecast to be sizeable, but smaller than in 1982.

Inflation

3.05 After the major reduction in inflation over the past year, there is likely to be a pause in 1983 as the effects of the recent fall in the exchange rate are absorbed. With increases in costs likely to continue below the rate of increase in prices, the gradual recovery in profits should continue.

Output

3.06 Growth in overseas markets, further increases in domestic demand as the effects of lower inflation and lower interest rates work through, together with gradually improving profitability, should lead to total output rising, by perhaps 2½ per cent between the first half of 1983 and the first half of 1984.

The world economy

Recent Developments

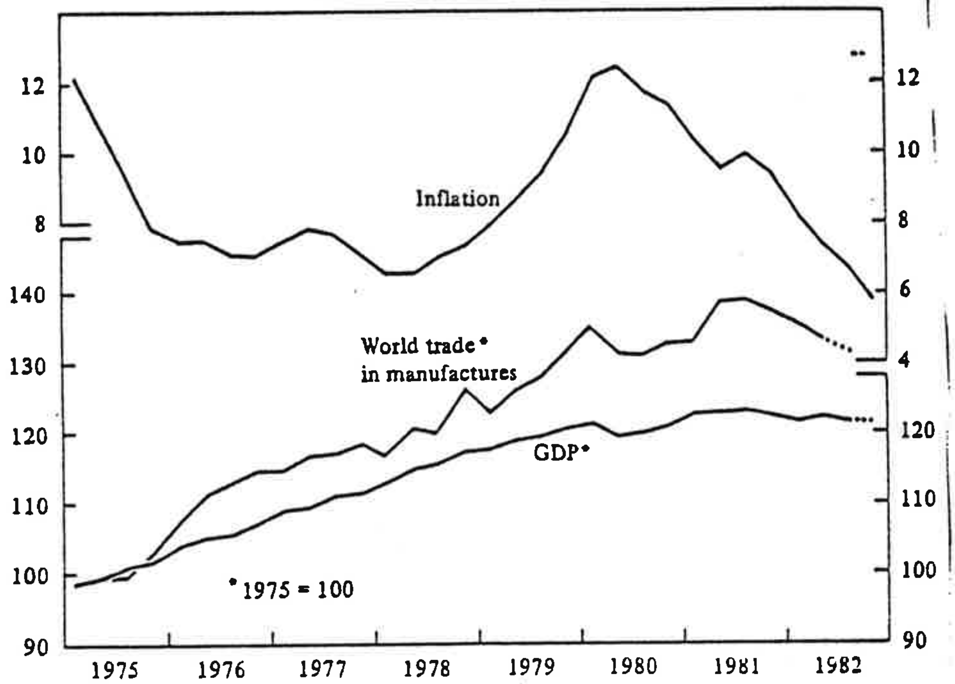
3.07 Two years of slow growth in 1980 and 1981 reflected the 140 per cent rise in oil prices in 1979–80 against the background of policies designed to contain the impact on inflation. By early 1982 there was a widespread expectation that a lower rate of inflation—already falling significantly and expected to contribute to lower interest rates—would lead to a recovery in demand and output in the industrialised world. Instead there were declines in industrial demand and activity, partly reflecting the continuing effects of high real interest rates particularly in the USA; while lower export earnings (as commodity prices fell), high interest rates and a strong dollar combined to raise doubts about credit-worthiness of heavily indebted countries.

3.08 In the course of 1982, inflation fell further, helped by continuing weakness in commodity prices (except oil). The reduction in inflation and the delay in economic recovery, combined with easier monetary policy in the United States,

led to substantially lower interest rates (at least in nominal terms). In the Western economies, stocks were run down further until by the end of the year the level of stocks was if anything below normal. The developing countries were reducing their imports, while their overall debt position was benefiting from lower interest rates.

CHART 3.1

Major six countries' GDP, inflation and UK weighted world trade in manufactures

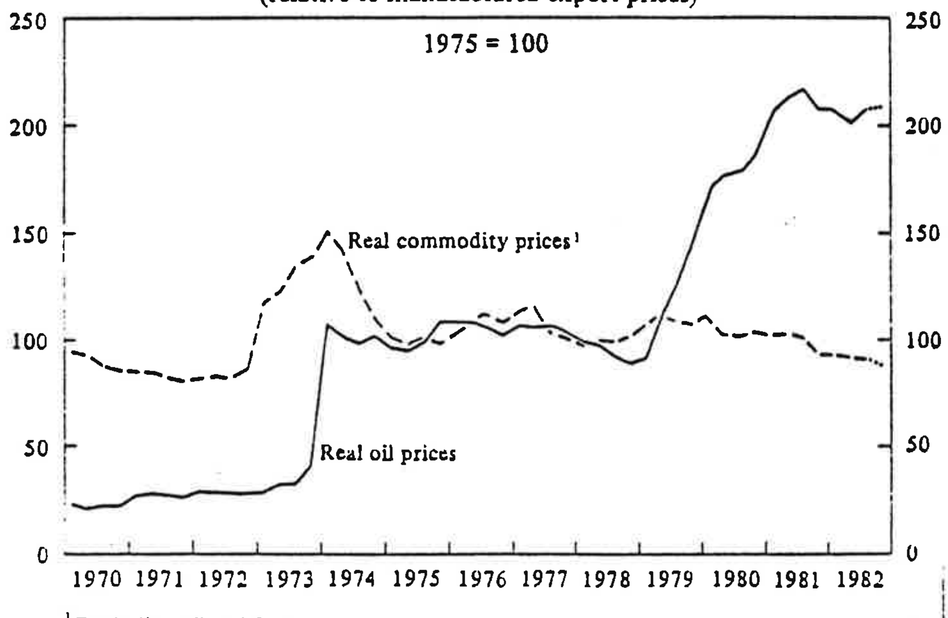


3.09 At the beginning of 1983, there is again a widespread expectation of a moderate recovery in activity, some evidence for which is provided by increases in industrial production and housing starts (in the US) and domestic industrial orders (in Germany). Both interest rates and inflation rates have come down sharply since early 1982 (Eurodollar rates for example fell from 15 per cent to under 9½ per cent), with fiscal and monetary conditions becoming less tight; partly as a result the stock rundown may now be largely over and final demand should rise further; and there is some prospect of an end to the decline in imports into developing countries although further reductions can be expected for oil producers.

CHART 3.2

World oil and non-oil commodity prices (relative to manufactured export prices)

NOTE! This chart to follow next paragraph overleaf.



[1] Excluding oil and food

3.10 In most of the economic cycles in the post-war years, the recovery of output has been followed by a rise in commodity prices. In the case of oil, prices are expected to be lower in 1983 not only because of the recession but also because of the lagged effects of earlier price rises. But other commodity prices are already at a low level in relation to world prices generally and rising demand from the industrialised countries will probably induce some increases by the first half of next year, allowing some recovery in the export earnings of developing countries. Indeed some commodities, particularly non-ferrous metals, may see a recovery in prices this year; there have already been scattered indications of this. The position up to the end of 1982 is set out in Chart 3.2.

Note! Take in Chart 3.2 (previous page)

Prospects

3.11 The forecast points to a rise in activity from the first half of 1983: this can be expected to result in only a small increase in output between the average levels of 1982 and 1983, but to a rather faster rate of growth by the first half of 1984. UK export markets should share in the recovery, though the fall in oil revenues will reduce the OPEC market in which the UK has a well above average share. The forecast is summarised in the table below:

Table 3.1

Per cent changes on a year earlier

	1975–80	1980	1981	1982	1983	1984 First half
GDP*	3½	1	1½	−½	1½	3½
Consumer prices*	8½	12	10	7	5	5½
Trade in manufactures (UK weighted)	6	4½	3	−3½	1	6

* Major 6: US, Germany, Japan, France, Italy, Canada.

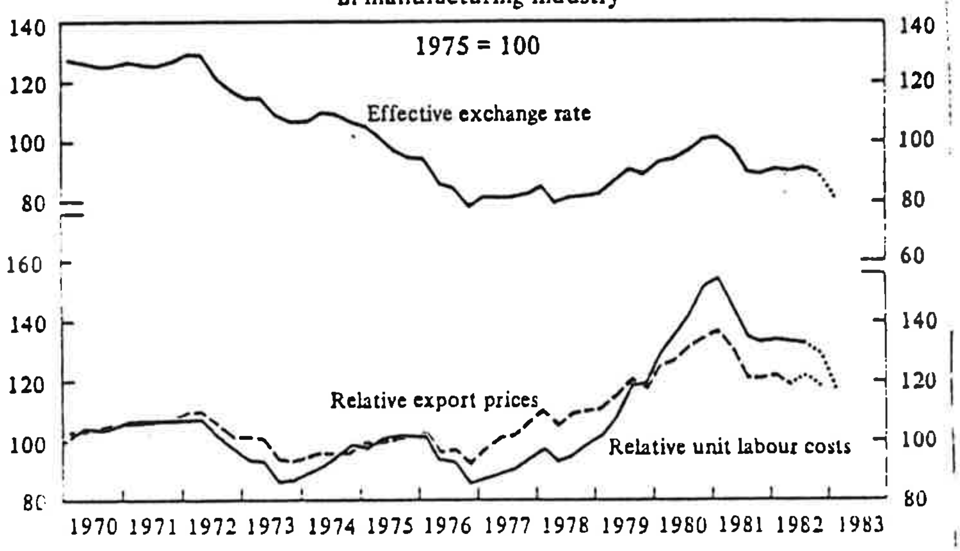
Exchange rate, trade, relative prices and costs

Sterling

3.12 The value of sterling, measured against a basket of other currencies, fell more than 10 per cent in late 1982 and early 1983, after a period of little change lasting over a year. The exchange rate will continue to be determined by market forces; for the purposes of this forecast, it is assumed that the effective exchange rate will remain around the level in February 1983. The prospect for inflation, which takes account of this assumption about the exchange rate, suggests that from now on there will be no substantial difference between inflation rates in the UK and in the average of our major competitors. On this basis, the level of cost competitiveness in the UK over the forecast period should be appreciably better than in 1980, 1981 or 1982. Chart 3.3 shows the position of UK costs and prices, relative to those of our competitors, up until early this year.

CHART 3.3

The exchange rate; relative prices and costs in manufacturing industry

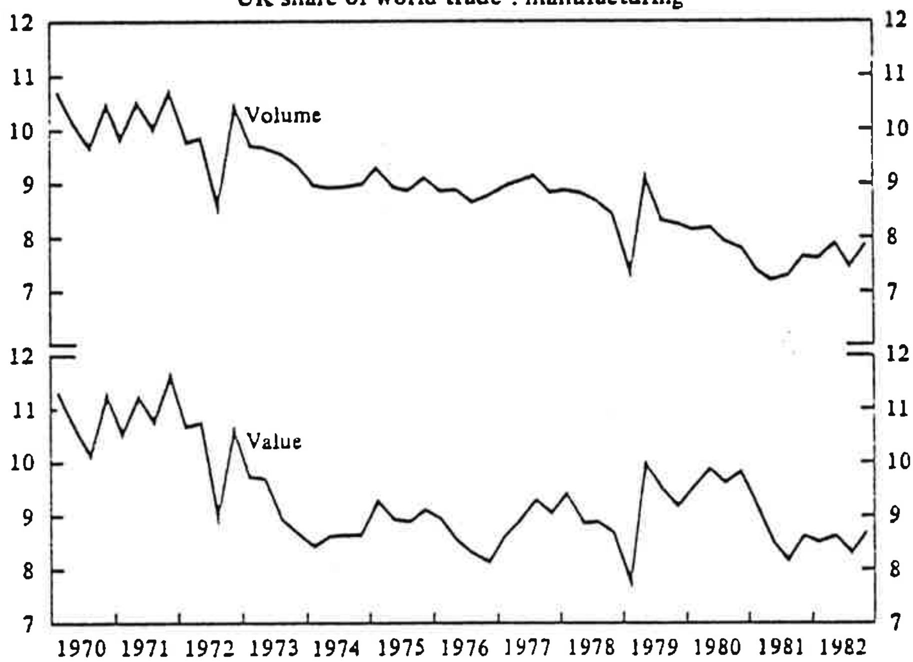


Tr... prices

3.13 The effect of the recent change in the value of sterling on price competitiveness is not yet clear. The fall in sterling in 1981, from the exceptional level at the beginning of that year, was reflected in a substantial improvement in relative export prices, as exporters took most of the benefits on prices rather than on profit margins; but in a rather small improvement in import price competitiveness as importers cut their margins to a greater extent than usual. By the end of 1982, profit margins on goods supplied to the UK seemed, on average, to be little higher than elsewhere and hence the scope for further reductions in importers' margins may be more limited than in 1981. With low inflation in most other industrialised countries a fall in oil prices and at least for a time no major recovery in other commodity prices, import prices (as measured by the average value index for total goods) by the second half of 1983 may be under 10 per cent higher than a year earlier.

3.14 In manufacturing, the UK has lost share by volume in most years, but value shares have been roughly constant in recent years:

CHART 3.4 UK share of world trade : manufacturing



Trade volumes

3.15 In 1982, when world trade in manufactures is estimated to have fallen over 3 per cent, there was a small rise in manufactured exports. This represented a significantly better performance than the substantial loss of share between 1977 and 1981. In the domestic market, there has been a fall in the share of domestic producers except at times of heavy de-stocking in late 1980 and early 1981, and again in the second half of 1982.

3.16 For the first half of 1983, most of the short-term indicators, including engineering orders and the replies to the CBI's questions on orders, as well as the January Trade figures suggest that the level of exports may well be little changed from the second half of 1982. As world recovery gets under way, and as the gains in cost competitiveness begin to be felt, then export growth should pick up, as the improvements in export optimism in the CBI survey also suggest. By the first half of 1984 exports of goods and services could be 5 per cent higher than a year earlier in volume terms.

3.17 The volume of imports levelled off in the course of 1982, despite the rise in final domestic demand, particularly personal consumption. That suggests and the latest figufes confirm a stock rundown in the second half of 1982. As that comes to an end an increase in imports can be expected.

Balance of payments

3.18 The current account of the balance of payments was again in large surplus in 1982, some £4 billion on provisional estimates. The high surplus in the second half of the year was partly a result of an exceptionally large surplus on oil.

3.19 With growth of demand in the UK forecast to be a little more than in other countries, and perhaps some worsening in the terms of trade there seems likely to be a further increase in the deficit on non-oil trade. But this may be partly offset by a growing surplus in invisibles—reflecting rising world activity and profitability, as well as the rising stock of overseas assets. The recent depreciation of sterling may not have much net impact on the current account in 1983 but should make for a higher surplus by 1984. In total, the current account is forecast to be in surplus of some £1½ billion in 1983.

Inflation

3.20 The reduction in inflation in the UK over the past year has been greater than in most other industrialised economies so that by early 1983 the UK inflation rate was well below the European average, though still rather above that of the United States, Germany and Japan.

Retail prices

3.21 In January 1983 the Retail Prices Index in the UK was only 5 per cent higher than a year earlier. The corresponding figure for January 1982 was 12 per cent. Over this period, the 1 per cent fall in the housing component of the index resulted from the 5 point cut in mortgage rates over this period; and there were falls in the prices of fresh vegetables and other seasonal items. Other indices, for example, wholesale prices and the GDP deflator (a price index for the whole of national output), also indicate a substantial fall in inflation though less marked. This is partly because of the greater weight in the RPI of housing costs and of seasonal foods. The index of wholesale output prices, on a definition excluding food, drink, tobacco and oil products (the latter omitted because extensive discounting has been causing bias in the list prices quoted in the index), was 7½ per cent higher than a year earlier in January 1982; by January 1983 the index was no more than 5½ per cent up on a year earlier.

Costs

3.22 1982 was a year in which inflation fell sharply but not at the expense of profit margins where in the non-oil sector there was some recovery from the low point in the second half of 1981. Figures for 1982 are not yet complete, but whole economy costs changed as follows:

Table 3.2

	Per cent changes on a year earlier	
	1981 Q3	1982 Q3
Labour costs per unit of output	8	3½
of which earnings	10½	8½
less productivity	−4	−4
plus other labour costs including NIS	1	−1
Import prices (goods and services)	9	3½
Expenditure prices (the deflator for total final expenditure)	10½	6
GDP deflator	11½	6½

3.23 The table shows that the rise in labour costs slowed down considerably in 1982, helped by the slower rate of earnings growth and the cut in the National Insurance Surcharge. Costs rose less than prices.

3.24 Settlements in the current pay round (since last autumn) have been running 1–2 per cent lower than in the previous round. The falling trend in wage settlements is reflected, with a lag, in the average earnings index: in December 1982, its year on year change was down to 8 per cent, from 11 per cent in the fourth quarter of 1981.

Real wages

3.25 In 1982 the rate of price inflation came down faster than the growth of earnings. In consequence real after-tax take-home pay, as it affected the average employee, began to rise from about the middle of 1982. But employers take account in addition of the selling prices of their goods and services, of productivity gains, and of taxes on employment. Continuing productivity gains in 1982, together with reductions in the National Insurance Surcharge, contributed to a fall in the average real wage, per unit of output, paid by employers.

CHART 3.5

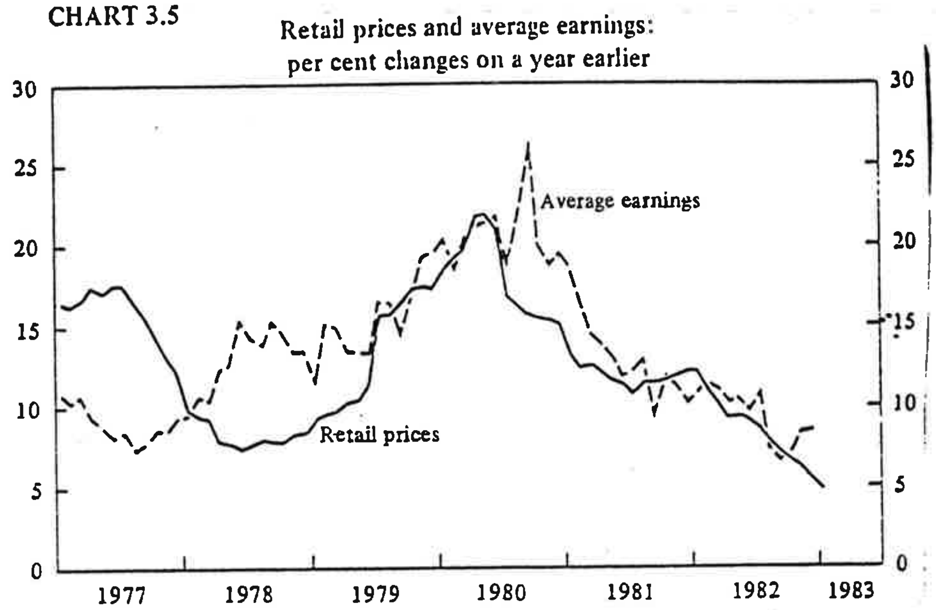


CHART 3.6

3.26 Thus by the end of 1982, the real wage received by employees was rising; the real wage paid by employers was edging down and was near the 1979 level. But over the period 1979–82, taken as a whole, both wages and prices rose faster in the UK than in other countries, on average, and this is reflected in measures of price and cost competitiveness.

Prospects

3.27 The fall in the exchange rate since October 1982 is already making for higher import prices. While the extent to which this will affect other prices and costs is very uncertain, it is likely that on average import prices will rise somewhat faster than domestic costs or prices.

3.28 Profit margins in the UK have begun to recover, from a low level, but moderate wage settlements and the limited extent of recovery forecast for the world economy will continue to restrain prices. The general rate of inflation, as measured by the rise in the GDP deflator, is forecast to be about 5½ per cent in 1983, rather below the rate last summer. Price indices which include a substantial direct import component are liable to show a slightly bigger increase for a time. The prices charged by the nationalised industries are expected to rise more slowly than the average of other prices, following a period of above average increases.

3.29 By the fourth quarter of 1983 the inflation rate as measured by the RPI may be about 6 per cent, much the same as in the fourth quarter of 1982. Noticeably lower figures will continue to be experienced for much of this year because of the factors referred to in paragraph 3.21. By mid 1984, the world and UK recoveries should be well under way, with perhaps more pressure on commodity prices and firms better placed to improve profit margins; but on the other hand there should be benefits from a greater stability of the exchange rate. The RPI by mid 1984 could be rising at an annual rate of 6 per cent—close to the assumed rise in the GDP deflator of 5½ per cent in financial year 1984–85 (see paragraph 2.18). Although a wide margin of error surrounds these forecasts, the rate of inflation over the forecast period should be below the rates seen at any time since the early 1970s. This change reflects in large part the influence of the monetary and fiscal policies pursued in recent years.

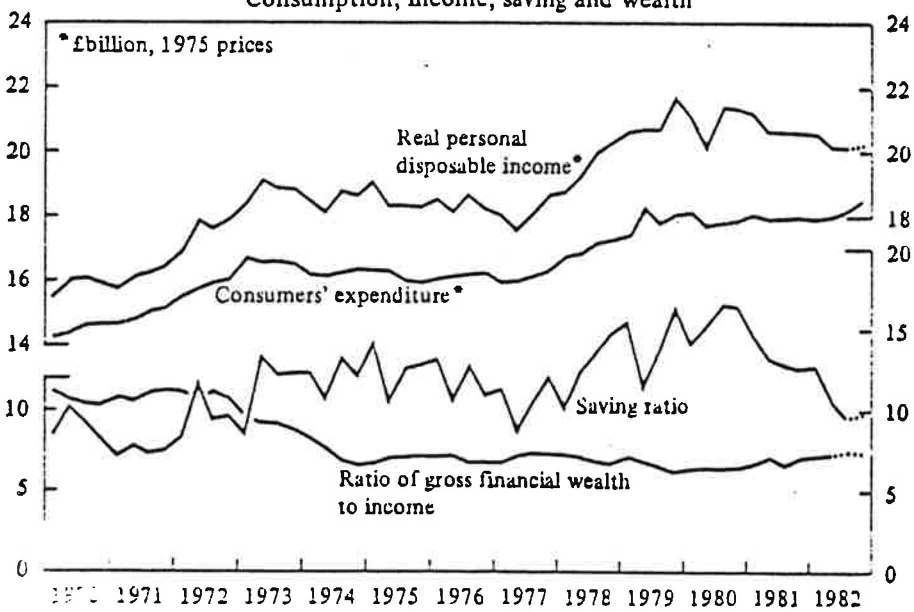
Demand and activity

Personal spending

3.30 After little change for about three years, personal spending rose sharply in the second half of 1982. Expenditure on durables in particular rose rapidly reflecting mainly the beginning of an upturn in real take-home pay, lower interest rates, the abolition of HP controls in July and continued easy availability of bank credit. In addition, low purchases of durables during the previous two years had left stocks of durables held by consumers rather depleted.

3.31 The fall in real personal disposable incomes—estimated at about 4 per cent between 1980 and 1982—was more than offset by a fall in the saving ratio. This went beyond the usual tendency for savings to act as a cushion for fluctuations in incomes and helps to confirm that the need for saving was becoming less as the rate of inflation and interest rates moved down substantially. The chart also shows how the personal sector has been able to begin to rebuild its financial asset holdings: the ratio of gross financial wealth to income has risen since 1980, with capital gains, reflecting lower nominal interest rates, and high borrowing more than offsetting the fall in the flow of saving.

CHART 3.7 Consumption, income, saving and wealth



3.32 By the end of 1982, the real earnings of those in work were rising again; and in 1983 the real value of personal disposable income, taking account of the tax changes proposed in the budget, is forecast to rise about 2 per cent. The saving ratio having already fallen sharply in the course of 1982 may remain a little below the 1982 average and consumer spending could rise 2½ per cent in 1983.

Stocks

3.33 With the rise in consumer spending in the second half of 1982 manufacturers and distributors ran down their stocks, and by the end of 1982 the ratio of stocks to sales had fallen by comparison with a year earlier. Over the forecast

period, it seems likely that distributors will want to rebuild their stocks of consumer goods. Manufacturers' stocks, however, could still be above desired levels, judging by the results of the recent CBI surveys; and with only limited prospects of recovery in their output, the level of stocks in this sector could fall further for a time. In aggregate, the destocking in 1982, now put at about £¾ billion at 1975 prices, could be followed by a small rise in stock levels in 1983.

Investment

3.34 Fixed investment in total in 1982 is estimated to have been 3½ per cent higher by volume than the previous year. In the private sector investment in new dwellings rose about 8 per cent, in response to the readily available supply of mortgage finance and successive reductions in interest rates. In the distributive and service sectors of the economy investment (excluding leased assets) rose 7 per cent. Prospects for demand and profitability have been stronger here than in the manufacturing sector, where investment (including leased assets) fell a further 8 per cent. In the public sector, there were increases in the volume of fixed investment by central government and the nationalised industries. Investment by local authorities, excluding council house sales (which count as negative investment), was little changed.

3.35 The surveys carried out by the Department of Industry and by the CBI are consistent with a further rise in industrial investment in total, in 1983; within the total the fall in manufacturing investment may come to an end in the course of the year. Taking investment and consumption together, the volume of expenditure by the public sector on goods and services is forecast to rise slowly, consistently with the proportion of total public expenditure in the economy falling slowly.

Demand and Activity

3.36 In total, domestic demand is expected to rise further in 1983 and the first half of 1984. The prospect of world recovery and the effects of recent gains in competitiveness point to a strong rise in UK exports by the first half of 1984:

Table 3.3

	Per cent changes on a year earlier		
	1982	1983	1984 First half
Domestic demand	2½	3½	3
Exports of goods and services	½	1	5

The absence of any further rundown in stocks and the faster growth of total demand points to further rises in imports, together with a growth of domestic output:

Table 3.4

	Per cent changes on a year earlier		
	1982	1983	1984 First half
Imports of goods and services	5	5	5
Domestic production: total GDP	½	2	2½

3.37 The share of manufacturing industry in total output has been falling since the early 1970s, and particularly strongly since 1979. Official forecasts of manufacturing output have generally proved over-optimistic, to a considerable extent because the demand for manufactures in total was overstated. The forecast of manufacturing output in 1983 takes account of recent survey information. By the first half of 1984, output in the manufacturing sector could be rising at much the same rate as in the rest of the economy.

Table 3.5

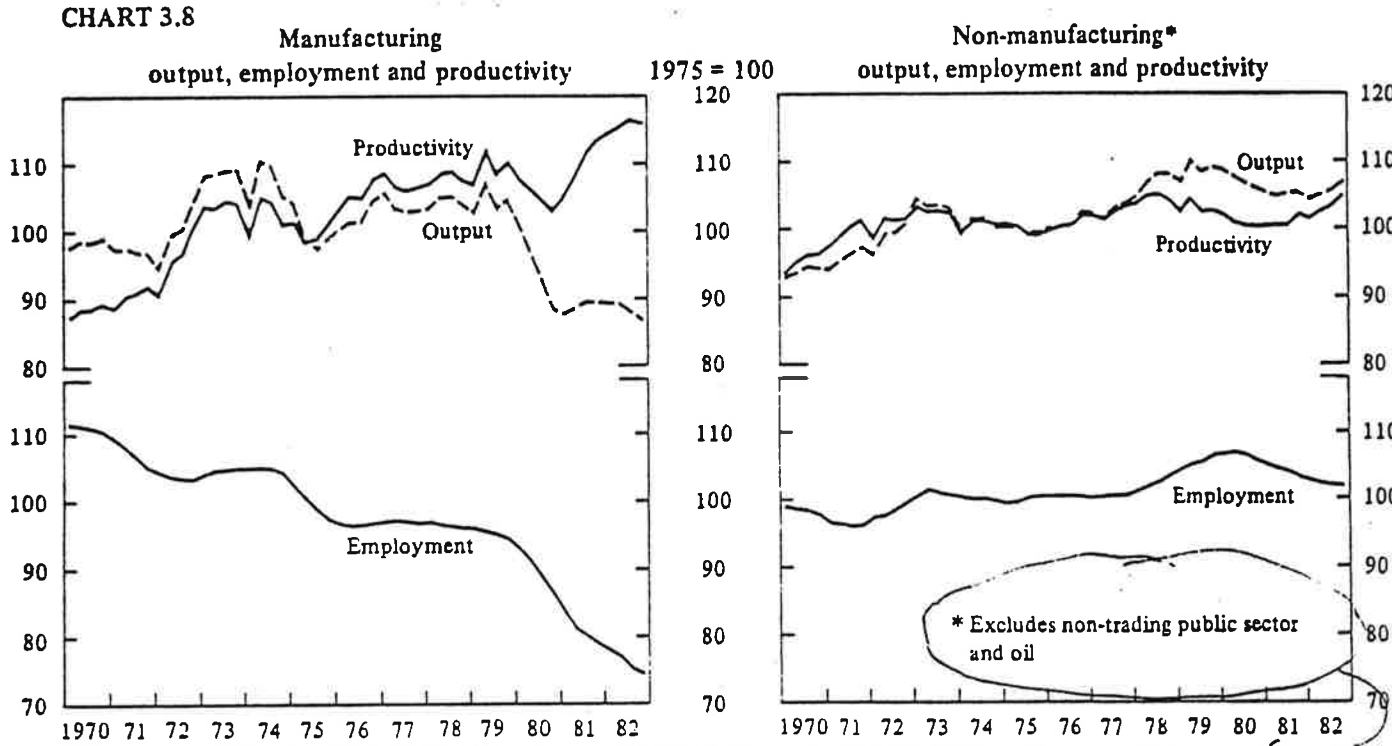
1975=100	1982 I	1982 II	1983 I	1983 II	1984 I
Gross domestic product	106	106½	107½	109	110
Manufacturing output	89½	87½	88	89	90

SECOND PROOF—F.S.

Employment, productivity and profitability

ployment 3.38 Total employment fell by some 1¾ million between 1979 and 1982, with a fall of nearly 1½ million in manufacturing, where the problems of profitability and competitiveness have been greatest. The further fall of employment in 1982 was accompanied by a rise in unemployment from 10.7 per cent in 1981 to 12.5 per cent in 1982, a slower rise than in the previous year. In manufacturing, there is convincing evidence of an above average gain in productivity since 1980, though the extent of the fall in output makes the precise size of this gain difficult to assess. Outside manufacturing, the revised employment data up to mid 1981, and the less reliable indications available for 1982, do not suggest any marked improvement in productivity growth since 1979. Chart 3.8 shows the main features:

CHART 3.8



oductivity 3.39 In 1982 there was evidence that the period of exceptionally rapid productivity gains in manufacturing was giving way, as had been expected, to more moderate gains. Growth of total output in the range 2–2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment.

ofitability 3.40 Company profitability reached a low point in 1981: DOI estimates, based on necessarily very uncertain assumptions about obsolescence of capital and about tax, suggest that for industrial and commercial companies outside the North Sea the average real rate of return was about 3 per cent, compared to about 10 per cent a decade ago. Preliminary estimates for 1982 point to some recovery; and the forecast for inflation is consistent with some further increase in profitability in 1983. This, in turn, should help to ensure that a good part of the rise in demand is met from domestic supply.

Forecast and outturn

ain Elements 3.41 The table below compares the main elements of the forecast published in the 1982 FSBR with outturns or latest estimates.

Table 3.[illegible]

	Forecast	Outturn Estimate
Total output, per cent change between 1981 and 1982	1½	½
Retail Prices Index: per cent increase between the fourth quarters of 1981 and 1982	9	6
Current account of the balance of payments in 1982, £ billion	4	4
PSBR, 1982–83, £ billion	9½	7½

utput and Trade 3.42 GDP increased rather less than forecast in 1982. World demand and trade were substantially less than forecast, accounting for more than all the difference of 3½ 3 per cent on exports of goods and services: consumer demand (helped by lower

prices) was a little higher than expected. But much of this was met out of stocks and with manufacturers keen to get stock levels down further there was another substantial fall in stocks in 1982. Much of this was reflected in lower imports. The current account surplus in 1982 turned out very close to the Budget estimate: both exports and imports were lower than forecast.

ices

3.43 Retail prices in the fourth quarter of 1982 were nearly 3 per cent lower than forecast. Major contributing factors were the much lower increases than expected in housing costs (including the mortgage rate) and in seasonal foods. The general level of prices, as measured by the GDP deflator, was subject to a smaller margin of error: the GDP deflator in 1982–83 is estimated to have been 7 per cent higher than a year earlier, compared with a figure of 7½ per cent expected at the time of the 1982 Budget.

SBR

3.44 The latest estimate for the PSBR in 1982–83, still subject to considerable uncertainty, is nearly £2 billion less than the forecast made in March 1982—rather more when allowance is made for the policy changes announced in November. Details will be found in Part 5.

Risks and uncertainties

3.45 No forecast is complete without some indication of error margins. Table 3.7 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide the best indication of possible errors in the current forecasts: while the size of errors will change over time as the economy fluctuates more or less, and as forecasting techniques change, in most cases the averages have not shifted very much since they were first published in 1976.

3.46 The forecasts of those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR approach £200 billion; and for the current account of the balance of payments approach £100 billion. For the RPI, average errors are derived from a period of high inflation, averaging 14 per cent and subject to large fluctuations.

The Prospects

mmary Table

Table 3.7 Short-term Economic Prospects

	Forecasts	Average errors from past forecasts*
A. *Output and expenditure at constant 1975 prices*		
Per cent changes between 1982 and 1983:		
Gross domestic product (at factor cost)	2	1
Consumers' expenditure	2½	1
General Government consumption	½	1½
Fixed investment	3½	2½
Exports of goods and services	1	2½
Imports of goods and services	5	2½
Change in stockbuilding (as per cent of level of GDP)	1	¾
B. *Balance of Payments on current account*		
£ billion:		
1982	4	—
1983	1½	2
1984 1st half (at an annual rate)	2	3½
C. *Public Sector Borrowing Requirement*		
£ billion; in brackets per cent of GDP at market prices:		
Financial year 1982–83	7½ (2¾)	—
Financial year 1983–84	8 (2¾)	4 (1½)
D. *Retail Prices Index*		
Per cent change:		
Fourth quarter 1982 to fourth quarter 1983	6	2
Second quarter 1983 to second quarter 1984	6	4

* The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables are derived from internal forecasts made during the period June 1965 to October 1980. For the current balance and the retail prices index, forecasts made between June 1970 and October 1980 are used. For the PSBR, Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

Table 3.8 Constant price forecasts of expenditure, imports and gross domestic product*

£ million at 1975 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less Imports of goods and services	Less Adjustment to factor cost	Plus Statistical adjustment	Gross domestic product at factor cost	GDP index 1975=100
1980	71 550	24 300	20 450	33 050	−1 550	147 800	34 100	12 200	200	101 700	108·0
1981	71 850	24 300	18 600	32 300	−1 850	145 200	33 900	12 100	0	99 200	105·4
1982	72 750	24 550	19 250	32 500	−700	148 350	35 550	12 350	−550	99 900	106·1
1983	74 650	24 700	19 950	32 800	300	152 400	37 400	12 650	−500	101 850	108·2
1981 H1	35 950	12 100	9 300	15 900	−1 400	71 850	15 950	6 100	−200	49 600	105·3
H2	35 900	12 200	9 300	16 400	−450	73 350	17 950	6 000	200	49 600	105·4
1982 H1	35 950	12 250	9 500	16 400	−50	74 050	18 050	6 050	−150	49 800	105·8
H2	36 800	12 300	9 750	16 100	−650	74 300	17 500	6 300	−400	50 100	106·4
1983 H1	37 100	12 300	9 990	16 200	0	75 500	18 450	6 300	−250	50 500	107·3
H2	37 550	12 400	10 050	16 600	300	76 900	18 950	6 350	−250	51 350	109·1
1984 H1	38 000	12 450	10 250	17 000	250	77 950	19 400	6 450	−250	51 850	110·2
% changes:											
1981 to 1982	1	1	3½	½		2	5	2		½	
1982 to 1983	2½	½	3½	1		2½	5	2½		2	
1983 H1 to 1984 H1	2½	1	3½	5		3	5	2		2½	

*GDP figures in the table are based on "compromise" estimates of gross domestic product. Figures in £ million are rounded to £50 million. Percentage changes are calculated from unrounded levels and then rounded to half per cent. The GDP index in the final column is calculated from unrounded numbers.

4. The Budget proposals in detail

4.01 The Budget proposals are described in detail in this part. The description of the Inland Revenue proposals is followed by those for Customs and Excise, Vehicle Excise Duty and the National Insurance Surcharge and by the expenditure measures in the Budget. The direct effects of changes in taxation are shown in Table 4.2 at the end of this part.

Inland Revenue

Income Tax

4.02 It is proposed—

to increase the single person's allowance and the wife's maximum earned income relief from £1,565 to £1,785 and the married allowance from £2,445 to £2,795.

to increase the additional personal allowance and widows' bereavement allowance from £880 to £1,010.

to increase the age allowance for the single person from £2,070 to £2,360, for the married from £3,295 to £3,755 and the age allowance income limit from £6,700 to £7,600.

to increase the basic rate limit to £14,600.

to increase the width of the 40 per cent band to £2,600, of the 45 per cent band to £4,600 and of the 50 per cent and 55 per cent bands to £7,100.

As a consequence of these changes, the structure of personal tax rates in operation in 1983–84 will be:—

Bands of Taxable Income £	Per cent
0 — 14 600	30
14 601 — 17 200	40
17 201 — 21 800	45
21 801 — 28 900	50
28 901 — 36 000	55
over 36 000	60

4.03 It is proposed—

to raise the threshold for the investment income surcharge for 1983–84 from £6,250 to £7,100.

to extend the widows' bereavement allowance to cover the year after the husband's death.

to increase with effect from 1984–85 the scales which determine the cash equivalents of car and car fuel benefits of directors and higher-paid employees.

[to alter the law in relation to benefits in kind of directors and employees from scholarships, loans, PAYE tax payments, and, from 1984–85, provided accommodation.]

to increase the limit on loans qualifying for mortgage interest relief from £25,000 to £30,000.

to extend mortgage interest relief to interest paid on certain loans for the purchase of a house by a borrower who is under a contractual obligation to live in other accommodation.

to extend the "Business Start-up Scheme" to investment in a wider range of companies and to make other changes ("Business Expansion Scheme").

to increase the maximum annual value for appropriations of shares to an employee under an approved profit-sharing scheme by adding to the present limit of £1,250 an alternative limit of 10 per cent of the employee's salary subject to a maximum of £5,000.

to raise from £50 to £75 the upper limit on monthly contributions by an employee under an approved savings-related share option scheme.

to extend from three to five years the period over which the income tax payable on the exercise of a share option by a director or employee may be paid by instalments.

to extend relief for interest paid on money borrowed to buy shares in an employee-controlled company as part of an employee buy-out.

to increase the limit on tax relief allowed to individuals for covenants in favour of charities at the higher and additional rates.

to make gains on certain "secondhand bonds" liable to income tax.

to increase to £1,000 the limit for not assessing income tax on an individual under the close companies' apportionment provisions.

Income tax and corporation tax

4.04 It is proposed—

to extend, until 31 March 1987, the 100 per cent first year allowance for expenditure on British films.

to extend, for one year, the 100 per cent first year allowance for expenditure on rented teletext sets.

to increase from 10 per cent to 25 per cent, for the industrial building allowance, the permissible cost relating to non-industrial purposes.

to allow expenditure on the conversion of existing premises to small industrial workshops to qualify for the 100 per cent allowance where the average size of all the converted units is within the prescribed limit.

to extend stock relief to houses taken in part exchange by housebuilders in certain circumstances.

[to allow payment of interest on Eurobonds in certain circumstances without deduction of tax.]

Income tax, corporation tax and capital gains tax

4.05 It is proposed to provide new rules for the tax treatment of stock issued by companies at a discount.

Corporation tax

4.06 It is proposed—

for the financial year 1982 to fix the "small companies" rate of corporation tax at 38 per cent (previously 40 per cent), to increase the limit for that rate from £90,000 to £100,000 and to increase the limit for marginal relief from £225,000 to £500,000.

[to extend from two to six years the period for which "surplus" advance corporation tax may be carried back and set against corporation tax].

[to allow credit for foreign tax paid against corporation tax before it is reduced by advance corporation tax.]

to enable Trustees Savings Banks to be treated for tax purposes as bodies corporate.

[to enable a charge to corporation tax to be imposed with effect from 6 April 1984 on United Kingdom resident companies which have an interest of 10 per cent or more in certain United Kingdom controlled companies resident in low tax territories, the charge being proportionate to their interest.]

to extend relief to companies for discount on bills of exchange accepted by banks carrying on business in the United Kingdom, and for the incidental costs of raising such finance.

to extend the relief for the incidental costs of obtaining loan finance.

to allow relief for the costs of employees seconded to charities.

to make provision with effect from [15 March 1983] against the avoidance of tax through group and consortium relief.

to introduce, for certain securities, an alternative method for calculating the indexation allowance applying to capital gains.

Oil taxation

4.07 It is proposed—

to reduce the rate of advance petroleum revenue tax from 20 per cent to 15 per cent from 1 July 1983; to 10 per cent from 1 January 1985; to 5 per cent from 1 January 1986; and to abolish it from 1 January 1987.

to allow relief against petroleum revenue tax (PRT) on any field for expenditure incurred after 15 March 1983 in searching for oil and appraising discovered reserves anywhere in the United Kingdom, and the United Kingdom Continental Shelf.

to increase the PRT oil allowance to 500,000 tonnes of oil per chargeable period subject to a cumulative limit of 10 million tonnes per field for offshore fields outside the Southern basin where development consent is given after 1 April 1982. (In addition the Secretary of State for Energy proposes to waive royalties for such fields.)

to revise the PRT rules for relief for expenditure on shared assets and to charge related receipts.

to exclude from charge oil won which the participator uses for production purposes in another field.

to correct certain technical defects in the PRT provisions.

Capital gains tax

4.08 It is proposed—

to increase the annual exempt amounts in line with the increase in the retail prices index so that for 1983–84 an individual will be exempt on the first £5,300, and most trusts on the first £2,650, of capital gains.

to increase the limit on reliefs affecting the transfer of a business on retirement.

to increase the limit on reliefs relating to the letting of residential accommodation and small part disposals of land.

to extend the private residence relief to gains arising to a person required by the terms of his trade or profession to live in other accommodation.

to abolish the small gifts exemption and the payment by instalment facilities.

to amend the rules relating to the value at which assets are deemed to be acquired from certain non-resident trusts.

Development land tax

4.09 It is proposed—

to defer the charge on a deemed disposal which is started before 1 April 1986 (instead of 1 April 1984 as at present) and is for the owner's use, and to extinguish *any* deferred liability which has not become chargeable within 12 years of the start of development.

[to improve the machinery for deducting tax from consideration when there is a disposal by a non-resident.]

to extend the period over which tax on deemed disposals can be paid by instalments from 8 to 10 years and remove the facility to pay by half-yearly instalments.

Capital transfer tax

4.10 It is proposed to introduce new rate schedules for both death and lifetime transfers as follows:

Band of chargeable value £'000	Rate on death per cent	Lifetime rate per cent
0 – 60	Nil	Nil
60 – 80	30	15
80 – 110	35	17½
110 – 140	40	20
140 – 175	45	22½
175 – 220	50	25
220 – 270	55	30
270 – 700	60	35
700 – 1 325	65	40
1 325 – 2 650	70	45
over 2 650	75	50

4.11 It is proposed—

to increase the rate of relief for transfers of minority holdings in unquoted companies from 20 per cent to 30 per cent.

to increase the rate of relief for transfers of tenanted agricultural land from 20 per cent to 30 per cent.

to extend the period over which tax may be paid by instalments from 8 to 10 years and remove the facility to pay by half-yearly instalments.

to remove the ceiling of £250,000 on the total value of transfers within one year of death to charities which is exempt.

to remove the special rule under which persons becoming domiciled in the Channel Islands or the Isle of Man may be regarded as remaining domiciled in the United Kingdom for tax purposes.

to clarify the rules about the incidence of tax on death when the Will contains no directions.

to amend the provisions relating to settled property.

Customs and Excise

Value added tax

4.12 It is proposed to increase the registration and deregistration limits by Order made under Section 13(3) of the Finance Act 1982. From 16 March 1983 the registration limits will become £18,000 per annum and £6,000 per quarter. From 1 June 1983 the deregistration limits will become £17,000 per annum where estimated future turnover is concerned, and £18,000 per annum where past turnover is concerned.

Alcoholic drinks

4.13 It is proposed, from midnight 15–16 March 1983, to increase:

—the rates of duty on spirits from £14·47 to £15·19 per litre of alcohol;

—the rate of duty on beer from £20·40 to £21·60 per hectolitre and the charge for each additional degree of original gravity above 1030° per hectolitre from £0·68 to £0·72;

—the rates of duty on wine by the following amounts per hectolitre:

Wine of an alcoholic strength:

not exceeding 15 per cent: from £106·80 to £113·00;

exceeding 15 per cent but not exceeding 18 per cent: from £137·90 to £145·90;

exceeding 18 per cent but not exceeding 22 per cent: £162·30 to £171·70;

exceeding 22 per cent: £171·70 plus £15·19 (instead of £14·47) for every 1 per cent, or part of 1 per cent, in excess of 22 per cent;

surcharge on sparkling wine: from £23·45 to £24·80;

—the rates of duty on made-wine by the following amounts per hectolitre:

Made-wine of an alcoholic strength:

not exceeding 10 per cent: from £73·10 to £79·30;

exceeding 10 per cent but not exceeding 15 per cent: from £103·80 to £109·80;

exceeding 15 per cent but not exceeding 18 per cent: from £127·80 to £135·20;

exceeding 18 per cent: £135·20 plus £15·19 (instead of £14·47) for every 1 per cent, or part of 1 per cent, in excess of 18 per cent;

surcharge on sparkling made-wine: from £10·75 to £11·35;

—the rate of duty on cider and perry from £8·16 to £9·69 per hectolitre.

Hydrocarbon oil

4.14 It is proposed from 6 pm on 15 March 1983, to increase:

—the rate of duty on light hydrocarbon oil from 15·54p to 16·30p per litre;

—the rate of duty on heavy hydrocarbon oil for use as road fuel from 13·25p to 13·82p per litre.

The duty on petrol substitutes and spirits used for making power methylated spirits is charged at the same rate as on light hydrocarbon oil, and aviation gasoline and gas for use as road fuel are charged at half the rate on light hydrocarbon oil.

Tobacco

4.15 It is proposed, from midnight 17–18 March 1983, to increase:

—the specific element in the duty on cigarettes from £20·68 to £21·67 per 1,000 cigarettes (the *ad valorem* element remaining unchanged);

—the duty on cigars from £39·00 to £40·85 per kilogram;

—the duty on hand-rolling tobacco from £33·65 to £35·40 per kilogram.

Table 4.1 Approximate direct effects of changes in Duty Rates on certain product prices

(All except VED inclusive of 15 per cent VAT)

Spirits duty	25p on a bottle of spirits
Beer duty	1p on a pint of beer of average strength
Wine duty	5p on a bottle of table wine
Fortified wine duty	7p on a bottle of sherry
Petrol duty	4p on a gallon of petrol
Derv duty	3p on a gallon of derv
Tobacco duty	3p on a packet of 20 cigarettes
Vehicle excise duty	£5 on a car licence

Vehicle Excise Duty

4.16 It is proposed to increase the excise duty on mechanically-propelled vehicles, other than goods vehicles, chargeable under Section 1 of the Vehicles (Excise) Act 1971 and under Section 1 of the Vehicles (Excise) Act (Northern Ireland) 1972 by about 6 per cent. This figure is broadly descriptive. There will be some variations within particular vehicle categories.

4.17 The duty on most cars and light commercial vehicles will rise by £5 to £85. The rates of duty on heavy goods vehicles at the lower end of the duty scales will be reduced by up to 12 per cent but on the most damaging heavy goods vehicles duty will be increased by up to 26 per cent. [The duty on a 32½ tonne lorry will rise by £470 to £2,290 and the duty on a 38 tonne lorry will be set at £2,940.] These changes have effect in relation to licences taken out after 15 March.

National Insurance Surcharge

4.18 It is proposed to reduce by ½ percentage point to 1 per cent the surcharge paid in respect of employees by secondary Class 1 contributors under the provisions of the National Insurance Surcharge Act 1976. This reduction will take effect from 1 August 1983. Expenditure programmes (excluding local authorities) will be reduced accordingly (see Table 5·5).

Expenditure Measures

Industrial innovation

4.19 New measures to encourage industrial investment and promote industrial innovation, including the revival of the Small Engineering Firms Investment Scheme, will involve additional expenditure of £185 million over the next three years. The cost is £39 million in 1983–84.

Housing improvement

4.20 Local authorities will be given additional capital spending allocations for use in 1983–84 on the improvement of run-down private sector housing through approved "enveloping" schemes. In addition, eligible expenses limits for improvement grants are to be increased by 15 per cent and local authorities will be permitted to increase expenditure on these grants as necessary.

Employment

4.21 A new part-time Job Release Scheme will be introduced, the gross cost of which will be fully offset by lower benefit payments in 1983–84. Over the two following years, net additional expenditure will be around £16 million. The Enterprise Allowance will be extended with a net expenditure cost of some £27 million over the next two years. The net cost in 1983–84 is £17 million.

Social Security

Men over 60 on Supplementary Benefit will qualify for the long-term rate immediately, no longer having to wait a year. In addition, unemployed men over 60 will not need to register for work to protect their entitlement to basic pension. These measures cost £23 million in 1983-84. It is also proposed to change the basis for calculating the uprating of benefits.

4.22 The 5 per cent abatement of unemployment benefit will be restored and a ~~number of new measures introduced to help the sick, the disabled and the less well off.~~ The net cost is £26 million in 1983–84.

Child benefit

4.23 Child benefit will be increased to £6.50 and One Parent Benefit to £4.05, both from November 1983. The cost is £74 million in 1983–84 over and above what is already provided for.

4.24 The gross cost of these measures, over and above what is already provided for on programmes, totals £25 million and will be charged to the Contingency Reserve.

Inland Revenue(*b*)

Table 4.2 Direct effects (a) of changes in taxation

£ million

	Forecast for 1983–84	Forecast for a full year
INLAND REVENUE		
Income Tax		
Increase in single allowance by £220 and married allowance by £350	−1 630 (*b*)	−1 995 (*b*)
Increase in additional personal allowance and widows' bereavement allowance by £130	−10 (*b*)	−10 (*b*)
Increase in age allowance by £290 (single) and by £460 (married) and in income limit by £900	−210 (*b*)	−260 (*b*)
Increase in basic rate limit by £1 800 to £14 600	−90 (*b*)	−140 (*b*)
Increase in further higher rate thresholds	−60 (*b*)	−115 (*b*)
Increase in investment income surcharge threshold	Negligible (*b*)	−25 (*b*)
Extension of widows' bereavement allowance	−25	−30
Fringe benefits—increases in car and car fuel scales for 1984–85	Nil	+35 (c)
[Fringe benefits—changes in relation to scholarships, loans, PAYE tax payments and (from 1984–85) to provided accommodation]	Nil	+10
Increase in mortgage interest relief limit	−50	−60
Extension of mortgage interest relief to certain borrowers	−2	−5
Extending the " Business Start-up Scheme "	−25(d)	−75 (*d*)
Increases in employee shareholding reliefs	−20	−35 (*d*)
Interest relief for borrowing to buy shares in employee-controlled companies	−1	−2
Change in relief on covenanted gifts to charities	Negligible	−3
Secondhand bonds	Negligible	Negligible
Limit for assessments of apportioned income	Negligible	Negligible
Income tax and Corporation tax		
Extension of capital allowances on British films	Nil	−30 (*e*)
Extension of capital allowances on teletext sets	Nil	−10 (*f*)
Industrial buildings allowance: increase in non-industrial space	Nil	−25 (*g*)
Conversions to small industrial workshops	Negligible	Negligible
Extension of stock relief for housebuilders	Negligible	−5
[Payment of Eurobond interest without deduction of tax]	Negligible	[−2]
Income tax, corporation tax and capital gains tax		
[Provisions relating to stock issued at a discount]	Negligible	[−15](*d*)(*h*)
Corporation tax		
Reduction in " small companies " rate and increase in limits	−40	−70
[Extension of carry back period for advance corporation tax]	Nil	
[Change in arrangements for setting off advance corporation tax and double taxation relief]	Nil	(*i*)
Treatment of TSBs as bodies corporate	−3	−10
[Charge to tax in respect of controlled foreign companies]	Nil	(*j*)
Relief for discounts etc. on bills of exchange	Negligible	−1
Incidental costs of obtaining loan finance	Negligible	Negligible
Employees seconded to charities	Negligible	Negligible
Provision against avoidance through group etc. relief	Negligible	+10 (*d*)
Alternative method for calculating indexation allowance applying to capital gains	Nil	Nil
Petroleum revenue tax		
Phasing out of advance petroleum revenue tax	−50	(*k*)
Appraisal and exploration relief	−40	(*l*)
Increase in PRT oil allowance for future fields	Nil	(*m*)
PRT expenditure relief for shared assets and charge on related receipts	−15	(*n*)
Minor PRT changes	−10	−5
Capital gains tax		
Indexation of annual exempt amounts	Nil (*b*)	−10 (o)
Increase in limit for retirement relief	Nil	−4
Increase in other monetary limits	Nil	−1
Other changes	Nil	Negligible
Development land tax		
Charge on a deemed disposal	Nil	−4
[Disposals by non-residents]	+1	+2
Extension of instalment period	Negligible	Nil
Capital transfer tax		
Increase in thresholds and changes in bands	−20 (*b*)	−50 (*b*)(*p*)
Increase in rates of business and agricultural relief	Negligible	−5
Extension of instalment period	−2	Nil (q)
Removal of ceiling in charity exemption	Negligible	−1
Other changes	−1	−2
TOTAL INLAND REVENUE	−2303	−2948 (*r*)

Table 4.2 Direct Effects (a) of Changes in Taxation *(continued)*

Customs and Excise

£ million

	Forecast for 1983–84	Forecast for a full year
CUSTOMS AND EXCISE		
Value added tax		
Increase in registration limits	−5	−5
Excise duties		
Increases in rates of duty on light oil, etc.	+190	+190
Increase in rate of duty on heavy oil for use in road vehicles	+40	+40
Increases in rates of tobacco products duty	+95	+100
Increase in rate of spirits duty	+25	+25
Increases in rates of beer duty	+85	+90
Increases in rates of wine and made-wine duties	+25	+25
Increase in rate of duty on cider and perry	+5	+5
TOTAL CUSTOMS AND EXCISE	+460	+470
Vehicle excise duty		
Increase in rates of duty	+130	+130
National Insurance surcharge		
Reduction in surcharge	−215	−400 (s)
Other		
Bus Fuel Grants	−5	−5
TOTAL CHANGES IN TAXATION	−1933	−2753

(*a*) Indirect effects are excluded. The expenditure tax figures do, however, allow for the effects of relative price changes on the composition of consumers' expenditure. This is explained in the note on page 9 of the Financial Statement and Budget Report 1981–82. A fuller description of the estimation of the direct effects of expenditure tax changes is provided in an article in *Economic Trends*, March 1980.

(*b*) *Taxes subject to statutory indexation.* The table below shows the direct revenue costs of indexing the income tax main allowances and thresholds, the capital gains tax exempt amounts and the capital transfer tax threshold and bands by reference to the increase in the general index of retail prices between December 1981 and December 1982 (5·4 per cent), rounded in accordance with the statutory provisions, together with the costs of the proposed changes on top of indexation:—

	Direct Revenue Costs: Indexation 1983–84	Indexation Full Year	Proposed changes on top of indexation 1983–84	Proposed changes on top of indexation Full Year
Income Tax				
Main allowances	−760	−930	−1 090	−1 335
Basic rate limit	−40	−60	−50	−80
Further higher rate thresholds	−30	−55	−30	−60
Investment income surcharge threshold	Negligible	−10	Negligible	−15
Total income tax	**−830**	**−1 055**	**−1 170**	**−1 490**
Capital gains tax				
Exempt amounts	Nil	−10	Nil	Nil
Capital transfer tax				
Thresholds and bands	−15	−35	−5	−15

(*c*) Effective from 1984–85; the yield in 1984–85 will be £30 million.

(*d*) These estimates are highly uncertain.

(*e*) The change takes effect from 1 April 1984, but the effect on tax receipts in 1984–85 will be negligible.

(*f*) The cost in 1984–85 will be £8 million.

(*g*) The cost in 1984–85 will be £10 million.

(*h*) Effect on tax liabilities for 1983–84; over a period of years there will be some deferment [or reduction] of tax liabilities.

~~(*i*) [The reduction of tax liabilities in a full year is highly uncertain but could be up to £50 million. The cost in 1984–85 is tentatively estimated at some £15 million.]~~

~~(*j*) The increase of tax liabilities in respect of 1984–85 is highly uncertain but could be up to £100 million.~~

(*k*) The main medium term effect of phasing out advance petroleum revenue tax is to defer payment of petroleum revenue tax; over the years the amount payable would be unchanged apart from a secondary effect on reliefs against petroleum revenue tax which may give some net yield in later years. In discounted terms the effect of this deferment is generally beneficial to the industry.

(*l*) The immediate cost will be offset by reductions in reliefs in future years but there will be a net benefit to the industry in discounted terms.

(*m*) The eventual cost depends on how many fields are developed in future; it could be a yield if additional fields are developed as a result of the proposal.

(*n*) The net cost in 1983–84 arises because the adjustments to be made in restrictions to relief already made, or due to be made, under existing law exceed the estimated yield from receipts. In subsequent years there is an estimated net yield (around £15 million a year on average for the years 1984–85 to 1986–87), but the industry will also be relieved from further substantial relief restrictions applicable under existing law. (These cannot be precisely quantified but the cost could run to some hundreds of million pounds over a period of years.)

(*o*) The effect on receipts in respect of tax liabilities for 1983–84; the effect on receipts in 1984–85 will be £3 million.

(*p*) The effect on receipts in respect of tax liabilities for 1983–84; the effect on receipts in 1984–85 will be £40 million.

(*q*) The cost in 1984–85 will be £4 million.

(*r*) No figures are included for the changes of petroleum revenue tax covered by footnotes (*k*) to (*n*) above; and any figures covered by footnotes (*i*) and (*j*) are broadly offsetting.

(s) Figures exclude public sector payments of [£75 million] in 1983-84 and [£225 million] in a full year. Public expenditure will be reduced accordingly. See Part 5, Table 5.5.

New footnotes (i) and (j)

(i) The cost will be negligible in 1984-85 and some £25 million in 1985-86; in the long term it could be up to £100 million.

(j) The yield will be negligible in 1984-85 and some £25 million in 1985-86, building up to £100 million.

5. Public sector transactions

5.01 The tables in Part 5 provide further information on the transactions of the public sector in 1982–83 and 1983–84. They elaborate the rounded and summary figures for those years shown in Parts 2 and 3. The 1983–84 forecasts incorporate the effects of Budget measures. The basis of the tables and the relationship between them is outlined in paragraphs 5.19–5.22.

The Public Sector Borrowing Requirement

5.02 Table 5.1 shows the composition of the Public Sector Borrowing Requirement (PSBR) in 1982–83 and 1983–84.

Table 5.1 Public Sector Borrowing Requirement

£ billion

Borrowing requirement of	1982–83 Budget forecast	1982–83 Latest Estimate	1983–84 Forecast
Central government	9·3	11·4	11·5
Central government own account(1)	5·4	6·3	9·0
Local authorities	0·6	−0·2	−0·2
Public corporations	1·9	1·2	0·8
Unallocated:			
Contingency reserve and cash underspending	2·4	—	−0·6
Special sales of assets	−0·7	—	−0·7
Public sector	9·5	7·3	8·2

(1) Central government borrowing less on lending to local authorities and public corporations.

5.03 The scale of borrowing towards the end of the financial year is always difficult to predict. Outturn information on the 1982–83 PSBR will not become available until late April although the CGBR will be available rather earlier. Based on outturns to end January for local authority and public corporations and to end February for central government borrowing and forecasts for the remainder of the year, the current estimate of the outturn is about £7¼ billion. The forecast for 1982–83 a year ago was £9½ billion, reduced to £9 billion in the Autumn Statement.

5.04 The PSBR in 1983–84(1) is forecast to be about £8¼ billion. The high CGBR reflects borrowing for on-lending to local authorities and public corporations. As in 1982–83 they are expected to repay a considerable amount of market debt, their collective borrowing requirements contributing relatively little to the PSBR.

Central government

5.05 Table 5.2 shows forecasts for central government receipts and expenditure in 1982–83 and 1983–84.

5.06 Receipts in 1982–83 are currently expected to be about the same as forecast a year ago. Receipts from north sea oil taxes in 1982–83 are about £1½ billion higher than expected, but this is offset by lower than expected receipts from VAT and national insurance contributions. Expenditure is expected to be over £2 billion more than forecast, more than accounted for by higher lending to local authorities but offset to some extent by underspending on cash limited votes. The CGBR is therefore expected to be £2 billion more than forecast, more than accounted for by on-lending to local authorities.

(1) The PSBR forecast for 1983–84 and its sub-sector components incorporate certain minor definitional changes. The most important is that changes in public sector deposits with banks are treated as transactions financing the PSBR rather than as affecting its size. The figures for 1982–83 are on the existing definition and will not be redefined until after the outturns are published in April.

Table 5.2 Central Government Transactions

£ billion

	1982–83 Budget forecast	1982–83 Latest Estimate	1983–84 Forecast
Receipts			
Taxes	77·0	78·1	81·3
National insurance contributions, etc.	19·5	18·7	21·2
Other	9·1	9·0	9·5
Total	**105·7**	**105·8**	**112·0**
Expenditure			
Current expenditure on goods and services	36·2	35·8	39·6
Capital consumption	0·8	0·8	0·8
Interest	11·4	11·4	11·9
Subsidies	4·2	4·4	4·2
Grants	55·3	57·1	61·1
Net lending and capital expenditure	5·4	7·7	7·1
Unallocated(1)	1·7	—	−1·4
Total	**115·0**	**117·2**	**123·5**
Central Government Borrowing Requirement	9·3	11·4	11·5
of which:			
for on lending to local authorities and public corporations	2·2	5·1	3·9
Own account	5·4	6·3	9·0
Unallocated(1)	1·7	—	−1·4

(1) Includes contingency reserve, special sales of assets and general allowance for underspending.

5.07 In 1983–84 central government expenditure is forecast to be nearly 6½ billion more than the 1982–83 outturn currently expected. Receipts are also expected to increase by about the same amount—half of which is accounted for by extra receipts from national insurance contributions. The difference met by borrowing is therefore expected to be almost the same as in 1982–83, the CGBR again reflecting a high level of on-lending to other parts of the public sector, which are repaying their other debt.

Local authorities

5.08 Table 5.3 shows local authority receipts and expenditure and the borrowing requirements for 1982–83 and 1983–84.

5.09 Local authority receipts in 1982–83 are currently expected to be nearly £1½ billion more than forecast a year ago, reflecting higher current grants from central government. Expenditure is expected to be £½ billion more than forecast but this masks an overspend of about £2 billion on current expenditure on goods and services, grants and subsidies, and capital underspending of nearly £1½ billion on fixed assets and net lending. Much of the capital underspending reflects higher receipts than expected from sales of council houses and land.

5.10 The LABR is expected to show a small net repayment in 1982–83. This forecast is particularly uncertain as, in recent years, the local authorities have borrowed heavily in the final weeks of the year and the figure for 1982–83 is heavily dependent on the forecast made for those weeks. The pattern of borrowing has been very different from the Budget forecast with heavy borrowing from central government more than matched by repayment of market debt.

5.11 Current expenditure on goods and services for 1983–84 is forecast to rise by 7 per cent or £1½ billion on 1982–83, with a greater proportionate rise is forecast for current grants to persons(2). Local authority net capital spending is expected to recover by about £½ billion from the 1982–83 level. Expenditure in total is forecast to increase by over £3 billion, less than £1 billion of which will be met from rates and the remainder from central government grants. With receipts and expenditure virtually in balance, the LABR is expected to be close to zero, again with high borrowing from central government approximately matched by repayment of market debt.

(2) Both sides of the local authority account in 1983–84 reflect the first full year of the complete transfer of the administration of housing benefits from central government to local authorities.

Table 5.3 Local Authorities' Transactions

£ billion

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Receipts			
Rates	12·2	12·3	13·0
Rate support grant	11·5	11·2	11·6
Other grants from central government	4·4	6·1	8·2
Other	5·1	4·9	5·0
Total	**32·2**	**34·6**	**37·9**
Expenditure			
Current expenditure on goods and services	21·5	22·7	24·3
Capital consumption	1·6	1·3	1·4
Grants and subsidies	2·6	3·7	5·2
Interest payments	4·7	4·4	4·1
Gross domestic fixed capital formation	2·5	1·6	2·4
Net lending to private sector	1·1	0·5	0·4
Total	**33·8**	**34·3**	**37·7**
Local Authority Borrowing Requirement	0·6	−0·2	−0·2
of which:			
Borrowing from central government	−0·3	2·2	2·0
Other borrowing	0·9	−2·5	−2·2

Public corporations

5.12 Expenditure and receipts for public corporations are shown in Table 5.4.

Table 5.4 Public Corporations Transactions

£ billion

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Capital expenditure			
Gross domestic capital formation	9·0	7·6	8·1
Increase in stocks	0·3	1·0	0·7
Total	**9·3**	**8·5**	**8·8**
Internally arising funds			
Gross trading surplus(1)	9·5	9·2	9·6
Rent and other non-trading income	1·0	1·3	1·4
Interest and dividend payments	−3·5	−3·7	−3·4
Taxes on income	−0·3	−0·4	−0·2
Total	**6·6**	**6·3**	**7·3**
Capital receipts	0·6	0·6	0·6
Excess of capital expenditure over internal funds and capital receipts	2·1	1·6	0·9
Less Net financial receipts	−0·2	−0·3	−0·1
Public Corporations Borrowing Requirements	1·9	1·2	0·8
of which:			
Borrowing from central government	2·4	2·7	1·9
Other borrowing	−0·6	−1·5	−1·1

(1) Including subsidies.

5.13 Lower borrowing in 1982–83 of over £½ billion less than forecast a year ago reflects nearly £1½ billion underspending on fixed assets, partly offset by an increase in the value of stocks held.

5.14 In 1983–84 public corporations collectively are expected to finance a slightly higher proportion of their capital expenditure than in 1982–83 from internally arising funds, leading to a borrowing requirement rather less than the 1982–83 estimate.

Public expenditure and the PSBR

5.15 Table 5.7 shows how the public expenditure plans and debt interest are expected to be financed. The expenditure side of the account repeats information from Cmnd 8789 but incorporates revisions to the planning total and debt interest

since its preparation. In 1982–83 expenditure including gross debt interest is £3 billion less than forecast a year ago. Tax receipts in total are expected to be about £1 billion more than predicted, offset by lower national insurance contributions. Most of the lower expenditure is reflected in the PSBR, which is £2¼ billion lower than forecast a year ago.

5.16 In 1983–84 expenditure is expected to increase by more than £6½ billion over the previous year. Taxation receipts and national insurance contributions are expected to increase by over £5½ billion. About £1 billion of the additional expenditure is expected to be met by an increase in the PSBR.

Public expenditure and GDP

5.17 The revised planning totals shown in Table 5.7 together with the latest forecasts for money GDP in Table 2.5, imply a ratio of public expenditure to GDP of 44 per cent in 1982–83, and 43½ per cent in 1983–84, as given in Cmnd. 8789 (Chart 1.6). The figures shown in Tables 2.3 and 2.5 imply a fall in this ratio to 41 per cent in 1985–86.

Planning total and Contingency Reserve

5.18 The latest position on the public expenditure planning total and on the Contingency Reserve in 1983–84 is shown in the following tables.

Table 5.5 Public Expenditure Planning Total: 1983–84

	£ million
As shown in the Autumn Statement	120 065
Changes between Autumn Statement and Cmnd. 8789	−497[1]
As shown in Cmnd. 8789	119 568
Reduction in national insurance surcharge	−81
Changes in general allowance for shortfall and in economic assumptions	−477
Planning Total after Budget measures and other changes	**119 010**

(¹) See Table 4.5 of Cmnd. 8789.

Table 5.6 Contingency Reserve 1983–84

		£ million
Amount of Reserve shown in Planning Total in the Autumn Statement and in Cmnd. 8789		1 500
Budget measures charged to Reserve		
Construction	60	
Industrial innovation	39	
Employment	53 (gross)	
Child benefit	74	(252)
Social security	26	
Other expenditure charged to Reserve		
BL equity(¹)	150	—
Increase in British Shipbuilders EFL	10	—
Additional support for overseas students	5	(165)
Uncommitted balance of Contingency Reserve		**1 089**

(¹) This comprises £100 million originally planned for the previous financial year which has been carried forward and £50 million out of the final allocation of £100 million that the Government has agreed to make available to finance the 1983 Corporate Plan.

Explanatory notes

5.19 The 1982–83 figures are latest forecasts based on published outturn data on the complete public sector accounts for the first half of the year, supplemented by less complete information for the third quarter and the first part of the final quarter.

5.20 Table 5.8 is based on the definitions used to compile the national income accounts(²) and is the most detailed presentation. Other tables are related to

(²) See *Financial Statistics Explanatory Handbook* 1982. The sector accounts are compiled quarterly and published in *Financial Statistics*. Key figures are published by press notice.

Table 5.8 and in addition include the 1982 Budget forecast for 1982–83. Tables 5.2, 5.3 and 5.4 are derived from Table 5.8 and summarise respectively the central government, local authority and public corporations accounts. These tables show how the sub-sector borrowing requirements are determined; they are brought together as the public sector borrowing requirement (PSBR) in Table 5.1. Tables 5.10, 5.11 and 5.12 present details of central government receipts and payments; these are totalled and shown in the summary table on the central government borrowing requirement (CGBR) in Table 5.9([3]).

Unallocated items

5.21 The unallocated items for 1983–84 shown in Tables 5.1, 5.2 and 5.8 take account of factors that by their nature cannot at this stage be attributed to a spending authority or economic category. They relate to £[1089] million representing the unallocated portion of the Contingency Reserve, receipts around £750 million from special sales of assets and a general allowance for shortfall of £1700 million. The figure for cash underspending compared to Main Supply Estimates and the Contingency Reserve shown in Table 5.11 includes an amount for holdback of rate support grant which has been allocated to current grants to local authorities in Table 5.8. Special sales of assets are included in other miscellaneous receipts in Table 5.10.

5.22 Table 5.6 shows the allocation of the Contingency Reserve, the whole of which is allocated to supply expenditure in Table 5.11. On experience it seems likely that use of the Contingency Reserve will make for a higher financial deficit than shown in Table 5.8 as well as adding to identified financial transactions. The central government own account borrowing figures in Tables 5.1, 5.2 and 5.8 exclude the effect of the Contingency Reserve and the other unallocated items.

([3]) Tables 5.9 to 5.12, unlike Tables 5.2 and 5.8 which are based on the national income accounts, follow the accounting principles of the central funds and accounts. These are monitored monthly by a Treasury press notice. The definition of the CGBR is identical in both accounting systems.

Table 5.7 Public expenditure, receipts and the PSBR

£ billion

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Income(1)			
Central government taxation			
Income tax	30·8	30·3	31·3
Value added tax	14·7	13·9	15·5
Oil duties	5·1	5·2	5·7
Corporation tax	4·8	5·4	6·1
Tobacco	3·5	3·5	3·7
National insurance surcharge	3·4	2·8	1·7
Spirits, beer, wine and perry	3·3	3·0	3·9
Petroleum revenue tax	2·3	3·3	[2·6]
Supplementary petroleum duty	2·0	2·4	[2·5]
Vehicle excise duty	1·8	1·8	1·9
Taxes on capital	1·4	1·6	1·5
European Community duties	1·3	1·3	1·4
Other (including accruals)	2·6	3·6	3·5
Total	77·0	78·1	81·3
National insurance etc., contributions	19·5	18·7	21·2
Local authorities rates	12·2	12·3	13·0
North Sea oil royalties	1·5	1·7	1·6
General government trading surplus and rent	3·4	3·4	3·3
General government interest and dividend receipts	2·4	2·4	2·3
Adjustments			
Accruals	0·5	−0·2	—
Public corporations transactions(2)	3·8	3·6	3·5
Other(3)	0·3	−0·1	−0·4
Total receipts	120·6	119·9	125·7
Public sector borrowing requirement	9·5	7·3	8·2
Total receipts and borrowing	130·1	127·2	133·9

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Expenditure			
Social security	32·0	32·5	34·4
Defence	14·1	14·4	16·0
Health and personal social services	13·6	13·9	14·6
Education and science	12·2	12·6	12·6
Scotland	6·1	6·3	6·4
Industry, energy, trade and employment	5·8	5·9	5·6
Transport	4·2	4·3	4·3
Order and protective services	4·1	4·3	4·6
Other environmental services	3·6	3·4	3·6
Northern Ireland	3·5	3·6	3·8
Housing	3·1	2·6	2·8
Wales	2·4	2·4	2·5
Overseas services	2·1	2·2	2·2
Other public services	1·7	1·7	1·7
Common services	1·6	1·6	1·0
Agriculture, fisheries, food and forestry	1·5	1·8	1·7
Government lending to nationalised industries	1·1	1·4	1·1
Arts and libraries	0·5	0·6	0·6
Local authority current expenditure not allocated to programmes (England)	—	—	0·9
Adjustments to programmes—			
PC market and overseas borrowing	−0·3	−1·1	−0·3
Special sales of assets	−0·6	−0·6	−0·8
Contingency Reserve	2·4	0·3	1·5(4)
General allowance for shortfall	—	−1·0	−1·2
Planning total in Cmnd 8789(5)	114·7	113·0	119·6
Revisions since Cmnd 8789	—	−0·8	−0·6(6)
Revised planning total	114·7	112·2	119·0
Gross debt interest	15·4	15·0	14·9
Planning total plus gross debt interest	130·1	127·2	133·9
MEMO ITEM			
Numerator(7) for public expenditure/GDP ratio.		120·2	128·4

(1) See Table 5.10 for taxation and Table 5.8 for other items.

(2) Comprises nationalised industries (and other public corporations treated similarly for public expenditure planning) total interest payments and the trading income of the remaining corporations.

(3) Comprises other miscellaneous receipts and adjustments from the definition of public expenditure used in the national income accounts to that used in Cmnd. 8789.

(4) See Table 5.6.

(5) Figures in the first column are from Table 19 in the *Financial Statement and Budget Report 1982–83* translated from Cmnd. 8494 to Cmnd. 8789 definitions.

(6) See Table 5.5.

(7) Planning total plus net debt interest, non-trading capital consumption and payments of VAT by local authorities (see paragraph 5.19). For the definition of net and gross debt interest see Cmnd. 8789—II, p 126.

Table 5.8 Public Sector transactions by sub-sector and economic category £ million

1982–83 Latest estimate

		General Government			Public corporations	Public Sector
		Central government	Local authorities	Total		
Current receipts						
Taxes on income	1	41 306	—	41 306	−441	40 865
Taxes on expenditure	2	35 245	12 300	47 545	—	47 545
National insurance, etc. contributions	3	18 674	—	18 674	—	18 674
Gross trading surplus	4	−201	253	52	9 230	9 282
Rent and oil royalties etc.	5	1 743	3 292	5 035	476	5 511
Interest and dividends from private sector and abroad	6	1 839	554	2 393	784	3 177
Non-trading capital consumption	7	785	1 295	2 080	—	2 080
Total	8	**99 391**	**17 694**	**117 085**	**10 049**	**127 134**
Current expenditure						
Final consumption	9	−36 548	−24 025	−60 573	—	−60 573
Subsidies	10	−4 419	−1 144	−5 563	—	−5 563
Debt interest to private sector and abroad	11	−11 468	−2 696	−14 164	−800	−14 964
Current grants to personal sector	12	−35 492	−1 929	−37 421	—	−37 421
Current grants paid abroad	13	−1 894	—	−1 894	—	−1 894
Total	14	**−89 821**	**−29 794**	**−119 615**	**−800**	**−120 415**
Current transfers within public sector						
Current grants	15	−16 891	16 891	—	—	—
Interest and dividends	16	4 472	−1 551	2 921	−2 921	—
Balance: current surplus/deficit	17	−2 849	3 240	391	6 328	6 719
Capital receipts						
Current surplus	18	−2 849	3 240	391	6 328	6 719
Taxes on capital	19	1 578	—	1 578	—	1 578
Capital transfers from private sector	20	—	—	—	148	148
Total	21	**−1 271**	**3 240**	**1 969**	**6 476**	**8 445**
Capital expenditure						
Gross domestic fixed capital formation	22	−2 254	−1 642	−3 896	−7 590	−11 486
Increase in stocks	23	−429	—	−429	−953	−1 382
Capital grants to private sector	24	−1 974	−537	−2 511	−47	−2 558
Total	25	**−4 657**	**−2 179**	**−6 836**	**−8 590**	**−15 426**
Capital transfers within public sector	26	−895	355	−540	540	—
Financial surplus/deficit (balance of current and capital accounts)	27	−6 823	1 416	−5 407	−1 574	−6 981
Financial transactions—(net)						
Transactions concerning certain public sector pension schemes	28	155	—	155	—	155
Accruals adjustments	29	−331	16	−315	88	−227
Miscellaneous financial transactions	30	620	−675	−55	760	−705
Lending to private sector	31	−401	−507	−908	−366	−1 274
Lending, etc. abroad	32	162	—	162	−101	61
Cash expenditure on company securities	33	301	—	301	−40	261
Total	34	**506**	**−1 166**	**−660**	**341**	**−319**
Lending within public sector	35	−5 075	2 326	−2 749	2 749	—
Contribution to Public sector borrowing requirement	39	**11 392**	**−2 576**	**8 816**	**−1 516**	**7 300**
Sectoral borrowing requirement		6 317	−250	6 067	1 233	7 300

Sign convention: receipts and borrowing positive, payments negative.

Relationships between lines: 17 = 8 + 14 + 15 + 16
27 = 21 + 25 + 26
39 = −27 −34 −35 −36 −37 −38

£ million

		1983–84 Forecast				
		General Government			Public corporations	Public sector
		Central government	Local authorities	Total		
Current receipts						
Taxes on income	1	42 712	—	42 712	−246	42 466
Taxes on expenditure	2	37 020	13 030	50 050	—	50 050
National insurance, etc. contributions	3	21 211	—	21 211	—	21 211
Gross trading surplus	4	−160	288	128	9 624	9 752
Rent and oil royalties etc.	5	1 674	3 106	4 780	506	5 286
Interest and dividends from private sector and abroad	6	1 761	518	2 279	852	3 131
Non-trading capital consumption	7	846	1 396	2 242	—	2 242
Total	8	105 064	18 338	123 402	10 736	134 138
Current expenditure						
Final consumption	9	−40 462	−25 648	−66 110	—	−66 110
Subsidies	10	−4 244	−1 232	−5 476	—	−5 476
Debt interest to private sector and abroad	11	−11 981	−2 218	−14 199	−669	−14 868
Current grants to personal sector	12	−37 073	−3 103	−40 176	—	−40 176
Current grants paid abroad	13	−1 813	—	−1 813	—	−1 813
Total	14	−95 573	−32 201	−127 774	−669	−128 443
Current transfers within public sector						
Current grants	15	−19 362	19 362	—	—	—
Interest and dividends	16	4 527	−1 752	2 775	−2 775	—
Balance: current surplus/deficit	17	−5 344	3 747	−1 597	7 292	5 695
Capital receipts						
Current surplus	18	−5 344	3 747	−1 597	7 292	5 695
Taxes on capital	19	1 550	—	1 550	—	1 550
Capital transfers from private sector	20	—	—	—	153	153
Total	21	−3 794	3 747	−47	7 445	7 398
Capital expenditure						
Gross domestic fixed capital formation	22	−2 551	−2 404	−4 955	−8 096	−13 051
Increase in stocks	23	−298	—	−298	−661	−959
Capital grants to private sector	24	−2 020	−740	−2 760	−63	−2 823
Total	25	−4 869	−3 144	−8 013	−8 820	−16 833
Capital transfers within public sector	26	−866	346	−520	520	—
Financial surplus/deficit (balance of current and capital accounts)	27	−9 529	949	−8 580	−855	−9 435
Financial transactions—(net)						
Transactions concerning certain public sector pension schemes	28	160	—	160	—	160
Accruals adjustments	29	−57	78	21	27	48
Miscellaneous financial transactions	30	833	−419	414	417	831
Lending to private sector	31	−221	−408	−629	−239	−868
Lending, etc. abroad	32	−3	—	−3	−101	−104
Cash expenditure on company securities	33	−150	—	−150	−43	−193
Total	34	562	−749	−187	61	−126
Lending within public sector	35	−3 886	1 991	−1 895	1 895	—
Unallocated items:						
Special sales of assets	36	750	—	750	—	750
Contingency reserve (1)	37	−1 089	—	−1 089	—	−1 089
General allowance for shortfall (2)	38	1 700	—	1 700	—	1 700
Contribution to Public sector borrowing requirement	39	11 492	−2 191	9 301	−1 101	8 200
Sectoral borrowing requirement		8 967(3)	−200	8 767(3)	794	8 200

(1) See table 5.6 for allocation of Contingency Reserve.
(2) Differs from table 5.11 because of holdback on local authorities' grants.
(3) Excludes unallocated items. See paragraph 5.21.

Table 5.9 Summary of Central Government Transactions

£ million

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Consolidated Fund			
Revenue (Table 5.10)	82 895	83 450	87 642
Expenditure (Table 5.11)	90 891	89 380	95 630
Deficit	7 996	5 930	7 988
National Loans Fund			
Consolidated Fund deficit (as above)	−7 996	−5 930	−7 988
Other transactions:			
Receipts (Table 5.12)	11 600	10 830	11 450
Payments (Table 5.12)	−13 236	−14 790	−14 777
Total net borrowing by the National Loans Fund	−9 632	−9 890	−11 315
Other funds and accounts (net)	+339	−1 502	−177
Central Government Borrowing Requirement	−9 293	−11 392	−11 492

Table 5.11 Supply and Consolidated Fund Standing Services

£ million

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Supply			
Main Supply Estimates	79 225	81 410(1)	85 446
Adjustment to Supply Issues(2)	—	−330	—
Supplementary provision	109	—	5(3)
Contingency reserve	2 400	—	1 500(4)
Reduction in national insurance surcharge	−360	—	−81(5)
General allowance for underspending	—	−1 600	−2 100(4)
Total Supply Issues	83 374	79 480	84 770
Consolidated Fund Standing Services			
Payment to the National Loans Fund in respect of service of the national debt	5 175	5 450	6 083
Northern Ireland—share of taxes, etc.	1 493	1 594	1 650
Payments to the European Communities	2 820	2 812	3 092
Other services	29	44	35
Total Consolidated Fund Standing Services	9 517	9 900	10 860
Total	90 891	89 380	95 630

(1) Taking into account supplementary provision granted during the year and departments' forecasts of excesses or shortfalls. See Table 1 of *Memorandum by the Chief Secretary to the Treasury* Cmnd. for an analysis by Class and Vote.

(2) The adjustment relates to Supply issued the previous year and placed in departmental balances but not spent and to supply issued in 1982–83 in respect of expenditure the previous year.

(3) Bus fuel grants (see Table 4.2).

(4) See paragraph 5.21.

(5) The figure represents forecast savings on supply provisions and public corporations external financing as a consequence of the reduction in the national insurance surcharge. This item has not been allocated between supply expenditure and lending from the National Loans Fund.

Table 5.10 Taxation and Miscellaneous Receipts

£ million

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Taxation			
Inland Revenue—			
Income tax (1)	30 775	30 302	31 270
Corporation tax(2)(3)	4 850	5 480	6 150
Petroleum revenue tax	2 290	3 280	5 250(4)
Supplementary petroleum duty	2 040	2 400	—
Capital gains tax	600	650	600
Development land tax	40	65	55
Estate duty	10	13	10
Capital transfer tax	465	500	540
Stamp duties	810	850	975
Total Inland Revenue	41 880	43 590	44 850
Customs and Excise—			
Value added tax	14 750	13 900	15 500
Oil	5 100	5 250	5 675
Tobacco	3 525	3 500	3 700
Spirits, beer, wine, cider and perry(5)	3 275	3 025	3 900
Betting and gaming	550	580	610
Car tax	600	575	615
Other excise duties	20	20	20
EC own resources(6)			
Customs duties, etc.	1 060	1 000	1 130
Agricultural levies	270	250	250
Total Customs and Excise	29 150	28 100	31 400
Vehicle excise duties	1 854	1 792	1 944
National insurance surcharge(7)	3 443	2 830	1 697
Total Taxation	76 327	76 262	79 891
Miscellaneous Receipts			
Broadcast receiving licences	754	736	766
Interest and dividends	321	382	370
Gas levy	512	470	555
Other(8)	4 981	5 600	6 060
Total	82 895	83 450	87 642

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
(1) Income tax receipts include surtax	2	2	1
(2) Corporation tax receipts include advance corporation tax: net of repayments	2 170	2 220	2 550

(3) The estimated proportion attributed to North Sea oil and gas production is £250 million in 1982–83 and £550 million in 1983–84. In addition an estimated £250 million in 1982–83 and £450 million in 1983–84 of corporation tax will be satisfied by setting off advance corporation tax (ACT). Thus, total revenues from the North Sea, inclusive of royalties, supplementary petroleum duty, petroleum revenue tax and corporation tax before any ACT set-off, are estimated to be £7,810 million in 1982–83 and £7,850 million in 1983–84.

(4) Petroleum revenue tax includes advance payments of petroleum revenue tax.

(5) Deferment of duties on spirits and wine, announced on 15 November 1982, reduced the Budget forecast of the duties on spirits, beer, wine, cider and perry to £2,975 million and the Budget forecast of total Customs and Excise duties to £28,850 million.

(6) Customs duties and agricultural levies are accountable to the European Communities as "own resources"; actual payments to the Communities are recorded in Table 5.11.

(7) A reduction in the National Insurance Surcharge, announced on 8 November 1982, reduced the Budget forecast of receipts of National Insurance Surcharge into the Consolidated Fund to £2,953 million (the net effect on the forecast of the PSBR and CGBR was a smaller reduction because expenditure by public corporations and central government departments was correspondingly reduced).

(8) Includes the 10 per cent of "own resources" refunded by the Communities to meet the costs of collection, proceeds from the special sales of assets, and estimated receipts of £1,630 million in 1982–83 and £1,600 million in 1983–84 in respect of oil royalties.

Table 5.12 National Loans Fund Receipts and Payments

£ million

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Receipts			
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 425	5 380	5 367
Service of the National Debt—balance met from the Consolidated Fund	5 175	5 450	6 083
Total Receipts	**11 600**	**10 830**	**11 450**
Payments			
Service of the National Debt			
Interest	11 467	10 694	11 314
Management and expenses	133	136	136
Total	**11 600**	**10 830**	**11 450**
Loans to Public Corporations			
Loans to Nationalised Industries:			
National Coal Board	318	300	604
Electricity (England, Wales and Scotland)	80	182	185
British Telecom	286	−113	−154
Other	37	−6	37
Total	721	363	672
Loans to other Public Corporations:			
New Towns—Development Corporations and Commission	360	357	314
Housing Corporations	330	502	230
Scottish Special Housing Association	42	39	32
Regional Water Authorities	503	450	410
Other	7	2	19
Total	1 242	1 350	1 005
General allowance for shortfall and alternative sources of finance	—	—	−300
Total	**1 963**	**1 872**	**1 377**
Loans to Local Authorities	**−300**	**2 240**	**2 000**
Loans to Private Sector:			
Building Societies	−1	—	—
British Aerospace	−4	−4	−4
British Nuclear Fuels Ltd.	−1	−1	−1
Housing Associations	—	−2	—
Total	**−6**	**−7**	**−5**
Loans within Central Government:			
Northern Ireland	94	74	83
Redundancy Fund	−115	−59	−127
Married quarters for armed forces	—	−1	−1
Total	−21	14	−45
Total—Net Lending	**1 636**	**3 960**	**3 327**
Total Payments	**13 236**	**14 790**	**14 777**

PWP

COVERING BUDGET SECRET

FROM: D R NORGROVE

DATE: 11 March 1983

1 MR ~~KEMP~~ see note below.

2 CHANCELLOR

C/
You need not read this if you decide to drop Mark II as recommended by Mr Kemp!

MCM
11/3

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Littler
Mr Middleton
Mr Bailey
Mr Moore
Mr Cassell
Mr Evans
Mrs Lomax
Mr Allen
Mr Hall
Mr Ridley
Sir Lawrence Airey (IR)
Mr Fraser (C&E)

FSBR MARK II

... Attached for you only is a copy of the FSBR as it might look with a Budget costing around £1 billion on the PSBR. As Mr Kemp said in his minute to you of yesterday, we could produce a printed version of this if the go-ahead was given by Sunday night. If a decision could not be taken until late on Monday we would still be able to produce bound photocopies of a printed version or, at worst, bound photocopies of a typed version.

2. We hope this work will be wasted.

D R Norgrove.

D R NORGROVE

We must all endorse Mr Norgrove's paragraph 2. For obvious reasons the attached has not been worked over as well as the Mark I version. If tomorrow it looks as though it might be needed, we would work on it on Sunday and so we would need your comments early that morning. The go/no go decision so far as printing is needed on Sunday evening. You will recall that if we did decide to go for a printed Mark II on Sunday evening, once the Printers start work on Monday (at 8 am) the option of a printed Mark I is virtually closed.

EPK

SECOND PROOF—F.S.

BUDGET—SECRET

1 of 2

CONTINGENCY PROOF. (note 1982-83 may need amending).

1. The Budget proposals

The Budget

1.01 The main proposals in the Budget are summarised in Table 1.1 below and described in detail in Part 4. These figures and those presented in Part 4 are estimates of the direct effects of the measures on public sector transactions; they are not estimates of the net effects of all the changes in public sector transactions, both direct and indirect, brought about by the tax and expenditure decisions. The Budget is defined to include the tax changes announced in the Budget Speech, and policy changes to the expenditure plans set out in the White Paper (Cmnd. 8789).

Summary table

Table 1.1 Budget measures: Direct Effects(1) on Public Sector Transactions(2)

£ million at current prices

	Effect in 1983–84		Effect in a full year	
	Change from indexed base	Change from non-indexed base	Change from indexed base	Change from non-indexed base
Income tax allowances and thresholds	−1 170	−2 000	−1 490	−2 545
Other income tax and other direct taxes	~~−270~~ −195	~~−285~~ −210	~~−425~~ −275	~~−470~~ −320
~~National Insurance Surcharge(3)~~	~~−215~~	~~−215~~	~~−400~~	~~−400~~
Excise duties	~~10~~ 150	~~595~~ 735	~~10~~ 150	~~605~~ 745
Other indirect taxes	—	−5	—	~~−10~~ −5
Total	~~−1 645~~ −1,215	~~−1 910~~ −1,480	~~−2 305~~ −1,615	~~−2 820~~ −2,125

(1) The direct effects of tax changes are the differences between the yields estimated by applying the new and the old tax rates and allowances to the taxable income and expenditure projected in the post-Budget forecast. A further adjustment is made to the estimates of the Customs and Excise taxes to allow for the changes in taxation resulting both from substitution by consumers between goods and the change in real incomes.

(2) +/− indicates an increase/decrease in revenue.

8 ~~(3) Estimates exclude public sector payments; the gross cost of the reduction in the surcharge is £295 million in 1983–84 and £600 million in a full year.~~

Tax proposals

1.02 The net effect of the tax proposals in the Budget is shown on two alternative bases. The first, conventionally used in the preparation of economic forecasts, allows for the full indexation of 1982–83 excise duty rates and main income tax allowances and thresholds in line with inflation in the year to December 1982. On this basis the net effect of the tax proposals in the Budget is to reduce revenue by ~~£1,595~~ £1,215 million in 1983–84 and by ~~£2,250~~ £1,615 million in a full year. The cost in 1983–84 of the increase in the main income tax allowances and thresholds over and above full revalorisation is estimated to be £1,170 million, and the yield of increasing excise duties over and above full indexation to be £150 million. The second basis, which corresponds with the actual changes in tax rates and allowances to be included in the Finance Bill, measures the effects of those changes as compared with existing rates and allowances. On this basis the increase in income tax allowances and thresholds is estimated to cost £2,000 million and the increase in excise duties to yield an additional ~~£595~~ £745 million in 1983–84.

Public expenditure measures

1.03 Public expenditure measures announced in the Budget total ~~£250~~ £255 million in 1983–84. They are listed in Part 4 and in Table 5.5. Their cost will be met entirely from the Contingency Reserve. They will not therefore lead to any increase in the public expenditure planning total for 1983–84 announced in the White Paper. ~~There will however be a reduction in planned public expenditure as a result of the further cut in the National Insurance Surcharge announced in the Budget, which will be recovered from central government and nationalised industries. In Table 1.1, the reduction in public expenditure is offset against the gross cost of the change in the Surcharge.~~

8

The effect on the PSBR

1.04 Taking the tax and expenditure changes together, and allowing for indirect, as well as direct, effects on public sector transactions, the Budget measures are expected to add about £1~~½~~ billion to the PSBR, compared with what it would have been on conventional assumptions about the indexation of tax rates and allowances. The level of the PSBR in 1983–84 is expected to be around £8½ billion, or ~~2¾~~ per cent of GDP (at market prices).

1/ 3/

The Autumn measures

1.05 Other changes affecting 1983–84 are set out in the Autumn Statement, published in November. They include the 1 percentage point reduction in the National Insurance Surcharge from 2½ per cent to 1½ per cent; changes to public expenditure plans which kept the planning total for 1983–84 within the figure given in the 1982 White Paper as modified by the 1982 Budget (£120.7 billion); and limited increases in employees' and employers' National Insurance Contributions. The ~~tax~~ reduction~~s~~ and the effect of holding the increase in National Insurance Contributions below the amount needed to balance the Fund were estimated to cost ~~about~~ £1 billion in 1983–84.

in the National Insurance Surcharge & nearly /

to hold 1982-83 needs checking again. CONTINGENCY PROOFS

2. Medium-term financial strategy

Objectives

2.01 Government policies have helped to bring about a rate of inflation that is already well into single figures. The objective over the medium term is to continue reducing inflation, and to secure a lasting improvement in the performance of the UK economy, so providing the foundations for sustainable growth in output and employment. Firm financial policies are an essential means to this end. The medium term financial strategy sets out the framework within which policy is operated.

The financial framework

2.02 Control of the money supply is a central part of this strategy. In judging the rate of monetary growth needed to reduce inflation, the Government will continue to take account of structural influences on the different monetary aggregates, as well as the behaviour of other financial indicators. Fiscal policy is designed to be consistent with this monetary framework and with the overall objective of reducing inflation. Over a period of years, a reduction in public sector borrowing, as a proportion of GDP, has a key part to play in securing a fall in interest rates, in both real and nominal terms.

~~**Need for lower costs**~~

2.03 The extent of the recovery in real activity over the next few years depends critically on bringing down cost increases, in all sectors of the economy. Lower domestic costs will enable British industry to compete more effectively, at home and abroad, without adding to inflationary pressures. Despite recent gains, UK productivity is still low in comparison with other major industrial countries. The long term health of the economy depends on further efforts to close this gap. Moderation in pay will help to ensure that improved efficiency is reflected in higher output and employment.

~~**Supply**~~

2.04 The Government will continue to pursue policies to strengthen the supply performance of the economy, by providing greater incentives for work and enterprise, and by improving the working of markets. A low rate of inflation will provide the right macro-economic environment in which these policies can succeed.

Recent financial conditions

Monetary growth in 1982–83

2.05 Monetary conditions have developed broadly as intended over the past year; in the year to February, the growth of the key monetary aggregates was within the target range of 8–12 per cent. Combined with the rapid fall in inflation, this contributed to a significant fall in interest rates. By mid-November, short term rates had come down to 9 per cent but, as the exchange rate weakened, market rates, and with them base rates, rose to around 11 per cent. This compares with a peak of 16 per cent in November 1981.

Table 2.1 Monetary Growth 1982-83

	Percentage growth					
	M_0(1)	M1	M2	£M3	PSL1	PSL2
February 1982–February 1983	3½	11	6½	10	8½	9

(1) Monetary base, wide definition.

Broad money

2.06 £M3 grew by 10 per cent over the first twelve months of the target period. During the spring and early summer the rate of growth was close to the bottom of the range. There was some rise in the late summer and autumn, but since ~~November~~ then growth has again slowed down. PSL2 grew by less than £M3—9 per cent in the year to February. The growth of bank lending followed much the same profile as that of £M3. This in-year variation was attributable largely to borrowing by companies, borrowing by persons remaining high throughout the year.

Narrow money

2.07 M1 grew more slowly than £M3 over the period 1979–81. Last year, as expected, the growth of M1 rose to 11 per cent over the twelve months to February. Narrower measures of money continued to grow comparatively slowly. The monetary base grew by only 3½ per cent, despite lower interest rates, possibly reflecting a faster decline in the importance of notes and coins relative to other means of payment. Transactions balances, as measured by ~~the new~~ M2 ~~statistics~~, grew by 6½ per cent, though lack of past data still makes this series difficult to interpret.

Chart 2.1 as before

Other indicators

2.08 Other financial indicators pointed to moderately restrictive monetary conditions. As in other industrial countries real short term interest rates remained high. For most of the year the exchange rate was strong. The fall after October seems to have owed much to external factors, such as concern about oil prices and sharp movements in other currencies and, possibly, to political uncertainties.

~~Real money balances~~

~~2.09~~ Against this background, the recent growth in real money balances, on most measures of money, largely reflects the fall in inflation and points to a recovery in real activity. For a given growth in the nominal money supply, higher real money balances are ~~an important mechanism by~~ one route through which lower inflation can help to raise the level of activity.

Monetary policy

Money ranges

2.09 ~~2.10~~ In recent years the economic significance of the wider aggregates has been affected by changes in saving behaviour and by structural changes to the financial system, associated in part with the ending of direct controls. Inflation has fallen fast despite the overrun in previous years' monetary targets. These developments led to last year's decision to raise the monetary ranges. Monetary growth within the new target range set for 1982–83 has been consistent with maintaining a reasonably restrictive stance.

Target for 1983–84

2.10 ~~2.11~~ As announced in the Budget Speech, the target range for 1983–84 is to be set at the 7–11 per cent indicated in last year's Financial Statement. As usual, this range applies to the annual rate over the fourteen months beginning in February 1983. A sustained reduction in monetary growth over a period of years will be needed to keep inflation on a downward trend. Illustrative ranges for the next few years are shown in table 2.2 Precise targets for 1984–85 and 1985–86 will be decided nearer the time.

SECOND PROOF—F.S.

8

Table 2.2 Ranges for Monetary Growth~~(¹)~~

	1983–84	1984–85	1985–86
Percentage change during year	7–11	6–10	5–9

8 ~~(¹) From 1983–84 onwards, the definition of £M3 will exclude public sector deposits. This is in line with the revised definition of the PSBR (see Part 5, para 5.04 footnote).~~

~~growth of M1~~

2.11 ~~2.12~~ The path shown in table 2.2 applies to both narrow and broad measures of money: M1 and £M3 (and PSL2). However, as noted in last year's FSBR, the combination of lower interest rates and lower inflation is likely to lead to a period of more rapid growth in M1 than in broader measures of money~~, The size and timing of these effects is uncertain, but if interest rates maintain their downward trend, and other indicators suggest that conditions remain moderately restrictive, it may be appropriate for M1 to grow more rapidly than the target range for 1983–84~~.

rpretation of monetary
ditions

2.~~13~~ As explained in last year's Financial Statement, the interpretation of monetary conditions will continue to take account of all the available evidence, including the exchange rate, structural changes in financial markets, saving behaviour, and the level and structure of interest rates. Policy decisions will be aimed at maintaining monetary conditions that will keep inflation on a downward trend. The ranges shown in Table 2.2 have once again been constructed on the assumption that there is no major change in the exchange rate from year to year.

Fiscal policy

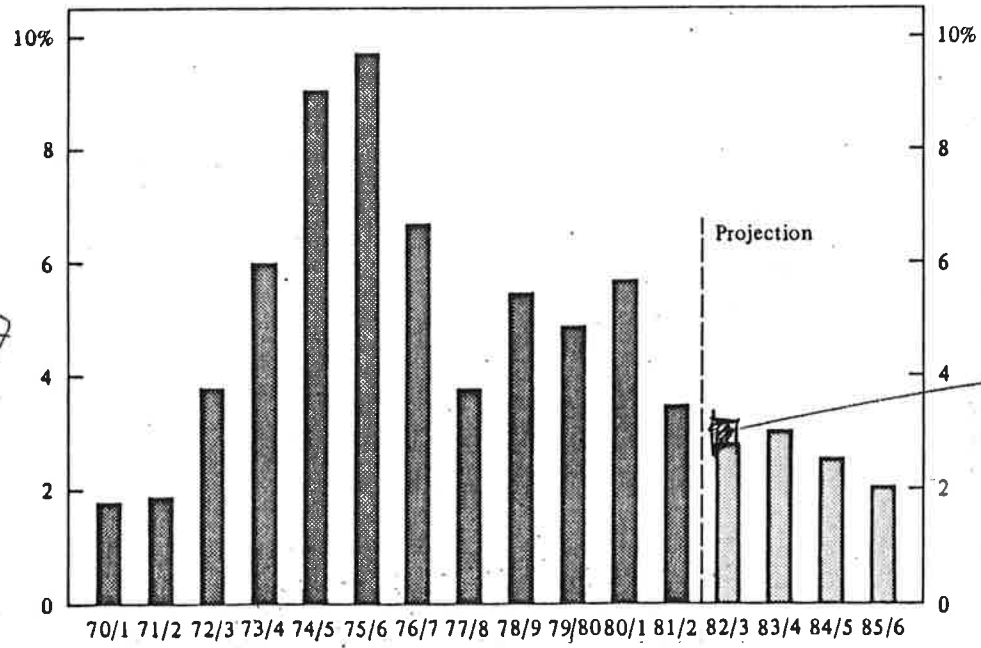
~~experience~~

2.~~14~~ 2 Sustained progress on both inflation and interest rates requires continued fiscal restraint. During the 1950's and 1960's the PSBR averaged about $2\frac{3}{4}$ per cent of GDP. As Chart 2.2 shows, there was a strong rise in this ratio during the first half of the 1970's, peaking in 1975–76, when the PSBR reached nearly 10 per cent of GDP. High fiscal deficits over this period were associated with high inflation and interest rates.

CHART 2.2

PSBR
Percentage of Money GDP

Revised block



possible further change.

PSBR path

trend 2.1~~5~~3 Government policies have been directed at achieving a ~~progressive~~ reduction in public sector borrowing over the medium term. The path that has been followed has also taken account of the depth of the recession. Two years ago the PSBR path was raised substantially for this reason, though the generally declining profile was retained. The PSBR was reduced from 5 per cent of GDP in 1979–80 to $3\frac{1}{2}$ per cent (£8·7 billion) in 1981–82.

The PSBR in 1982–83

2.16 The latest estimate ~~estimated outturn~~ for 1982–83 is £8 billion equivalent to about 2¾ per cent of GDP. This is some £1½ billion lower than the Autumn Statement forecast, and about £[illegible] billion lower than expected at the time of the Budget, though still some way above the 2¼ per cent of GDP envisaged for the year now ending in the 1980 FSBR. ~~Identifiable factors contributing to the lower outturn this year include unexpectedly high receipts from North Sea oil taxes, reflecting a higher sterling oil price, and underspending in some areas of public expenditure, notably local authority capital.~~

PSBR projections

2.17 The PSBR for 1983–84 is forecast to be £8½ billion, equivalent to about 3 per cent of GDP, close to the figure suggested ~~as suggested~~ a year ago ~~and in the Autumn Statement~~. Thereafter, the fiscal projections summarised in table 2.5 show a ~~further~~ reduction in the PSBR as a proportion of GDP, to around 2½ per cent in 1984–85, and 2 per cent in 1985–86. This path should leave room within the monetary guidelines for a fall in interest rates over the next few years. The figures for 1984–85 and 1985–86 are illustrative. Decisions about the appropriate size of the PSBR in any particular year will be taken nearer the time.

Assumptions

2.18 The fiscal projections in tables 2.3–2.5 are based on the public expenditure plans shown in the Public Expenditure White Paper (Cmnd 8789), updated where necessary to take account of Budget changes and estimating changes. Further details for 1982–83 and 1983–84 are given in Part 5. Real output is assumed to grow by 2½ per cent a year on average over the three years. The general rate of inflation, as measured by the GDP deflator was 7 per cent in 1982–83. It is forecast to fall to 5½ per cent in 1983–84. (The ~~relationship between the~~ forecasts for the GDP deflator and the more widely known Retail Prices Index are ~~is~~ discussed in para 3.28. There are many reasons why the two indices may move differently over relatively short periods of time including, for example, the differing impact of changes in mortgage interest rates, seasonal food prices, oil prices and import costs.) In the later years, the GDP deflator is assumed to rise by 5½ per cent in 1984–85, and by 5 per cent in 1985–86. These assumptions imply an average growth in money GDP of about 8 per cent over the period as a whole.

Public expenditure

Public Expenditure

2.19 Table 2.3 shows the relationship between the planning total for public expenditure shown in Cmnd. 8789 and general government expenditure in national accounts terms (the definition of public expenditure lying behind the general government borrowing requirement).

Table 2.3 General Government Expenditure

£ billion, cash

	1981–82	1982–83	1983–84	1984–85	1985–86
Public expenditure planning total(1)	104·7	113	119½	126½	132½
Planning total adjustments(2)	−1·0	1½	1	—	—
General government expenditure(3)	103·7	114½	120½	126½	132½
Differences due to policy measures and economic assumptions(4)	—	−1½	−1[illegible]	−1[illegible]	−1
National accounts adjustment(5)	2·7	3	4	5½	5
Interest payments(6)	13·8	14	14	14[illegible]	14½
Total expenditure in national accounts terms(7)	**120·2**	**130**	**137½**	**145**	**151[illegible]**

(1) Public expenditure planning total, see Cmnd. 8789, table 1.1, line 9.

(2) Adjustment to line 1 to exclude certain public corporations' capital expenditure, public corporations' net overseas and market borrowing and general allowance for shortfall as in Cmnd. 8789.

(3) Expenditure on programmes by central government and local authorities plus the contingency and provisional reserves and special asset sales. Broad assumptions have been made about the share of general government in the total of expenditure on programmes shown in Cmnd. 8789, table 1.1 for 1984–85 and 1985–86.

(4) Incorporates later information for 1982–83 than in Cmnd. 8789. For 1983–84 onwards includes Budget measures and estimating changes, shortfall and the net effects of different economic assumptions from those in Cmnd. 8789. Revised planning totals for 1982–83 and 1983–84 are shown in table 5.7.

(5) Adjustments to line 3 to the definitions used in National Accounts Statistics.

(6) For 1981–82 see table 2.1, Financial Statistics, February 1983. For 1982–83 and 1983–84 see table 5.8.

(7) For 1981–82 see table 2.4, Financial Statistics, February 1983. For 1982–83 and 1983–84 see

Revenue

Revenue

2.~~20~~ 18 The growth of Government revenues in cash terms over the medium term will depend on the growth of incomes, spending and prices, as well as policy decisions. Revenue is projected on the conventional assumption of constant tax rates and indexed allowances and thresholds at the proposed 1983–84 levels. National Insurance contribution rates in future years are assumed to be adjusted to maintain an adequate balance in the Fund. Projections of North Sea tax revenues assume that the North Sea fiscal regime is changed as proposed in the Budget and that oil prices remain around their present levels for the ~~next two~~ year and then rise broadly in line with world inflation.

rest of this

2.~~21~~ 17 On these assumptions, general government receipts are projected to rise by nearly 22 per cent between 1982–83 and 1985–86, a little less than the growth in total money income. Government revenue from the North Sea is expected to account for about ~~6~~ per cent of total ~~revenues~~ throughout the period.

5½ receipts

Table 2.4 General Government Receipts

£ billion, cash

	1981–82	1982–83	1983–84	1984–85	1985–86
Taxes on incomes expenditure and capital	85·9	92	~~98~~ 95½	103	113
National Insurance and other contributions	16·5	18½	21	22½	~~24~~ 23½
Interest and other receipts	10·~~8~~ 7	11	11	11½	11½
Accruals adjustment	−1·~~6~~ 4	−½	—	−½	−½
Total	**111·7**	**121**	**128**	~~127~~ 136½	~~148~~ 147½
of which North Sea tax([1])	6·3	7½	7	~~8~~ 7	~~9½~~ 8½

([1]) Royalties, Supplementary Petroleum Duty (in 1981–1982 and 1982–83). Petroleum Revenue Tax (including advance payments from 1983–84) and Corporation Tax from North Sea oil and gas production (before Advance Corporation Tax set off).

Public sector borrowing

Public sector borrowing

2.~~22~~ 20 The new projections of Government receipts and expenditure are brought together in table 2.5 to provide projections of the general government borrowing requirement (GGBR) and the PSBR. The size of the fiscal adjustment, conventionally assumed to take the form of lower personal taxes, depends critically on the estimates of revenues and expenditure. These are subject to major uncertainties about, for example, the tax yield for an assumed set of tax rates, the behaviour of oil prices, and the actual level of public spending in relation to the plans.

Table 2.5 Public Sector Borrowing

£ billion, cash

	1981–82	1982–83	1983–84	1984–85	1985–86
General government expenditure	120·2	130	137½	145	151
General government receipts	111·7	121	128	~~137~~ 136½	~~148~~ 147½
Implied fiscal adjustment([1])	—	—	—	−8	3½
GGBR	8·5	9	9½	8½	7
PSBR~~(2)~~	8·7	7½	8½	8	7
as % GDP	3½	2¾	3	2½	2
Money GDP at market prices	254	275	296	~~321½~~ 322	346

([1]) + means lower taxes or higher expenditure than assumed in lines 1 and 2.

~~(2) From 1983–84 onwards,~~ the definition of the PSBR and its components ~~will exclude changes~~

?

Comparison with the 1982 Revenue and Expenditure Projections

2.2~~3~~1 Table 2.6 shows changes in the fiscal projections since the 1982 FSBR.

Table 2.6 Revenue and Expenditure: Comparison with the 1982 projections

£ billion, cash

Changes (+ increases)	1982–83	1983–84	1984–85
General government expenditure	−1½	~~−1~~ −½	−3
General government receipts	−½	−2	−6½
Implied fiscal adjustment([1])	—	−½	~~1½~~ −2
GGBR	−1	[illegible] 1	1½
PSBR	−2	−[illegible]	1½
Change in PSBR ratio (%)	−¾	[illegible]	½

([1]) By definition the fiscal adjustment for 1983–84, in this year's projections, is eliminated by the 1983 Budget measures.

~~Averages~~ Changes in assumptions

2.2~~4~~2 The level of money GDP in 1982–83 is estimated to have been nearly 2 per cent lower than expected a year ago, reflecting both lower output and lower prices. The average growth in real output from now on is much the same as in last year's projections, while inflation is rather lower, implying a slower growth in money GDP than assumed a year ago. ~~This year's Budget measures have the usual effect of taking up some of the fiscal adjustment in 1984–85. The projected PSBR is unchanged, as a percentage of money GDP, in 1983–84, and ½ per cent higher in 1984–85, compared with last year's projections.~~

Changes in receipts and expenditure

2.2~~5~~3 The main factors affecting the estimated outturn for 1982–83 are discussed in Part 5. Changes to expenditure in 1983–84 and 1984–85 reflect the decisions set out in Cmnd. 8789 and in the Budget Speech and revised economic assumptions. General government receipts are now projected at the proposed 1983–84 tax rates, which are lower than those used last year. The lower level of receipts also reflects the lower level of money GDP now assumed. In 1983–84, revenues from the North Sea are expected to be £1[illegible] billion higher than projected a year ago, the net effect of a higher assumed level of production, particularly in tax-paying fields, a lower dollar oil price, and the fall in the ~~dollar~~ sterling exchange rate that has already taken place. ~~Projected revenues for 1984–85 are unchanged, with higher production from tax-paying fields helping to offset the effect of a lower sterling oil price than previously assumed.~~ Projected revenues in 1984-85 are £1 billion lower than a year ago, reflecting a lower sterling oil price.

Conclusions

2.2~~6~~4 The projections shown in tables 2.3–2.5 are no more than illustrative of one particular evolution of the economy. If the domestic and world economies develop in a different way, the projections for public finances could be substantially affected. The policy response to such changes would depend on their nature, but the intention would be to hold firmly to the strategy, by maintaining monetary conditions consistent with a continued trend to lower inflation. The key to sustained recovery lies in reducing the growth of costs and increasing the returns to investment and enterprise. Within the financial framework set out here, this would make room for a faster growth in output, without damaging the outlook for inflation.

2.2~~7~~5 Progress in reducing inflation over the next couple of years will be influenced to some extent, by the strength of the cyclical recovery in output, both domestically and in the rest of the world. The strategy outlined here presupposes a slow recovery in output and trade in other industrial countries. As explained in Part 3, the path of the Retail Prices Index over the next year or so may be affected by special factors, including the recent decline in the exchange rate, and the effect of the fall in mortgage interest rates last Autumn. It is not to be expected, therefore, that the path of inflation will be smooth. But the Government's policies will continue to be directed towards achieving a progressive reduction in its underlying trend.

MK II Version
Differences from MK I version
identified by (x)

3. The economy: Recent developments and prospects to mid-198~~3~~4

Summary

Economy

3.01 By the end of 1982 lower interest rates and lower inflation, particularly in the United States, were pointing towards some increase in world activity in 1983. The fall in oil prices in recent weeks improves the prospects for both recovery and low inflation.

United Kingdom Economy

3.02 In the United Kingdom, the effects of lower world activity in 1982 were to a considerable extent offset by a good performance by exporters in world markets and by a rise in final domestic demand, led by consumer spending. But with some further fall in stocks, the growth in total output was probably not much more than ½ per cent, most of which was accounted for by higher oil production, and there were further rises in unemployment.

3.03 The forecasts for 1983 and the first half of 1984 are based on the fiscal and monetary policies set out in the Budget speech and in the Medium Term Financial Strategy. Recent developments and future prospects for monetary growth are described in Part 2 of this Report; details of the PSBR and public sector transactions will be found in Part 5.

and the Current Account

3.04 The recovery in world trade should lead to a renewed rise in exports, helped by better cost competitiveness, from the first half of this year. With imports likely to increase rather faster as domestic demand continues to rise and as the rundown in stocks comes to an end, the surplus on the current account of the balance of payments is forecast to ~~be sizeable, but~~ smaller than in 1982. continue, but be

on

3.05 After the major reduction in inflation over the past year, there is likely to be a pause in 1983 as the effects of the recent fall in the exchange rate are absorbed. With increases in costs likely to continue below the rate of increase in prices, the gradual recovery in profits should continue.

t

3.06 Growth in overseas markets, further increases in domestic demand as the effects of lower inflation and lower interest rates work through, together with gradually improving profitability, should lead to total output rising, by perhaps 2½ per cent between the first half of 1983 and the first half of 1984.

The world economy

Developments

3.07 Two years of slow growth in 1980 and 1981 reflected the 140 per cent rise in oil prices in 1979–80 against the background of policies designed to contain the impact on inflation. By early 1982 there was a widespread expectation that a lower rate of inflation—already falling significantly and expected to contribute to lower interest rates—would lead to a recovery in demand and output in the industrialised world. Instead there were declines in industrial demand and activity, partly reflecting the continuing effects of high real interest rates particularly in the USA; while lower export earnings (as commodity prices fell), high interest rates and a strong dollar combined to raise doubts about credit-worthiness of heavily indebted countries.

3.08 In the course of 1982, inflation fell further, helped by continuing weakness in commodity prices (except oil). The reduction in inflation and the delay in economic recovery, combined with easier monetary policy in the United States,

led to substantially lower interest rates (at least in nominal terms). In the Western economies, stocks were run down further until by the end of the year the level of stocks was if anything below normal. The developing countries were reducing their imports, while their overall debt position was benefiting from lower interest rates.

Chart 3.1

3.09 At the beginning of 1983, there is again a widespread expectation of a moderate recovery in activity, some evidence for which is provided by increases in industrial production and housing starts (in the US) and domestic industrial orders (in Germany). Both interest rates and inflation rates have come down sharply since early 1982 (Eurodollar rates for example fell from 15 per cent to under 9½ per cent), with fiscal and monetary conditions becoming less tight; partly as a result the stock rundown may now be largely over and final demand should rise further; and there is some prospect of an end to the decline in imports into developing countries although further reductions can be expected for oil producers.

~~3.2~~ 3.2

3.10 In most of the economic cycles in the post-war years, the recovery of output has been followed by a rise in commodity prices. In the case of oil, prices are expected to be lower in 1983 not only because of the recession but also because of the lagged effects of earlier price rises. But other commodity prices are already at a low level in relation to world prices generally and rising demand from the industrialised countries will probably induce some increases by the first half of next year, allowing some recovery in the export earnings of developing countries. Indeed some commodities, particularly non-ferrous metals, may see a recovery in prices this year; there have already been scattered indications of this. The position up to the end of 1982 is set out in Chart 3.2. Update in Chart 3.2

3.11 The forecast points to a rise in activity from the first half of 1983: this can be expected to result in only a small increase in output between the average levels of 1982 and 1983, but to a rather faster rate of growth by the first half of 1984. UK export markets should share in the recovery, though the fall in oil revenues will reduce the OPEC market in which the UK has a well above average share. The forecast is summarised in the table below:

Table 3.1

	Per cent changes on a year earlier					
	1975–80	1980	1981	1982	1983	1984 First half
GDP*	3½	1	1½	−½	~~1½~~ 2	3½
Consumer prices*	8½	12	10	7	5	5½
Trade in manufactures (UK weighted)	6	4½	3	−3½	½	6

* Major 6: US, Germany, Japan, France, Italy, Canada.

Exchange rate, trade, relative prices and costs

3.12 The value of sterling, measured against a basket of other currencies, fell more than 10 per cent in late 1982 and early 1983, after a period of little change lasting over a year. The exchange rate will continue to be determined by market forces; for the purposes of this forecast, it is assumed that the effective exchange rate will remain ~~around the level in~~ a little below the level of February 1983. The prospect for inflation, which takes account of this assumption about the exchange rate, suggests that from now on there will be no substantial difference between inflation rates in the UK and in the average of our major competitors. On this basis, the level of cost competitiveness in the UK over the forecast period should be appreciably better than in 1980, 1981 or 1982. Chart 3.3 shows the position of UK costs and prices, relative to those of our competitors, up until early this year.

Chart 3.3

Trade prices

3.13 The effect of the recent change in the value of sterling on price competitiveness is not yet clear. The fall in sterling in 1981, from the exceptional level at the beginning of that year, was reflected in a substantial improvement in relative export prices, as exporters took most of the benefits on prices rather than on profit margins; but in a rather small improvement in import price competitiveness as importers cut their margins to a greater extent than usual. By the end of 1982, profit margins on goods supplied to the UK seemed, on average, to be little higher than elsewhere and hence the scope for further reductions in importers' margins may be more limited than in 1981. With low inflation in most other industrialised countries a fall in oil prices and at least for a time no major recovery in other commodity prices, import prices (as measured by the average value index for total goods) by the second half of 1983 may be under 10 per cent higher than a year earlier.

3.14 In manufacturing, the UK has lost share by volume in most years, but value shares have been roughly constant in recent years:

Chart 3.4

Trade volumes

3.15 In 1982, when world trade in manufactures is estimated to have fallen over 3 per cent, there was a small rise in manufactured exports. This represented a significantly better performance than the substantial loss of share between 1977 and 1981. In the domestic market, there has been a fall in the share of domestic producers except at times of heavy de-stocking in late 1980 and early 1981, and again in the second half of 1982.

3.16 For the first half of 1983, most of the short-term indicators, including engineering orders and the replies to the CBI's questions on orders, as well as the January Trade figures suggest that the level of exports may well be little changed from the second half of 1982. As world recovery gets under way, and as the gains in cost competitiveness begin to be felt, then export growth should pick up, as the improvements in export optimism in the CBI survey also suggest. By the first half of 1984 exports of goods and services could be 5 per cent higher than a year earlier in volume terms.

3.17 The volume of imports levelled off in the course of 1982, despite the rise in final domestic demand, particularly personal consumption. That suggests and the latest figures confirm a stock rundown in the second half of 1982. As that comes to an end an increase in imports can be expected.

Balance of payments

3.18 The current account of the balance of payments was again in large surplus in 1982, some £4 billion on provisional estimates. The high surplus in the second

3.19 With growth of demand in the UK forecast to be a little more than in other countries, and perhaps some worsening in the terms of trade there seems likely to be a further increase in the deficit on non-oil trade. But this may be partly offset by a growing surplus in invisibles—reflecting rising world activity and profitability, as well as the rising stock of overseas assets. The recent depreciation of sterling may not have much net impact on the current account in 1983 but should make for a higher surplus by 1984. In total, the current account is forecast to be in surplus of some £1~~½~~ billion in 1983.

Inflation

3.20 The reduction in inflation in the UK over the past year has been greater than in most other industrialised economies so that by early 1983 the UK inflation rate was well below the European average, though still rather above that of the United States, Germany and Japan.

etail prices

3.21 In January 1983 the Retail Prices Index in the UK was only 5 per cent higher than a year earlier. The corresponding figure for January 1982 was 12 per cent. ~~Over this period~~ The 1 per cent fall in the housing component of the index since January 1982 resulted from the 5 point cut in mortgage rates over this period; and there were falls in the prices of fresh vegetables and other seasonal items. Other indices, for example, wholesale prices and the GDP deflator (a price index for the whole of national output), also indicate a substantial fall in inflation though less marked. This is partly because of the greater weight in the RPI of housing costs and of seasonal foods. The index of wholesale output prices, on a definition excluding food, drink, tobacco and oil products (the latter omitted because extensive discounting has been causing bias in the list prices quoted in the index), was 7½ per cent higher than a year earlier in January 1982; by January 1983 the index was no more than 5½ per cent up on a year earlier.

osts

3.22 1982 was a year in which inflation fell sharply but not at the expense of profit margins where in the non-oil sector there was some recovery from the low point in the second half of 1981. Figures for 1982 are not yet complete, but whole economy costs changed as follows:

Table 3.2

	Per cent changes on a year earlier	
	1981 Q3	1982 Q3
Labour costs per unit of output	8	3½
of which earnings	10½	8½
less productivity growth	−4	−4
plus other labour costs including NIS	1	−1
Import prices (goods and services)	9	3½
Expenditure prices (the deflator for total final expenditure)	10½	6
GDP deflator	11½	6½

3.23 The table shows that the rise in labour costs slowed down considerably in 1982, helped by the slower rate of earnings growth and the cut in the National Insurance Surcharge. Costs rose less than prices.

3.24 Settlements in the current pay round (since last autumn) have been running 1–2 per cent lower than in the previous round. The falling trend in wage settlements is reflected, with a lag, in the average earnings index: in December 1982, its year on year change was down to 8 per cent, from 11 per cent in the fourth quarter of 1981.

eal wages

3.25 In 1982 the rate of price inflation came down faster than the growth of earnings. In consequence real after-tax take-home pay, as it affected the average employee, began to rise from about the middle of 1982. But employers take account in addition of the selling prices of their goods and services, of productivity gains, and of taxes on employment. Continuing productivity gains in 1982, together with reductions in the National Insurance Surcharge, contributed to a fall in the average real wage, per unit of output, paid by employers.

3·5

~~3·7~~

~~3·6~~

Real Wages

3.25 In 1982 . . .

3.6

3.26 Thus by the end of 1982, the real wage received by employees was rising; the real wage paid by employers was edging down and was near the 1979 level. But over the period 1979–82, taken as a whole, both wages and prices rose faster in the UK than in other countries, on average, and this is reflected in measures of price and cost competitiveness.

Prospects

3.27 The fall in the exchange rate since October 1982 is already making for higher import prices. While the extent to which this will affect other prices and costs is very uncertain, it is likely that on average import prices will rise somewhat faster than domestic costs or prices.

3.28 Profit margins in the UK have begun to recover, from a low level, but moderate wage settlements and the limited extent of recovery forecast for the world economy will continue to restrain prices. The general rate of inflation, as measured by the rise in the GDP deflator, is forecast to be about 5½ per cent in 1983, rather below the rate last summer. Price indices which include a substantial direct import component are liable to show a slightly bigger increase for a time. The prices charged by the nationalised industries are expected to rise more slowly than the average of other prices, following a period of above average increases.

3.29 By the fourth quarter of 1983 the inflation rate as measured by the RPI may be about 6 per cent, much the same as in the fourth quarter of 1982. Noticeably lower figures will continue to be experienced for much of this year because of the factors referred to in paragraph 3.21. By mid 1984, the world and UK recoveries should be well under way, with perhaps more pressure on commodity prices and firms better placed to improve profit margins; but on the other hand there should be benefits from a greater stability of the exchange rate. The RPI by mid 1984 could be rising at an annual rate of 6 per cent—close to the assumed rise in the GDP deflator of 5½ per cent in financial year 1984–85 (see paragraph 2.18). Although a wide margin of error surrounds these forecasts, the rate of inflation over the forecast period should be below the rates seen at any time since the early 1970s. This change reflects in large part the influence of the monetary and fiscal policies pursued in recent years.

Demand and activity

Personal spending

3.30 After little change for about three years, personal spending rose sharply in the second half of 1982. Expenditure on durables in particular rose rapidly reflecting mainly the beginning of an upturn in real take-home pay, lower interest rates, the abolition of HP controls in July and continued easy availability of bank credit. In addition, low purchases of durables during the previous two years had left stocks of durables held by consumers rather depleted.

3.31 The fall in real personal disposable incomes—estimated at about 4 per cent between 1980 and 1982—was more than offset by a fall in the saving ratio. This went beyond the usual tendency for savings to act as a cushion for fluctuations in incomes and helps to confirm that the need for saving was becoming less as the rate of inflation and interest rates moved down substantially. The chart also shows how the personal sector has been able to begin to rebuild its financial asset holdings: the ratio of gross financial wealth to income has risen since 1980, with capital gains, reflecting lower nominal interest rates, and high borrowing more than offsetting the fall in the flow of saving.

3.7

3.32 By the end of 1982, the real earnings of those in work were rising again; and in 1983 the real value of personal disposable income, taking account of the tax changes proposed in the budget, is forecast to rise about 2 per cent. The saving ratio having already fallen sharply in the course of 1982 may remain a little below the 1982 average and consumer spending could rise 2½ per cent in 1983.

Stocks

3.33 With the rise in consumer spending in the second half of 1982 manufacturers and distributors ran down their stocks, and by the end of 1982 the ratio of

period, it seems likely that distributors will want to rebuild their stocks of consumer goods. Manufacturers' stocks, however, could still be above desired levels, judging by the results of the recent CBI surveys; and with only limited prospects of recovery in their output, the level of stocks in this sector could fall further for a time. In aggregate, the destocking in 1982, now put at about £¾ billion at 1975 prices, could be followed by a small rise in stock levels in 1983.

Investment

3.34 Fixed investment in total in 1982 is estimated to have been 3½ per cent higher by volume than the previous year. In the private sector investment in new dwellings rose about 8 per cent, in response to the readily available supply of mortgage finance and successive reductions in interest rates. In the distributive and service sectors of the economy investment (excluding leased assets) rose 7 per cent. Prospects for demand and profitability have been stronger here than in the manufacturing sector, where investment (including leased assets) fell a further 8 per cent. In the public sector, there were increases in the volume of fixed investment by central government and the nationalised industries. Investment by local authorities, excluding council house sales (which count as negative investment), was little changed.

3.35 The surveys carried out by the Department of Industry and by the CBI are consistent with a further rise in industrial investment in total, in 1983; within the total the fall in manufacturing investment may come to an end in the course of the year. Taking investment and consumption together, the volume of expenditure by the public sector on goods and services is forecast to rise slowly, consistently with the proportion of total public expenditure in the economy falling slowly.

Demand and Activity

3.36 In total, domestic demand is expected to rise further in 1983 and the first half of 1984. The prospect of world recovery and the effects of recent gains in competitiveness point to a strong rise in UK exports by the first half of 1984:

Table 3.3

Per cent changes on a year earlier

	1982	1983	1984 First half
Domestic demand	2½	3½	3
Exports of goods and services	½	1	5

The absence of any further rundown in stocks and the faster growth of total demand points to further rises in imports, together with a growth of domestic output:

Table 3.4

Per cent changes on a year earlier

	1982	1983	1984 First half
Imports of goods and services	5	5	5
Domestic production: total GDP	½	2	2½

3.37 The share of manufacturing industry in total output has been falling since the early 1970s, and particularly strongly since 1979. Official forecasts of manufacturing output have generally proved over-optimistic, to a considerable extent because the demand for manufactures in total was overstated. The forecast of manufacturing output in 1983 takes account of recent survey information. By the first half of 1984, output in the manufacturing sector could be rising at much the same rate as in the rest of the economy.

Table 3.5

1975=100	1982 I	1982 II	1983 I	1983 II	1984 I
Gross domestic product	106	106½	107½	109	110

SECOND PROOF—F.S.

Employment, productivity and profitability

Employment

3.38 Total employment fell by some 1¾ million between 1979 and 1982, with a fall of nearly 1½ million in manufacturing, where the problems of profitability and competitiveness have been greatest. The further fall of employment in 1982 was accompanied by a rise in unemployment from 10.7 per cent in 1981 to 12.5 per cent in 1982, a slower rise than in the previous year. In manufacturing, there is convincing evidence of an above average gain in productivity since 1980, though the extent of the fall in output makes the precise size of this gain difficult to assess. Outside manufacturing, the revised employment data up to mid 1981, and the less reliable indications available for 1982, do not suggest any marked improvement in productivity growth since 1979. Chart 3.8 shows the main features:

3.8

Productivity

3.39 In 1982 there was evidence that the period of exceptionally rapid productivity gains in manufacturing was giving way, as had been expected, to more moderate gains. Growth of total output in the range 2–2½ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, is probably consistent with no great change in unemployment. more too

Profitability

3.40 Company profitability reached a low point in 1981: DOI estimates, based on necessarily very uncertain assumptions about obsolescence of capital and about tax, suggest that for industrial and commercial companies outside the North Sea the average real rate of return was about 3 per cent, compared to about 10 per cent a decade ago. Preliminary estimates for 1982 point to some recovery; and the forecast for inflation is consistent with some further increase in profitability in 1983. This, in turn, should help to ensure that a good part of the rise in demand is met from domestic supply.

Forecast and outturn

Main Elements

3.41 The table below compares the main elements of the forecast published in the 1982 FSBR with outturns or latest estimates.

Table 3.6

	Forecast	Outturn Estimate
Total output, per cent change between 1981 and 1982	1½	½
Retail Prices Index: per cent increase between the fourth quarters of 1981 and 1982	9	6
Current account of the balance of payments in 1982, £ billion	4	4
PSBR, 1982–83, £ billion	9½	7½

Output and Trade

3.42 GDP increased rather less than forecast in 1982. World demand and trade were substantially less than forecast, accounting for more than all the difference of ~~3½~~ 3 per cent on exports of goods and services; consumer demand (helped by lower

prices) was a little higher than expected. But much of this was met out of stocks and with manufacturers keen to get stock levels down further there was another substantial fall in stocks in 1982. Much of this was reflected in lower imports. The current account surplus in 1982 turned out very close to the Budget estimate: both exports and imports were lower than forecast.

es

3.43 Retail prices in the fourth quarter of 1982 were nearly 3 per cent lower than forecast. Major contributing factors were the much lower increases than expected in housing costs (including the mortgage rate) and in seasonal foods. The general level of prices, as measured by the GDP deflator, was subject to a smaller margin of error: the GDP deflator in 1982–83 is estimated to have been 7 per cent higher than a year earlier, compared with a figure of 7½ per cent expected at the time of the 1982 Budget.

R

3.44 The latest estimate for the PSBR in 1982–83, still subject to considerable uncertainty, is ~~nearly~~ £2 billion less than the forecast made in March 1982— about rather more when allowance is made for the policy changes announced in November. Details will be found in Part 5.

Risks and uncertainties

3.45 No forecast is complete without some indication of error margins. Table 3.7 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide the best indication of possible errors in the current forecasts: while the size of errors will change over time as the economy fluctuates more or less, and as forecasting techniques change, in most cases the averages have not shifted very much since they were first published in 1976.

3.46 The forecasts of those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR approach £200 billion; and for the current account of the balance of payments approach £100 billion. For the RPI, average errors are derived from a period of high inflation, averaging 14 per cent and subject to large fluctuations.

The Prospects

mary Table

Table 3.7 Short-term Economic Prospects

	Forecasts	Average errors from past forecasts*
A. Output and expenditure at constant 1975 prices		
Per cent changes between 1982 and 1983:		
Gross domestic product (at factor cost)	2	1
Consumers' expenditure	2½	1
General Government consumption	½	1½
Fixed investment	3½	2½
Exports of goods and services	1	2½
Imports of goods and services	5	2½
Change in stockbuilding (as per cent of level of GDP)	1	¾
B. Balance of Payments on current account		
£ billion:		
1982	4	—
1983	~~1½~~ 1	2
1984 1st half (at an annual rate)	2	3½
C. Public Sector Borrowing Requirement		
£ billion; in brackets per cent of GDP at market prices:		
Financial year 1982–83	7½ (2¾)	—
Financial year 1983–84	~~8 (2¾)~~ 8½ (3)	4 (1½)
D. Retail Prices Index		
Per cent change:		
Fourth quarter 1982 to fourth quarter 1983	6	2
Second quarter 1983 to second quarter 1984	6	4

* The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables are derived from internal forecasts made during the period June 1965 to October 1980. For the current balance and the retail prices index, forecasts made between June 1970 and October 1980 are used. For the PSBR, Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

Table 3.8 Constant price forecasts of expenditure, imports and gross domestic product*

£ million at 1975 prices, seasonally adjusted

	Consumers' expenditure	General government consumption	Total fixed investment	Exports of goods and services	Change in stocks	Total final expenditure	Less Imports of goods and services	Less Adjustment to factor cost	Plus Statistical adjustment	Gross domestic product at factor cost	GDP index 1975=100
1980	71 550	24 300	20 450	33 050	−1 550	147 800	34 100	12 200	200	101 700	108·0
1981	71 850	24 300	18 600	32 300	−1 850	145 200	33 900	12 100	0	99 200	105·4
1982	72 750	24 550	19 250	32 500	−700	148 350	35 550	12 350	−550	99 900	106·1
1983	74 650	24 700	19 950	32 800	300	152 400	37 400	12 650	−500	101 850	108·2
1981 H1	35 950	12 100	9 300	15 900	−1 400	71 850	15 950	6 100	−200	49 600	105·3
H2	35 900	12 200	9 300	16 400	−450	73 350	17 950	6 000	200	49 600	105·4
1982 H1	35 950	12 250	9 500	16 400	−50	74 050	18 050	6 050	−150	49 800	105·8
H2	36 800	12 300	9 750	16 100	−650	74 300	17 500	6 300	−400	50 100	106·4
1983 H1	37 100	12 300	~~9 990~~ 9900	16 200	0	75 500	18 450	6 300	−250	50 500	107·3
H2	37 550	12 400	10 050	16 600	300	76 900	18 950	6 350	−250	51 350	109·1
1984 H1	38 000	12 450	10 250	17 000	250	77 950	19 400	6 450	−250	51 850	110·2
% changes:											
1981 to 1982	1	1	3½	½		2	5	2		½	
1982 to 1983	2½	½	3½	1		2½	5	2½		2	
1983 H1 to 1984 H1	2½	1	3½	5		3	5	2		2½	

*GDP figures in the table are based on " compromise " estimates of gross domestic product. Figures in £ million are rounded to £50 million. Percentage changes are calculated from unrounded levels and then rounded to half per cent. The GDP index in the final column is calculated from unrounded numbers.

4. The Budget proposals in detail

4.01 The Budget proposals are described in detail in this part. The description of the Inland Revenue proposals is followed by those for Customs and Excise, Vehicle Excise Duty and the National Insurance Surcharge and by the expenditure measures in the Budget. The direct effects of changes in taxation are shown in Table 4.2 at the end of this part.

Inland Revenue

Income Tax

4.02 It is also proposed—

to increase the single person's allowance and the wife's maximum earned income relief from £1,565 to £1,785 and the married allowance from £2,445 to £2,795.

to increase the additional personal allowance and widows' bereavement allowance from £880 to £1,010.

to increase the age allowance for the single person from £2,070 to £2,360, for the married from £3,295 to £3,755 and the age allowance income limit from £6,700 to £7,600.

to increase the basic rate limit to £14,600.

to increase the width of the 40 per cent band to £2,600, of the 45 per cent band to £4,600 and of the 50 per cent and 55 per cent bands to £7,100.

As a consequence of these changes, the structure of personal tax rates in operation in 1983–84 will be:—

Bands of Taxable Income

£	Per cent
0 — 14 600	30
14 601 — 17 200	40
17 201 — 21 800	45
21 801 — 28 900	50
28 901 — 36 000	55
over 36 000	60

4.03 It is also proposed—

to raise the threshold for the investment income surcharge for 1983–84 from £6,250 to £7,100.

~~to extend the widows' bereavement allowance to cover the year after the husband's death.~~

to increase with effect from 1984–85 the scales which determine the cash equivalents of car and car fuel benefits of directors and higher-paid employees.

to alter the law in relation to benefits in kind of directors and employees from scholarships, ~~loans,~~ PAYE tax payments, and, from 1984–85, provided accommodation.

~~to increase the limit on loans qualifying for mortgage interest relief from £25,000 to £30,000.~~

to extend mortgage interest relief to interest paid on certain loans for the purchase of a house by a borrower who is under a contractual obligation to live in other accommodation.

to extend the "Business Start-up Scheme" to investment in a wider range of companies and to make other changes ("Business Expansion Scheme").

to increase the maximum annual value for appropriations of shares to an employee under an approved profit-sharing scheme by adding to the present limit of £1,250 an alternative limit of 10 per cent of the employee's salary subject to a maximum of £5,000.

to raise from £50 to £75 the upper limit on monthly contributions by an employee under an approved savings-related share option scheme.

to extend from three to five years the period over which the income tax payable on the exercise of a share option by a director or employee may be paid by instalments.

to extend relief for interest paid on money borrowed to buy shares in an employee-controlled company as part of an employee buy-out.

to increase the limit on tax relief allowed to individuals for covenants in favour of charities at the higher and additional rates.

to make gains on certain "secondhand bonds" liable to income tax.

to increase to £1,000 the limit for not assessing income tax on an individual under the close companies' apportionment provisions.

Income tax and corporation tax

4.04 It is proposed—

to extend, until 31 March 1987, the 100 per cent first year allowance for expenditure on British films.

to extend, for one year, the 100 per cent first year allowance for expenditure on rented teletext sets.

to increase from 10 per cent to 25 per cent, for the industrial building allowance, the permissible cost relating to non-industrial purposes.

to allow expenditure on the conversion of existing premises to small industrial workshops to qualify for the 100 per cent allowance where the average size of all the converted units is within the prescribed limit.

to extend stock relief to houses taken in part exchange by housebuilders in certain circumstances.

to allow payment of interest on Eurobonds in certain circumstances without deduction of tax.

Income tax, corporation tax and capital gains tax

4.05 It is proposed to provide new rules for the tax treatment of stock issued by companies at a discount.

Corporation tax

4.06 It is proposed—

for the financial year 1982 to fix the "small companies" rate of corporation tax at 38 per cent (previously 40 per cent), to increase the limit for that rate from £90,000 to £100,000 and to increase the limit for marginal relief from £225,000 to £500,000.

to extend progressively from two to six years the period for which "surplus" advance corporation tax may be carried back and set against corporation tax.

to allow credit for foreign tax ~~paid~~ against corporation tax before it is reduced by advance corporation tax.

to enable Trustees Savings Banks to be treated for tax purposes as bodies corporate.

to enable a charge to corporation tax to be imposed with effect from 6 April 1984 on United Kingdom resident companies which have an interest of 10 per cent or more in certain United Kingdom controlled companies resident in low tax territories, the charge being proportionate to their interest.

to extend relief to companies for discount on bills of exchange accepted by banks carrying on business in the United Kingdom, and for the incidental costs of raising such finance.

to extend the relief for the incidental costs of obtaining loan finance.

to allow relief for the costs of employees seconded to charities.

to make provision against the avoidance of tax through group and consortium relief.

to introduce, for certain securities, an alternative method for calculating the indexation allowance applying to capital gains.

Oil taxation

4.07 It is proposed—

to reduce the rate of advance petroleum revenue tax from 20 per cent to 15 per cent from 1 July 1983; to 10 per cent from 1 January 1985; to 5 per cent from 1 January 1986; and to abolish it from 1 January 1987.

to allow relief against petroleum revenue tax (PRT) on any field for expenditure incurred after 15 March 1983 in searching for oil and appraising discovered reserves anywhere in the United Kingdom, and the United Kingdom Continental Shelf.

to increase the PRT oil allowance to 500,000 tonnes of oil per chargeable period subject to a cumulative limit of 10 million tonnes per field for

offshore fields outside the Southern basin where development consent is given after 1 April 1982. (In addition the Secretary of State for Energy proposes to ~~waive~~ abolish royalties for such fields.)

to revise the PRT rules for relief for expenditure on shared assets and to charge related receipts.

to exclude from charge oil won which the participator uses for production purposes in another field.

to correct certain technical defects in the PRT provisions.

Capital gains tax

4.08 It is proposed—

to increase the annual exempt amounts in line with the increase in the retail prices index so that for 1983–84 an individual will be exempt on the first £5,300, and most trusts on the first £2,650, of capital gains.

to increase the limit on reliefs ~~affecting~~ relating to the transfer of a business on retirement.

to increase the limit on reliefs relating to the letting of residential accommodation and small part disposals of land.

to extend the private residence relief to gains arising to a person required by the terms of his trade or profession to live in other accommodation.

to abolish the small gifts exemption and the payment by instalment facilities.

to amend the rules relating to the value at which assets are deemed to be acquired from certain non-resident trusts.

Development land tax

4.09 It is proposed—

to defer the charge on a deemed disposal which is started before 1 April 1986 (instead of 1 April 1984 as at present) and is for the owner's use, and to extinguish *any* deferred liability which has not become chargeable within 12 years of the start of development.

to improve the machinery for deducting tax from consideration when there is a disposal by a non-resident.

to extend the period over which tax can be paid by instalments from 8 to 10 years and remove the facility to pay by half-yearly instalments.

Capital transfer tax

4.10 It is proposed to introduce new rate schedules for both death and lifetime transfers as follows:

Band of chargeable value £'000	Rate on death per cent	Lifetime rate per cent
0 – 60	Nil	Nil
60 – 80	30	15
80 – 110	35	17½
110 – 140	40	20
140 – 175	45	22½
175 – 220	50	25
220 – 270	55	30
270 – 700	60	35
700 – 1 325	65	40
1 325 – 2 650	70	45
over 2 650	75	50

4.11 It is also proposed—

to increase the rate of relief for transfers of minority holdings in unquoted companies from 20 per cent to 30 per cent.

to increase the rate of relief for transfers of tenanted agricultural land from 20 per cent to 30 per cent.

to extend the period over which tax may be paid by instalments from 8 to 10 years and remove the facility to pay by half-yearly instalments.

to remove the ceiling of £250,000 on the total value of transfers within one year of death to charities which is exempt.

to remove the special rule under which persons becoming domiciled in the Channel Islands or the Isle of Man may be regarded as remaining domiciled in the United Kingdom for tax purposes.

to clarify the rules about the incidence of tax on death when the Will contains no directions.

to amend the provisions relating to settled property.

Customs and Excise

Value added tax

4.12 It is proposed to increase the registration and deregistration limits by Order made under Section 13(3) of the Finance Act 1982. From 16 March 1983 the registration limits will become £18,000 per annum and £6,000 per quarter. From 1 June 1983 the deregistration limits will become £17,000 per annum where estimated future turnover is concerned, and £18,000 per annum where past turnover is concerned.

Alcoholic drinks

4.13 It is proposed, from midnight 15–16 March 1983, to increase:

—the rates of duty on spirits from £14·47 to £15·19 per litre of alcohol;

—the rate of duty on beer from £20·40 to £21·60 per hectolitre and the charge for each additional degree of original gravity above 1030° per hectolitre from £0·68 to £0·72;

—the rates of duty on wine by the following amounts per hectolitre:

Wine of an alcoholic strength:

not exceeding 15 per cent: from £106·80 to £113·00;

exceeding 15 per cent but not exceeding 18 per cent: from £137·90 to £145·90;

exceeding 18 per cent but not exceeding 22 per cent: £162·30 to £171·70;

exceeding 22 per cent: £171·70 plus £15·19 (instead of £14·47) for every 1 per cent, or part of 1 per cent, in excess of 22 per cent;

surcharge on sparkling wine: from £23·45 to £24·80;

—the rates of duty on made-wine by the following amounts per hectolitre:

Made-wine of an alcoholic strength:

not exceeding 10 per cent: from £73·10 to £79·30;

exceeding 10 per cent but not exceeding 15 per cent: from £103·80 to £109·80;

exceeding 15 per cent but not exceeding 18 per cent: from £127·80 to £135·20;

exceeding 18 per cent: £135·20 plus £15·19 (instead of £14·47) for every 1 per cent, or part of 1 per cent, in excess of 18 per cent;

surcharge on sparkling made-wine: from £10·75 to £11·35;

—the rate of duty on cider and perry from £8·16 to £9·69 per hectolitre.

Hydrocarbon oil

4.14 It is proposed from 6 pm on 15 March 1983, to increase: 16·68

—the rate of duty on light hydrocarbon oil from 15·54p to ~~16·30~~p per litre;

—the rate of duty on heavy hydrocarbon oil for use as road fuel from 13·25p to ~~13·82~~p per litre.
14·20

The duty on petrol substitutes and spirits used for making power methylated spirits is charged at the same rate as on light hydrocarbon oil, and aviation gasoline and gas for use as road fuel are charged at half the rate on light hydrocarbon oil.

Tobacco

4.15 It is proposed, from midnight 17–18 March 1983, to increase: 22·00

—the specific element in the duty on cigarettes from £20·68 to £~~21·67~~ per 1,000 cigarettes (the *ad valorem* element remaining unchanged);

41·50

—the duty on cigars from £39·00 to £~~40·85~~ per kilogram;

35·80

—the duty on hand-rolling tobacco from £33·65 to £~~35·40~~ per kilogram.

Table 4.1 Approximate direct effects of changes in Duty Rates on certain product prices

(All except VED inclusive of 15 per cent VAT)

Spirits duty	25p on a bottle of spirits
Beer duty	1p on a pint of beer of average strength
Wine duty	5p on a bottle of table wine
Fortified wine duty	7p on a bottle of sherry
Petrol duty	6p ~~4p~~ on a gallon of petrol
Derv duty	5p ~~3p~~ on a gallon of derv
Tobacco duty	4p ~~3p~~ on a packet of 20 cigarettes
Vehicle excise duty	£5 on a car licence

Vehicle Excise Duty

4.16 It is proposed to increase the excise duty on mechanically-propelled vehicles, other than goods vehicles, chargeable under Section 1 of the Vehicles (Excise) Act 1971 and under Section 1 of the Vehicles (Excise) Act (Northern Ireland) 1972 by about 6 per cent. This figure is broadly descriptive. There will be some variations within particular vehicle categories.

4.17 The duty on most cars and light commercial vehicles will rise by £5 to £85. The rates of duty on heavy goods vehicles at the lower end of the duty scales will be reduced by about 10 per cent but on the most damaging heavy goods vehicles duty will be increased by up to 26 per cent. [The duty on a 32½ tonne lorry will rise by £470 to £2,290 and the duty on a 38 tonne lorry will be set at £2,940.] These changes have effect in relation to licences taken out after 15 March.

~~National Insurance Surcharge~~

~~4.18 It is proposed to reduce by ½ percentage point to 1 per cent the surcharge paid in respect of employees by secondary Class 1 contributors under the provisions of the National Insurance Surcharge Act 1976. This reduction will take effect from 1 August 1983. Expenditure programmes (excluding local authorities) will be reduced accordingly (see Table 5–5).~~

Expenditure Measures

Industrial innovation

4·18 ~~4.19~~ New measures to encourage industrial investment and promote industrial innovation, including the revival of the Small Engineering Firms Investment Scheme, will involve additional expenditure of £185 million over the next three years. The cost is £39 million in 1983–84.

Housing improvement

4·19 ~~4.20~~ Local authorities will be given additional capital spending allocations for use in 1983–84 on the improvement of run-down private sector housing through approved "enveloping" schemes. In addition, eligible expenses limits for improvement grants are to be increased by 15 per cent and local authorities will be permitted to increase expenditure on these grants as necessary. The two measures are likely to lead to additional expenditure by local authorities of around £60 million in 1983–84.

Employment

4·20 ~~4.21~~ A new part-time Job Release Scheme will be introduced, the gross cost of which will be fully offset by lower benefit payments in 1983–84. Over the two following years, net additional expenditure will be around £16 million. The Enterprise Allowance will be extended with a net expenditure cost of some £27 million over the next two years. The net cost in 1983–84 is £17 million.

Social Security

4·21 ~~4.22~~ The 5 per cent abatement of unemployment benefit will be restored and a number of new measures introduced to help the sick, the disabled and the less well off. The net cost is £26 million in 1983–84. Men over 60 on supplementary benefit will qualify for the long-term rate immediately, no longer having to wait a year. In addition, unemployed men over 60 will not need to register for work to protect their entitlement to basic pension. These measures cost £23 million in 1983–84. It is also proposed to change the basis for calculating the uprating of benefits.

Child benefit

4·22 ~~4.23~~ Child benefit will be increased to £6.50 and One Parent Benefit to £4.05, both from November 1983. The cost is £74 million in 1983–84 over and above what is already provided for.

Gross cost

4·23 ~~4.24~~ The gross cost of these measures, totalling £251 million, will be charged to the Contingency Reserve and will not therefore add to public expenditure.

Inland Revenue(*b*)

Table 4.2 Direct effects (a) of changes in taxation

£ million

	Forecast for 1983–84	Forecast for a full year
INLAND REVENUE		
Income Tax		
Increase in single allowance by £220 and married allowance by £350	−1 630 (*b*)	−1 995 (*b*)
Increase in additional personal allowance and widows' bereavement allowance by £130	−10 (*b*)	−10 (*b*)
Increase in age allowance by £290 (single) and by £460 (married) and in income limit by £900	−210 (*b*)	−260 (*b*)
Increase in basic rate limit by £1 800 to £14 600	−90 (*b*)	−140 (*b*)
Increase in further higher rate thresholds	−60 (*b*)	−115 (*b*)
Increase in investment income surcharge threshold	Negligible (*b*)	−25 (*b*)
~~Extension of widows' bereavement allowance~~	~~25~~	~~30~~
Fringe benefits—increases in car and car fuel scales for 1984–85	Nil	+35 (*c*)
Fringe benefits—changes in relation to scholarships, ~~loans,~~ PAYE tax payments and (from 1984–85) to provided accommodation	Nil	+10
~~Increase in mortgage interest relief limit~~	~~50~~	~~60~~
Extension of mortgage interest relief to certain borrowers	−2	−5
Extending the " Business Start-up Scheme "	Nil ~~25 (*d*)~~	−75 (*d*)
Increases in employee shareholding reliefs	−20	−35 (*d*)
Interest relief for borrowing to buy shares in employee-controlled companies	−1	−2
Change in relief on covenanted gifts to charities	Negligible	−3
Secondhand bonds	Negligible	Negligible
Limit for assessments of apportioned income	Negligible	Negligible
Income tax and Corporation tax		
Extension of capital allowances on British films	Nil	−30 (*e*)
Extension of capital allowances on teletext sets	Nil	−10 (*f*)
Industrial buildings allowance: increase in non-industrial space	Nil	−25 (*g*)
Conversions to small industrial workshops	Negligible	Negligible
Extension of stock relief for housebuilders	Negligible	−5
Payment of Eurobond interest without deduction of tax	Negligible	−2
Income tax, corporation tax and capital gains tax		
Provisions relating to stock issued at a discount	Negligible	−15 (*d*)(*h*)
Corporation tax		
Reduction in " small companies " rate and increase in limits	−40	−70
Extension of carry back period for advance corporation tax	Nil	(*i*)
Change in arrangements for setting off advance corporation tax and double taxation relief	Nil	(*j*)
Treatment of TSBs as bodies corporate	−3	−10
Charge to tax in respect of controlled foreign companies	Nil	(*k*)
Relief for discounts etc. on bills of exchange	Negligible	−1
Incidental costs of obtaining loan finance	Negligible	Negligible
Employees seconded to charities	Negligible	Negligible
Provision against avoidance through group etc. relief	Negligible	+10 (*d*)
Alternative method for calculating indexation allowance applying to capital gains	Nil	Nil
Petroleum revenue tax		
Phasing out of advance petroleum revenue tax	−50	(*l*)
Appraisal and exploration relief	−40	(*m*)
Increase in PRT oil allowance for future fields	Nil	(*n*)
PRT expenditure relief for shared assets and charge on related receipts	−15	(*o*)
Minor PRT changes	−10	−5
Capital gains tax		
Indexation of annual exempt amounts	Nil (*b*)	−10 (*b*)(*p*)
Increase in limit for retirement relief	Nil	−4
Increase in other monetary limits	Nil	−1
Other changes	Nil	Negligible
Development land tax		
Charge on a deemed disposal	Nil	−4
Disposals by non-residents	+1	+2
Extension of instalment period	Negligible	Nil
Capital transfer tax		
Increase in thresholds and changes in bands	−20 (*b*)	−50 (*b*)(*q*)
Increase in rates of business and agricultural relief	Negligible	−5
Extension of instalment period	−2	Nil (*r*)
Removal of ceiling in charity exemption	Negligible	−1
Other changes	−1	−2
TOTAL INLAND REVENUE	~~−2 303~~ −2203	~~−2 948~~ (*s*) −2858

BUDGET—SECRET

SECOND PROOF—F.S.

Customs and Excise

Table 4.2 Direct Effects (a) of Changes In Taxation *(continued)*

	Forecast for 1983–84	Forecast for a full year
		£ million
CUSTOMS AND EXCISE		
Value added tax		
Increase in registration limits	−5	−5
Excise duties		
Increases in rates of duty on light oil, etc.	~~+190~~ +280	~~+190~~ +280
Increase in rate of duty on heavy oil for use in road vehicles	~~+40~~ +60	~~+40~~ +60
Increases in rates of tobacco products duty	~~+95~~ +125	~~+100~~ +130
Increase in rate of spirits duty	+25	+25
Increases in rates of beer duty	+85	+90
Increases in rates of wine and made-wine duties	+25	+25
Increase in rate of duty on cider and perry	+5	+5
TOTAL CUSTOMS AND EXCISE	~~+460~~ +600	~~+470~~ +610
Vehicle excise duty		
Increase in rates of duty	+130	+130
~~**National Insurance surcharge**~~		
~~Reduction in surcharge~~	~~−215~~	~~−400 (t)~~
Other		
Bus Fuel Grants	~~−5~~ −8	−8 ~~−5 (u)~~ (t)
TOTAL CHANGES IN TAXATION	~~−1 033~~ −1481	~~−2 763~~ −2126

(*a*) Indirect effects are excluded. The expenditure tax figures do, however, allow for the effects of relative price changes on the composition of consumers' expenditure. This is explained in the note on page 9 of the Financial Statement and Budget Report 1981–82. A fuller description of the estimation of the direct effects of expenditure tax changes is provided in an article in *Economic Trends*, March 1980.

(*b*) *Taxes subject to statutory indexation.* The table below shows the direct revenue costs of indexing the income tax main allowances and thresholds, the capital gains tax exempt amounts and the capital transfer tax threshold and bands by reference to the increase in the general index of retail prices between December 1981 and December 1982 (5·4 per cent), rounded in accordance with the statutory provisions, together with the costs of the proposed changes on top of indexation:—

Direct Revenue Costs	Indexation 1983–84	Indexation Full Year	Proposed changes on top of indexation 1983–84	Proposed changes on top of indexation Full Year
				(£ million)
Income Tax				
Main allowances	−760	−930	−1 090	−1 335
Basic rate limit	−40	−60	−50	−80
Further higher rate thresholds	−30	−55	−30	−60
Investment income surcharge threshold	Negligible	−10	Negligible	−15
Total income tax	−830	−1 055	−1 170	−1 490
Capital gains tax				
Exempt amounts	Nil	−10	Nil	Nil
Capital transfer tax				
Thresholds and bands	−15	−35	−5	−15

(*c*) Effective from 1984–85; the yield in 1984–85 will be £30 million.

(*d*) These estimates are highly uncertain.

(*e*) The change takes effect from 1 April 1984, but the effect on tax receipts in 1984–85 will be negligible.

(*f*) The cost in 1984–85 will be £8 million.

(*g*) The cost in 1984–85 will be £10 million.

(*h*) Effect on tax liabilities for 1983–84; over a period of years there will be some deferment of tax liabilities.

(*i*) Tax liabilities for accounting periods ending in 1981–82 and later will be reduced. The costs in 1984–85 and 1985–86 are tentatively estimated at £1 million and £15 million respectively, and there will be some continuing costs thereafter.

(*j*) The cost will be negligible in 1984–85 and some £25 million in 1985–86; in the long term it could be up to £100 million.

(*k*) The yield will be negligible in 1984–85 and some £25 million in 1985–86, building up to £100 million.

(*l*) The main medium term effect of phasing out advance petroleum revenue tax is to defer payment of petroleum revenue tax; over the years the amount payable would be unchanged apart from a secondary effect on reliefs against petroleum revenue tax which may give some net yield in later years. In discounted terms the effect of this deferment is generally beneficial to the industry.

(*m*) The immediate cost will be offset by reductions in reliefs in future years but there will be a net benefit to the industry in discounted terms.

(*n*) The eventual cost depends on how many fields are developed in future; it could be a yield if additional fields are developed as a result of the proposal.

(*o*) The net cost in 1983–84 arises because the adjustments to be made in restrictions to relief already made, or due to be made, under existing law exceed the estimated yield from receipts. In subsequent years there is an estimated net yield (around £15 million a year on average for the years 1984–85 to 1986–87), but the industry will also be relieved from further substantial relief restrictions applicable under existing law. (These cannot be precisely quantified but the cost could run to some hundreds of million pounds over a period of years.)

(*p*) The effect on receipts in respect of tax liabilities for 1983–84; the effect on receipts in 1984–85 will be £3 million.

(*q*) The effect on receipts in respect of tax liabilities for 1983–84; the effect on receipts in 1984–85 will be £40 million.

(*r*) The cost in 1984–85 will be £5 million.

(*s*) No figures are included for the changes covered by footnotes (*i*) and (*l*) to (*o*) above; and any figures covered by footnotes (*j*) and (*k*) are broadly offsetting.

~~(*t*) Figures exclude public sector payments of [£75 million] in 1983–84 and [£225 million] in a full year. Public expenditure will be reduced accordingly. See Part 5, Table 5.5.~~

(t) ~~(*u*)~~ This is consequential on the increase in road fuel duties.

Sent to Printer 11/3/83

MARK II

NOTE 1982-83 will need amending

5. Public sector transactions

5.01 The tables in Part 5 provide further information on ~~the~~ transactions of the public sector in 1982–83 and 1983–84. They elaborate the rounded and summary figures for those years shown in Parts 2 and 3. The ~~1983–84~~ forecasts incorporate the effects of Budget measures. The basis of the tables and the relationship between them is outlined in paragraphs 5.19–5.22.

The Public Sector Borrowing Requirement

5.02 Table 5.1 shows the composition of the Public Sector Borrowing Requirement (PSBR) in 1982–83 and 1983–84.

Table 5.1 Public Sector Borrowing Requirement

£ billion

Borrowing requirement of	1982–83 Budget forecast	1982–83 Latest Estimate	1983–84 Forecast
Central government	9·3	11·5	~~11·5~~ 12·0
Central government own account(¹)	5·4	6·4	~~8·6~~ 9·0
Local authorities	0·6	−0·1	−0·2
Public corporations	1·9	1·5	1·~~[illegible]~~2
Unallocated(²)	1·7	—	−1·~~[illegible]~~2
Public sector	9·5	7·8 *	8·~~[illegible]~~7

(¹) Central government borrowing less on-lending to local authorities and public corporations.

(²) Includes unallocated Contingency Reserve, special sales of assets and general allowance for shortfall. See ~~Table 5.8 for breakdown of 1983–84.~~ paragraph 5.21.

* at risk to change to 7·9 in FSBR Mark I

5.03 The scale of borrowing towards the end of the financial year is always difficult to predict. Outturn information on the 1982–83 PSBR will not become available until late April although the CGBR will be available rather earlier. Based on outturns to end February and a forecast for March, the current estimate of outturn is ~~about £7½~~ nearly £8 billion. The forecast for 1982–83 a year ago was £9½ billion, reduced to £9 billion in the Autumn Statement.

5.04 The PSBR in 1983–84~~(¹)~~ is forecast to be ~~about £8½~~ ~~just over £8~~ between £8½ and £9 billion. The high CGBR reflects borrowing for on-lending to local authorities and public corporations. As in 1982–83, they are expected to repay a considerable amount of market debt.

Central government

5.05 Table 5.2 shows forecasts for central government receipts and expenditure in 1982–83 and 1983–84.

5.06 Total Receipts in 1982–83 are currently expected to be about the same as forecast a year ago. ~~Receipts from~~ North sea oil taxes in 1982–83 are about £1¼ billion higher than expected, but this is offset by lower than expected receipts from VAT and national insurance contributions. Expenditure is expected to be over £2 billion more than forecast, more than accounted for by higher lending to local authorities but offset to some extent by underspending on cash limited votes. The CGBR is therefore expected to be nearly £2 billion more than forecast, although this is very uncertain given the difficulty of forecasting receipts and expenditure in March.

~~(¹) The PSBR forecast for 1983–84 and its sub-sector components incorporate certain minor definitional changes. The most important is that changes in public sector deposits with banks are treated as transactions financing the PSBR rather than as affecting its size. The figures for 1982–83 are on the existing definition and will not be redefined until after the outturns are published in April.~~

Table 5.2 Central Government Transactions

£ billion

	1982-83 Budget forecast	1982-83 Latest Estimate	1983-84 Forecast
Receipts			
Taxes	77·0	78·0	81·2
National insurance contributions, etc.	19·5	18·6	21·2
Other	9·1	9·1	9·1
Total	**105·7**	**105·8**	~~112·1~~ 111·6
Expenditure			
Current expenditure on goods and services	36·2	35·8	39·5
Capital consumption	0·8	0·8	0·8
Interest	11·4	11·4	11·8
Subsidies	4·2	4·5	4·3
Grants	55·3	57·1	61·0
Net lending and capital expenditure	5·4	7·7	7·5
Unallocated(¹)	1·7	—	−1·2
Total	**115·0**	**117·2**	**123·6**
Central Government Borrowing Requirement	9·3	11·5	~~11·5~~ 12·0
of which:			
for on lending to local authorities and public corporations	2·2	5·1	4·2
Own account	5·4	6·4	~~8·6~~ 9·0
Unallocated(¹)	1·7	—	−1·2

unallocated

(¹) Includes Contingency Reserve, special sales of assets and general allowance for shortfall.

5.07 In 1983–84 central government expenditure is forecast to be ~~about £6½ billion~~ STET more than the 1982–83 outturn currently expected. Receipts are expected to increase by ~~about the same amount~~ ~~nearly~~ under £6 billion — half of which is accounted for by extra receipts from national insurance contributions. The CGBR is therefore expected to be ~~almost the same as~~ about £½ billion more than in 1982–83. This again reflects a high level of on-lending to other parts of the public sector, which are repaying their other debt.

Local authorities

5.08 Table 5.3 shows local authority receipts and expenditure and ~~the~~ borrowing requirements for 1982–83 and 1983–84.

Table 5.3 Local Authorities' Transactions

£ billion

	1982-83 Budget forecast	1982-83 Latest estimate	1983-84 Forecast
Receipts			
Rates	12·2	12·3	13·0
Rate support grant	11·5	11·2	11·0
Other grants from central government	4·4	6·1	8·2
Other	5·1	4·7	5·0
Total	33·2	34·4	37·8
Expenditure			
Current expenditure on goods and services	21·5	22·7	24·3
Capital consumption	1·6	1·3	1·4
Grants and subsidies	2·6	3·7	5·1
Interest payments	4·7	4·4	4·1
Gross domestic fixed capital formation	2·5	1·6	2·4
Net lending to private sector	1·1	0·5	0·4
Total	33·8	34·3	37·6
Local Authority Borrowing Requirement	0·6	−0·1	−0·2
of which:			
Borrowing from central government	−0·3	2·2	2·0
Other borrowing	0·9	−2·3	−2·2

5.09 Local authority receipts in 1982–83 are currently expected to be ~~nearly £1½~~ over £1 billion more than forecast a year ago, reflecting higher current grants from central government. Expenditure is expected to be £½ billion more than forecast but

this masks an overspend of about £2 billion on current expenditure on goods and services, grants and subsidies, and capital underspending of nearly £1½ billion on fixed assets and net lending. Much of the capital underspending reflects higher receipts than expected from sales of council houses and land.

x

5.10 The LABR is expected to be close to zero in 1982–83. This ~~forecast~~ estimate is particularly uncertain as local authorities have borrowed heavily in the final weeks of the year in recent years and the figure for 1982–83 is heavily dependent on the forecast made for those weeks. The pattern of borrowing has been very different from the last Budget forecast with heavy borrowing from central government more than matched by repayment of market debt.

5.11 Current expenditure on goods and services for 1983–84 is forecast to rise by 7 per cent or £1½ billion on 1982–83, with a greater proportionate rise forecast for current grants to persons(2). Local authority net capital spending is expected to recover by over £½ billion from the 1982–83 level. Expenditure in total is forecast to increase by over £3 billion, less than £1 billion of which will be met from rates and the remainder from central government grants. With receipts and expenditure virtually in balance the LABR is expected to be close to zero, again with high borrowing from central government approximately matched by repayment of market debt.

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ublic corporations

5.12 Expenditure and receipts for public corporations are shown in Table 5.4.

x

Table 5.4 Public Corporations' Transactions £ billion

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Capital expenditure			
Gross domestic capital formation	9·0	7·6	8·1
Increase in stocks	0·3	1·0	0·7
Total	9·3	8·5	8·8
Internally arising funds			
Gross trading surplus(1)	9·5	9·2	9·~~4~~ 5
Rent and other non-trading income	1·0	1·3	1·4
Interest and dividend payments	−3·5	−3·7	−3·4
Taxes on income	−0·3	−0·4	−0·2
Total	6·6	6·3	7·~~1~~ 2
Capital receipts	0·6	0·6	0·6
Excess of capital expenditure over internal funds and capital receipts	2·1	1·6	~~0·9~~ 1·0
Less Net financial receipts	−0·2	−0·1	−0·2
Public Corporations' Borrowing Requirement	1·9	1·5	1·~~1~~ 2
of which:			
Borrowing from central government	2·4	2·7	2·2
Other borrowing	−0·6	−1·2	−1·1

x

(1) Including subsidies.

5.13 Lower borrowing in 1982–83 of about £½ billion less than forecast a year ago reflects nearly £1½ billion underspending on fixed assets, partly offset by an increase in the value of stocks held.

5.14 In 1983–84 public corporations collectively are expected to finance a slightly higher proportion of their capital expenditure than in 1982–83 from internally arising funds, leading to a borrowing requirement rather less than the latest estimate for 1982–83.

Public expenditure and the PSBR

5.15 Table 5.~~X~~5 shows how the public expenditure plans and debt interest are expected to be financed. The expenditure side of the account repeats information from Cmnd 8789 but incorporates revisions to the planning total and debt interest

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(2) Both sides of the local authority account in 1983–84 reflect the first full year of the complete transfer of the administration of housing benefits from central government to local authorities.

Table 5.5 Public expenditure, receipts and the PSBR

£ billion

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Income(1)			
Central government taxation			
Income tax	30·8	30·2	31·5
Value added tax	14·7	13·9	15·5
Oil duties	5·1	5·2	5·8
Corporation tax	4·8	5·5	6·2
Tobacco	3·5	3·5	3·7
National insurance surcharge	3·4	2·8	2·0
Spirits, beer, wine and perry	3·3	3·0	3·9
Petroleum revenue tax	2·3	3·3	4·5
Supplementary petroleum duty	2·0	2·4	—
Vehicle excise duty	1·8	1·8	1·9
Taxes on capital	1·4	1·6	1·5
European Community duties	1·3	1·3	1·4
Other (including accruals)	2·6	3·5	3·4
Total	77·0	78·0	81·2
National insurance etc., contributions	19·5	18·6	21·2
Local authorities rates	12·2	12·3	13·0
North Sea oil royalties	1·5	1·7	1·4
General government trading surplus and rent	3·4	3·4	3·3
General government interest and dividend receipts	2·4	2·4	2·3
Adjustments			
Accruals	0·5	−0·2	—
Public corporations transactions(2)	3·8	3·6	3·5
Other(3)	0·3	−0·2	−0·5
Total receipts	120·6	119·7	125·4
Public sector borrowing requirement	9·5	7·8	8·7
Total receipts and borrowing	130·1	127·5	134·1

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Expenditure			
Social security	32·0	32·5	34·4
Defence	14·1	14·4	16·0
Health and personal social services	13·6	13·9	14·6
Education and science	12·2	12·6	12·6
Scotland	6·1	6·3	6·4
Industry, energy, trade and employment	5·8	5·9	5·6
Transport	4·2	4·3	4·3
Order and protective services	4·1	4·3	4·6
Other environmental services	3·6	3·4	3·6
Northern Ireland	3·5	3·6	3·8
Housing	3·1	2·6	2·8
Wales	2·4	2·4	2·5
Overseas services	2·1	2·2	2·2
Other public services	1·7	1·7	1·7
Common services	1·6	1·6	1·0
Agriculture, fisheries, food and forestry	1·5	1·8	1·7
Government lending to nationalised industries	1·1	1·4	1·1
Arts and libraries	0·5	0·6	0·6
Local authority current expenditure not allocated to programmes (England)	—	—	0·9
Adjustments to programmes—			
PC market and overseas borrowing	−0·3	−1·1	−0·3
Special sales of assets	−0·6	−0·6	−0·8
Contingency Reserve	2·4	0·3	1·5(4)
General allowance for shortfall	—	−1·0	−1·2
Planning total in Cmnd 8789(5)	114·7	113·0	119·6
Revisions since Cmnd 8789	—	−0·5	−0·3(6)
Revised planning total	114·7	112·5	119·3
Gross debt interest	15·4	15·0	14·8
Planning total plus gross debt interest	130·1	127·5	134·1
MEMO ITEM			
Numerator(7) for public expenditure/GDP ratio.	123·9	120·5	128·7

italics please

(1) See Table 5.11 for taxation and Table 5.8 for other items.

(2) Comprises total interest payments by nationalised industries (and other public corporations treated similarly for public expenditure planning) and the trading income of the remaining corporations.

(3) Comprises other miscellaneous receipts and adjustments from the definition of public expenditure used in the national income accounts to that used in Cmnd. 8789.

(4) See Table 5.7.

(5) Figures in the first column are from Table 19 in the *Financial Statement and Budget Report 1982–83* translated from Cmnd. 8494 to Cmnd. 8789 definitions.

(6) See Table 5.6.

(7) Planning total plus net debt interest, non-trading capital consumption and payments of VAT by local authorities (see paragraph 5.17). For the definition of net and gross debt interest see Cmnd. 8789—II, p 126.

Much about £1½

since its preparation. In 1982–83 expenditure including gross debt interest is £2½ billion less than forecast a year ago. Tax receipts in total are expected to be about £1 billion more than predicted, offset by lower national insurance contributions. ~~Most~~ of the lower expenditure is reflected in the PSBR, which is ~~£1¾~~ billion lower than forecast a year ago.

over £5½ billion ~~nearly~~

5.16 In 1983–84 expenditure is expected to increase by about £6½ billion over the previous year. Taxation receipts and national insurance contributions are expected to increase by ~~about £6 billion. About £½ billion of the additional expenditure is expected to be met by an increase in the PSBR.~~ ~~About~~ Nearly £1 billion of the increase in expenditure is met by any increase in the PSBR.

Public expenditure and GDP

5.17 The revised planning totals shown in Table 5.X, together with the latest forecasts for money GDP in Table 2.5, imply a ratio of public expenditure to GDP of 44 per cent in 1982–83, and 43½ per cent in 1983–84, as given in Cmnd. 8789 ~~(Chart 1.6)~~. The figures shown in Tables 2.3 and 2.5 imply a fall in this ratio to ~~[41]~~ 41½ per cent in 1985–86.

Planning total and Contingency Reserve

5.18 The latest position on the public expenditure planning total and on the Contingency Reserve in 1983–84 is shown in the following tables.

Table 5.~~5~~6 Public Expenditure Planning Total: 1983–84

	£ million
As shown in the Autumn Statement	120 065
Changes between Autumn Statement and Cmnd. 8789	–497(1)
As shown in Cmnd. 8789	119 568
Reduction in national insurance surcharge	–81
Changes in general allowance for shortfall and in economic assumptions	~~–115~~ ~~–110~~ –154
Planning Total after Budget measures and other changes	119 ~~344~~ ~~247~~ 333(2)

(1) See Table 4.5 of Cmnd. 8789.

(2) incorporates a reduction in British Telecom's EFL.

Table 5.~~6~~7 Contingency Reserve 1983–84

		£ million
Amount of Reserve shown in Planning Total in the Autumn Statement and in Cmnd. 8789		1 500
Budget measures charged to Reserve(1)		
Construction	60	
Industrial innovation	39	
Employment	38 ~~52 (gross)~~	
Child benefit	74	
Social security	26	~~251~~ 237
Other expenditure charged to Reserve		
BL equity(2)	150	
Increase in British Shipbuilders EFL	10	
Additional support for overseas students	5	165
Uncommitted balance of Contingency Reserve		~~1 084~~ ~~98~~ 1158

Printer: omit the two brackets please

(1) See paragraphs 4.19 to 4.24.

(2) This comprises £100 million originally planned for the previous financial year which has been carried forward and £50 million out of the final allocation of £100 million that the Government has agreed to make available to finance the 1983 Corporate Plan.

Explanatory notes on Part 5 tables

5.19 The 1982–83 figures are latest forecasts based on published outturn data on the complete public sector accounts for the first half of the year, supplemented by less complete information for the third quarter and the first part of the final quarter.

move to next page please

5.20 Table 5.8 is based on the definitions used to compile the national income accounts(3) and is the most detailed presentation. Other tables are related to

(3) See *Financial Statistics Explanatory Handbook* 1982. The sector accounts are compiled quarterly and published in *Financial Statistics*. Key figures are published by press notice.

Table 5.8 and in addition include the 1982 Budget forecast for 1982–83. Tables 5.2, 5.3 and 5.4 are derived from Table 5.8 and summarise respectively the central government, local authority and public corporations accounts. These tables show how the sub-sector borrowing requirements are determined; they are brought together as the public sector borrowing requirement (PSBR) in Table 5.1. Tables 5.10, 5.11 and 5.12 present details of central government receipts and payments; these are totalled and shown in the summary table on the central government borrowing requirement (CGBR) in Table 5.9(4).

(4).

Unallocated items

5.21 The unallocated items shown in Tables 5.1, 5.2 and 5.8 take account of factors that by their nature cannot be attributed to a spending authority or economic category at the time of a Budget forecast. In 1983–84 they relate to £~~1088~~ 98 million representing the unallocated portion of the Contingency Reserve (see Table 5.7), receipts of £750 million from special sales of assets and a general allowance for shortfall of £1600 million (which is consistent with the planning total shown in Tables 5.5 and 5.6). The figure for shortfall shown in Table 5.10 includes an amount for holdback of rate support grant which has been allocated to current grants to local authorities in ~~the~~ other tables. Special sales of assets are included in other miscellaneous receipts in Table 5.11.

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5.22 Table 5.~~6~~ 7 shows the allocation of the Contingency Reserve, the whole of which is allocated to supply expenditure in Table 5.10. On past experience it seems likely that use of the Contingency Reserve will make for a higher financial deficit than shown in Table 5.8 as well as adding to identified financial transactions. The central government own account borrowing figures in Tables 5.1, 5.2 and 5.8 exclude the ~~effect of the~~ unallocated Contingency Reserve and the other unallocated items.

(4)

(4) Tables 5.9 to 5.12, unlike Tables 5.2 and 5.8 which are based on the national income accounts, follow the accounting principles of the central funds and accounts. These are monitored monthly in a Treasury press notice. The definition of the CGBR is identical in both accounting systems.

Table 5.8 Public Sector transactions by sub-sector and economic category

£ million

	Line	1982–83 Latest estimate: General Government: Central government	General Government: Local authorities	General Government: Total	Public corporations	Public Sector
Current receipts						
Taxes on income	1	41 186	—	41 186	−441	40 745
Taxes on expenditure	2	35 245	12 300	47 545	—	47 545
National Insurance, etc. contributions	3	18 644	—	18 644	—	18 644
Gross trading surplus	4	−201	253	52	9 230	9 282
Rent and oil royalties etc.	5	1 743	3 292	5 035	476	5 511
Interest and dividends from private sector and abroad	6	1 839	554	2 393	784	3 177
Non-trading capital consumption	7	785	1 295	2 080	—	2 080
Total	8	**99 241**	**17 694**	**116 935**	**10 049**	**126 984**
Current expenditure						
Final consumption	9	−36 548	−24 025	−60 573	—	−60 573
Subsidies	10	−4 469	−1 144	−5 613	—	−5 613
Debt interest to private sector and abroad	11	−11 468	−2 696	−14 164	−800	−14 964
Current grants to personal sector	12	−35 492	−1 929	−37 421	—	−37 421
Current grants paid abroad	13	−1 894	—	−1 894	—	−1 894
Total	14	**−89 871**	**−29 794**	**−119 665**	**−800**	**−120 465**
Current transfers within public sector						
Current grants	15	−16 891	16 891	—	—	—
Interest and dividends	16	4 472	−1 551	2 921	−2 921	—
Balance: current surplus/deficit	17	−3 049	3 240	191	6 328	6 519
Capital receipts						
Current surplus	18	−3 049	3 240	191	6 328	6 519
Taxes on capital	19	1 598	—	1 598	—	1 598
Capital transfers from private sector	20	—	—	—	148	148
Total	21	**−1 451**	3 240	1 789	6 476	**8 265**
Capital expenditure						
Gross domestic fixed capital formation	22	−2 224	−1 642	−3 866	−7 590	−11 456
Increase in stocks	23	−429	—	−429	−953	−1 382
Capital grants to private sector	24	−1 974	−537	−2 511	−47	−2 558
Total	25	**−4 627**	**−2 179**	**−6 806**	**−8 590**	**−15 396**
Capital transfers within public sector	26	−895	355	−540	540	—
Financial surplus/deficit (balance of current and capital accounts)	27	−6 973	1 416	−5 557	−1 574	−7 131
Financial transactions—(net)						
Transactions concerning certain public sector pension schemes	28	155	—	155	—	155
Accruals adjustments	29	−331	16	−315	88	−227
Miscellaneous financial transactions	30	705	−825	−120	493	373
Lending to private sector	31	−401	−507	−908	−366	−1 274
Lending, etc. abroad	32	162	—	162	−101	61
Cash expenditure on company securities	33	301	—	301	−40	261
Total	34	**591**	**−1 316**	**−725**	**74**	**−651**
Lending within public sector	35	−5 075	2 326	−2 749	2 749	—
Contribution to Public sector borrowing requirement	39	**11 457**	**−2 426**	**9 031**	**−1 249**	**7 782**
Sectoral borrowing requirement		6 382	−100	6 282	1 500	7 782

Sign convention: receipts and borrowing positive, payments negative.

Relationships between lines:
$17 = 8 + 14 + 15 + 16$
$27 = 21 + 25 + 26$
$39 = -27 - 34 - 35 - 36 - 37 - 38$

£ million

		1983-84 Forecast				
		General Government			Public corpora-tions	Public sector
		Central govern-ment	Local authori-ties	Total		
Current receipts						
Taxes on income	1	42 ~~892~~ 212	—	42 ~~892~~ 212	−246	~~42 646~~ 1966
Taxes on expenditure	2	37 ~~020~~ 465	13 030	50 ~~050~~ 495	—	50 ~~050~~ 495
National insurance, etc. contributions	3	21 241	—	21 241	—	21 241
Gross trading surplus	4	−160	288	128	9 ~~624~~ 524	9 ~~752~~ 652
Rent and oil royalties etc.	5	1 ~~674~~ 474	3 106	4 ~~780~~ 580	506	5 ~~286~~ 086
Interest and dividends from private sector and abroad	6	1 761	518	2 279	852	3 131
Non-trading capital consumption	7	846	1 396	2 242	—	2 242
Total	8	105 ~~274~~ 4839	18 338	123 ~~612~~ 177	10 ~~736~~ 636	134 ~~348~~ 3813
Current expenditure						
Final consumption	9	−40 ~~460~~ ~~368~~ 23	−25 648	~~−66 110~~ ~~016~~ −65971	—	~~−66 110~~ ~~016~~ −65971
Subsidies	10	−4 259	−1 232	−5 491	—	−5 491
Debt interest to private sector and abroad	11	−11 881	−2 218	−14 099	−669	−14 768
Current grants to personal sector	12	−36 ~~824~~ 724	−3 103	~~−40 027~~ −39 827	—	~~−40 027~~ −39 827
Current grants paid abroad	13	~~−1 813~~ −2013	—	~~−1 813~~ −2013	—	~~−1 813~~ −2013
Total	14	−95 ~~339~~ ~~245~~ 00	−32 201	−127 ~~540~~ ~~446~~ 01	−669	−128 ~~209~~ ~~115~~ 070
Current transfers within public sector						
Current grants	15	−19 ~~302~~ 47	19 ~~302~~ 47	—	—	—
Interest and dividends	16	4 527	−1 752	2 775	−2 775	—
Balance: current surplus/deficit	17	~~−4 900~~ ~~806~~ −5181	3 ~~742~~ 32	~~−1 158~~ ~~059~~ −1449	7 ~~292~~ 192	~~6 130~~ ~~233~~ 5743
Capital receipts						
Current surplus	18	~~−4 900~~ ~~806~~	3 ~~742~~ 32	~~−1 158~~ ~~059~~	7 ~~292~~ 192	~~6 189~~ ~~233~~
Taxes on capital	19	1 550	—	1 550	—	1 550
Capital transfers from private sector	20	—	—	—	153	153
Total	21	~~−3 350~~ ~~256~~ −3631	3 ~~742~~ 32	~~397~~ ~~491~~ 101	7 ~~445~~ 345	7 ~~842~~ ~~936~~ 446
Capital expenditure						
Gross domestic fixed capital formation	22	−2 551	−2 404	−4 955	−8 096	−13 051
Increase in stocks	23	−298	—	−298	−661	−959
Capital grants to private sector	24	−2 020	~~−740~~ −680	−2 ~~760~~ 00	−63	−2 ~~823~~ 763
Total	25	−4 869	−3 ~~144~~ 084	~~−8 013~~ −7953	−8 820	−16 ~~833~~ 773
Capital transfers within public sector	26	−866	346	−520	520	—
Financial surplus/deficit (balance of current and capital accounts)	27	~~−9 066~~ ~~−8991~~ −9366	~~942~~ 94	−8 ~~136~~ ~~042~~ 372	~~−855~~ −955	~~−8 991~~ ~~897~~ −9327
Financial transactions—(net)						
Transactions concerning certain public sector pension schemes	28	160	—	160	—	160
Accruals adjustments	29	−57	78	21	27	48
Miscellaneous financial transactions	30	~~796~~ ~~16~~ 613	−4~~10~~ 64	~~377~~ ~~297~~ 149	~~177~~ ~~17~~ 147	~~494~~ ~~14~~ 296
Lending to private sector	31	−221	−408	−629	−239	−868
Lending, etc. abroad	32	−3	—	−3	−101	−104
Cash expenditure on company securities	33	−150	—	−150	−43	−193
Total	34	~~526~~ ~~445~~ 342	−7~~48~~ 94	~~−224~~ ~~304~~ −452	−2~~39~~ 09	~~−469~~ ~~543~~ −661
Lending within public sector	35	−4 ~~186~~ 230	1 991	−2 ~~196~~ 239	2 ~~195~~ 239	—
Unallocated items:						
Special sales of assets	36	750	—	750	—	750
Contingency reserve (1)	37	−1 ~~084~~ ~~98~~ 158	—	−1 ~~084~~ ~~98~~ 158	—	−1 ~~084~~ ~~98~~ 158
General allowance for shortfall (2)	38	1 ~~600~~ 50	—	1 ~~600~~ 50	—	1 ~~600~~ 50
Contribution to Public sector borrowing requirement	39	~~11 480~~ 12012	−2 191	9 ~~289~~ 821	−1 ~~101~~ 075	8 ~~188~~ 746
Sectoral borrowing requirement		~~8 500(3)~~ ~~46(3)~~ 8824(3)	−200	~~8 300(3)~~ ~~46(3)~~ 8824(3)	1 ~~094~~ 164	~~8 188~~ leave blank

(1) See table 5.~~8~~ 7 for allocation of Contingency Reserve.
(2) Differs from table 5.10 because of holdback on local authorities' grants.
(3) Excludes unallocated items. See paragraph§5.21 and § 22

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BUDGET—SECRET

Table 5.9 Summary of Central Government Transactions

£ million

	1982-83 Budget forecast	1982-83 Latest estimate	1983-84 Forecast
Consolidated Fund			
Revenue (Table 5.11)	82 895	83 350	87 ~~822~~ 387
Expenditure (Table 5.10)	90 891	89 241	95 ~~557~~ 88
Deficit	7 996	5 891	~~7 735~~ 8201
National Loans Fund			
Consolidated Fund deficit (as above)	−7 996	−5 891	~~−7 735~~ −8201
Other transactions:			
Receipts (Table 5.12)	11 600	10 830	11 350
Payments (Table 5.12)	13 236	−14 790	~~−14 977~~ −15057
Total net borrowing by the National Loans Fund	**−9 632**	**−9 851**	**−11 ~~362~~ 908**
Other funds and accounts (net)	**+339**	**−1 606**	**~~−118~~ −104**
Central Government Borrowing Requirement	**−9 293**	**−11 457**	**~~−11 480~~ −12012**

Table 5.10 Supply and Consolidated Fund Standing Services

£ million

	1982-83 Budget forecast	1982-83 Latest estimate	1983-84 Forecast
Supply			
Main Supply Estimates	79 225	80 77~~1~~5(1)	85 373(1)
Adjustment to Supply Issues(2)	—	−33~~0~~4	—
Supplementary provision	109	—	5(3)
Contingency reserve	2 400	—	1 500(4)
Reduction in national insurance surcharge	−360	—	~~−81(5)~~ —
General allowance for underspending	—	−1 100	−2 ~~000(4)~~ 50(4)
Total Supply Issues	**81 374**	**79 341**	**84 ~~797~~ 828**
Consolidated Fund Standing Services			
Payment to the National Loans Fund in respect of service of the national debt	5 175	5 450	5 983
Northern Ireland—share of taxes, etc.	1 493	1 594	1 650
Payments to the European Communities	2 820	2 812	3 092
Other services	29	44	35
Total Consolidated Fund Standing Services	**9 517**	**9 900**	**10 760**
Total	**90 891**	**89 241**	**95 ~~557~~ 88**

(1) Taking into account supplementary provision granted during the year and departments' forecasts of excesses or shortfalls. See Table (1a) of *Memorandum by the Chief Secretary to the Treasury* Cmnd. 8817 for an analysis by Class and Vote.

(2) The adjustment relates to Supply issued the previous year and placed in departmental balances but not spent and to Supply issued in 1982–83 in respect of expenditure the previous year.

(3) Bus fuel grants (see Table 4.2).

(4) See paragraph 5.21.

(5) The figure represents forecast savings on Supply provision and public corporations' external financing as a consequence of the reduction in the national insurance surcharge. This item has not been allocated between Supply expenditure and lending from the National Loans Fund.

Table 5.11 Taxation and Miscellaneous Receipts

£ million

	1982-83 Budget forecast	1982-83 Latest estimate	1983-84 Forecast
Taxation			
Inland Revenue—			
Income tax (1)	30 775	30 222	31 ~~400~~ 70
Corporation tax(2)(3)	4 850	5 480	6 200
Petroleum revenue tax	2 290	3 280	~~5 250(4)~~ 4500(4)
Supplementary petroleum duty	2 040	2 400	—
Capital gains tax	600	630	600
Development land tax	40	65	55
Estate duty	10	13	10
Capital transfer tax	465	500	540
Stamp duties	810	850	975
Total Inland Revenue	*41 880*	*43 440*	*45 ~~020~~* 350
Customs and Excise—			
Value added tax	14 750	13 900	15 500
Oil	5 100	5 250	5 ~~675~~ 800
Tobacco	3 525	3 500	3 ~~700~~ 25
Spirits, beer, wine, cider and perry	3 275(5)	3 025	3 900
Betting and gaming	550	580	610
Car tax	600	575	615
Other excise duties	20	20	20
EC own resources(6)			
Customs duties, etc.	1 060	1 000	1 130
Agricultural levies	270	250	250
Total Customs and Excise	*29 150(5)*	*28 100*	*31 ~~400~~* 550
Vehicle excise duties	*1 854*	*1 792*	*1 944*
National insurance surcharge	*3 443(7)*	*2 830*	*1 ~~597~~* 992
Total Taxation	**76 327**	**76 162**	~~**80 071**~~ 79836
Miscellaneous Receipts			
Broadcast receiving licences	754	736	766
Interest and dividends	321	382	370
Gas levy	512	470	555
Other(8)	4 981	5 600	~~6 060~~ 5860
Total	**82 895**	**83 350**	**87 ~~822~~** 387

(1) Income tax receipts include surtax	2	2	1
(2) Corporation tax receipts include advance corporation tax: net of repayments	2 170	2 200	2 270

(3) The estimated proportion attributed to North Sea oil and gas production is £250 million in 1982–83 and £550 million in 1983–84. In addition an estimated £250 million in 1982–83 and £450 million in 1983–84 of corporation tax will be satisfied by setting off advance corporation tax (ACT). Thus, total revenues from the North Sea, inclusive of royalties, supplementary petroleum duty, petroleum revenue tax and corporation tax before any ACT set-off, are estimated to be £7,810 million in 1982–83 and ~~£7,850~~ 6900 million in 1983–84.

(4) Petroleum revenue tax includes advance payments of petroleum revenue tax.

(5) Deferment of duties on spirits and wine, announced on 15 November 1982, reduced the Budget forecast of the duties on spirits, beer, wine, cider and perry to £2,975 million and the Budget forecast of total Customs and Excise duties to £28,850 million.

(6) Customs duties and agricultural levies are accountable to the European Communities as "own resources"; actual payments to the Communities are recorded in Table 5.10.

(7) A reduction in the National Insurance Surcharge, announced on 8 November 1982, reduced the Budget forecast of receipts of National Insurance Surcharge into the Consolidated Fund to £2,953 million (the net effect on the forecast of the PSBR and CGBR was a smaller reduction because expenditure by public corporations and central government departments was correspondingly reduced).

(8) Includes the 10 per cent of "own resources" refunded by the Communities to meet the costs of collection, proceeds from the special sales of assets, and estimated receipts of £1,630 million in 1982–83 and £1,~~600~~ 400 million in 1983–84 in respect of oil royalties.

Table 5.12 National Loans Fund Receipts and Payments

£ million

	1982–83 Budget forecast	1982–83 Latest estimate	1983–84 Forecast
Receipts			
Interest on loans, profits of the Issue Department of the Bank of England, etc.	6 425	5 380	5 367
Service of the National Debt—balance met from the Consolidated Fund	5 175	5 450	5 983
Total Receipts	**11 600**	**10 830**	**11 350**
Payments			
Service of the National Debt			
Interest	11 467	10 694	11 214
Management and expenses	133	136	136
Total	**11 600**	**10 830**	**11 350**
Loans to Nationalised Industries:			
National Coal Board	318	300	~~604~~ 684
Electricity (England, Wales and Scotland)	80	182	185
British Telecom	286	−113	−154
Other	37	−6	37
Total	721	363	~~672~~ 752
Loans to other Public Corporations:			
New Towns—Development Corporations and Commission	360	357	314
Housing Corporations	330	502	230
Scottish Special Housing Association	42	39	32
Regional Water Authorities	503	450	410
Other	7	2	19
Total	1 242	1 350	1 005
Loans to Local Authorities	−300	2 240	2 000
Loans to Private Sector:			
Building Societies	−1	—	—
British Aerospace	−4	−4	−4
British Nuclear Fuels Ltd.	−1	−1	−1
Housing Associations	—	−2	—
Total	−6	−7	−5
Loans within Central Government:			
Northern Ireland	94	74	83
Redundancy Fund	−115	−59	−127
Married quarters for armed forces	—	−1	−1
Total	−21	14	−45
Total—Net Lending	1 636	3 960	~~3 627~~ 3 707
Total Payments	13 236	14 790	~~14 977~~ 15 057

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

RMJ

R M Gair Esq
Foreign Office Press
HMSO

16 March 1983

Dear Mr Gair,

The Chancellor has asked me to let you know how pleased he is with the "new look" FSBR. He feels that the new layout has greatly improved its readibility.

I am told that the move to A4 caused your staff a great deal more work than in previous years. The Chancellor would be grateful if you would pass on his thanks to all concerned.

Yours sincerely,

John Kerr.

J O KERR
Principal Private Secretary

FROM: D R NORGROVE
DATE 16 MARCH 1983

~~MR~~ KERR

cc Mr Kemp

THE FSBR

On the antique machines that the HMSO have at the moment, the move to A4 this year apparently doubled the amount of printing and machining needed to produce the new-style FSBR. Some of the machinists worked 23 hours overnight on Monday to get it out. No doubt they were well paid for that in terms of overtime, but I think it would be a good gesture to write to the Manager of the operation, and I attach a draft.

D R Norgrove

D R NORGROVE

DRAFT LETTER FOR MR KERR'S SIGNATURE

Mr Ron Gaire
Foreign Office Press
HMSO

~~You should~~ has asked me to let you know how pleased he is with the "new
The Chancellor ~~and other Treasury Ministers have remarked how much better~~ the
look" He feels that T has greatly improved
FSBR. ~~looks this year and also how much~~ the new layout ~~has helped~~ its readability. ~~Any faults on that score now lie with the authors!~~ I am told that the move to A4 caused
The Chancellor would be
your staff a great deal more work than in previous years. ~~I wanted you to know that it~~
grateful if ~~you~~ you would pass on his
~~is appreciated, and I would be very glad if you would pass on the Chancellor~~'s thanks to
~~your staff.~~ all concerned.

[J O KERR]

Proposal	Cost/Yield	State of Play
Counteract "3L" avoidance device	£30m lost latterly.	MST(R) recommends legislation after consulting Stitt (Institute of Taxation) + Sutherland.
ICI Scholarships	£10m current loss, but potentially hr.	Letter sent to SoS Education; No. 10 not enamoured of scheme.
D - Car Benefit/ Fuel Benefit scales	20% increase = £45m	IR advocate 20% increase FST/MST(R) propose slightly lower increase (range 15.4 - ~~16~~ 17.6)
D - Threshold + Official Rate for beneficial loans		MST(R) + FST recommend no change (Agreed)
D - Double £25,000 device - for getting 2 sets of tax-free loans	£1m	~~Abandon~~ Do if m.i.r. ceiling increased (Agreed)
D - Stop "Marks + Spencer" device on renting houses to directors at nominal rent by charging as interest free loan	+ £1m	FST supports
D - Director's PAYE tax - underpayment of PAYE separately accounted for by companies	+ £10m	FST suggests to await Keith
D - Easement of potential double charge on co. cars which arises where husband/wife/child are both genuine employees	negligible	FST favours if space allows.
E - Secondhand Bonds - closure of loophole		Decision to act taken last summer (agreed)
F - DLT Disposals of development land by non-residents: close loophole being used in 40% of sales by non-residents	+ £2m (current loss)	MST(R) recommends action

G - CGT on non-resident trusts: disapply market value rules except for ordinary family distributions	v. small	FST favours action
H - Taxation of International Business	+ £100m full yr.	MST(R) will advise orally
J - Stock relief commodity bullion dealers	+ £20 - £40m	You agreed with MST(R) that this should not be included this yr.
K - Denial of Stock Relief on Payments on Account	+ £15m (current loss)	MST(R) minuted recommending against action: You agreed
L - Trustee Savings Banks as Bodies Corporate	- £5m in 1983/4 - £20m full year.	MST(R) authorised drafting of clauses on basis of undertaking in last year's Finance Bill debate. TSBs will be disappointed if no action.
M - Job - Related Mortgage Interest relief for self-employed: to allow interest relief on 2nd house where employee obliged to live in provided accommodation		FST favoured action where contractual obligation existed.
N - Employee Buy-Outs - extend interest relief for purchase of shares in employee - controlled co.	- £2m	FST supports, " MST(R). You expressed sympathy at first sight
P - Employee Share schemes - decision needed on instalment period (3 raised to 5 yrs) or to charge only 75% to income tax.		You wanted to look in context of overall balance between rich / poor.

Q - Capit Tax packages		
1) Endorse scale G?	-£20m (1983/4) -£50m (f.y)	
2) Increase 20% relief to 30%	-£½m (1983/4) -£5m (f.y)	Strong support from FST.
(CGT: Abolition of small gifts exemption)	—	Approved by FST: fallen into disuse.
R - Net of tax pay tables		FST has urged you to commend in Budget speech - IR v. chary.
S - Schedule D/Schedule E (wapps).	FST concludes that not much worthwhile can be done on redef. of line between employment + self employment. Recommends leaflet to clarify present position - ~~wants to do~~ to do further work on employees/contractors and employees/principals.	~~FST to make oral report on state of play (covers your submission to PM)~~
T - ACT limit on loans		Linked to decision on mortgage interest relief ceiling.
U - ~~CCT~~ Tax treatment of interest paid by companies to non-residents		Consultation ended on 22/2; you may like to ask MST(R) to report on the reaction to this potential sweetener.
V - Small Industrial Workshops - extension of 2,500 sq. ft limit until March 1985 -		CST disinclined. MST(R) " FST asked whether av. col be raised to 1,750 sq. ft. from 1,250.
W - Stock Relief: House-builders part exchange schemes	- £10m	CST anxious to avoid help for property dealers - IR suggest drafting to avoid 3rd parties if there is a decision to go ahead. MST(R) does not support move. CST does.
X - Capital Allowances for Co. cars - abolition of ceiling combined with reduction in writing down allowance from 25 to 20%	Rev. neutral	FST: keep £8,000 ceiling (? increase to £10,000 ceiling); reduce but favours reducing ~~ad~~ write down to 20%

Y - Stc p duty consultative document - ~~gifts~~ — £5¼m

Q of plucking plums from document - gifts and exemption of deeds to family arrangements. You inclined against selecting these.

2 Treatment of Rental Income - tax relief for landlords on management expenses

IR cautious abt changing present borderline. FST feels this should be done if something is done on capital allowances for self-caterers. CST has discussed this with SoS Trade + will be minuting.

Own goals? BoP, Ex-rate?

FINANCIAL STATEMENT AND BUDGET REPORT: PART 3

Summary

By the end of 1982 lower interest rates and lower inflation, particularly in the United States, were pointing towards some increase in world activity in 1983. The fall in oil prices in recent weeks improves the prospects both of recovery and of a further fall in inflation.

2. In the United Kingdom, the effects of lower world activity in 1982 were to a considerable extent offset by a good performance by exporters in world markets and by a rise in final domestic demand, led by consumer spending. But with some further fall in stocks, the growth in total output was probably not much more than ½ per cent, most of which was accounted for by higher oil production, and there were further rises in unemployment.

3. The forecasts for 1983 and the first half of 1984 are based on the fiscal and monetary policies set out in the Budget speech and in the Medium Term Financial Strategy. Recent developments and future prospects for monetary growth are described in Part 2 of this Report; details of the PSBR and public sector transactions will be found in Part 5.

4. The recovery in world trade should lead to a renewed rise in exports, helped by better cost competitiveness, from the first half of this year. But with imports likely to increase rather faster as domestic demand continues to rise and as the rundown in stocks comes to an end, the surplus on the current account of the balance of payments is forecast to be considerably smaller than in 1982.

5. After the major reduction in inflation over the past year, there is likely to be a pause in 1983 as the effects of the recent fall in the exchange rate are absorbed. With increases in costs likely to continue below the rate of increase in prices, the gradual recovery in profits should continue.

6. Over the next year growth in overseas markets, increases in domestic demand as the effects of lower inflation and lower interest rates work through, together with gradually improving profitability, should lead to total output rising, by perhaps 2-2½ per cent with some prospect of the fall in employment coming to an end.

5.04
[illegible]

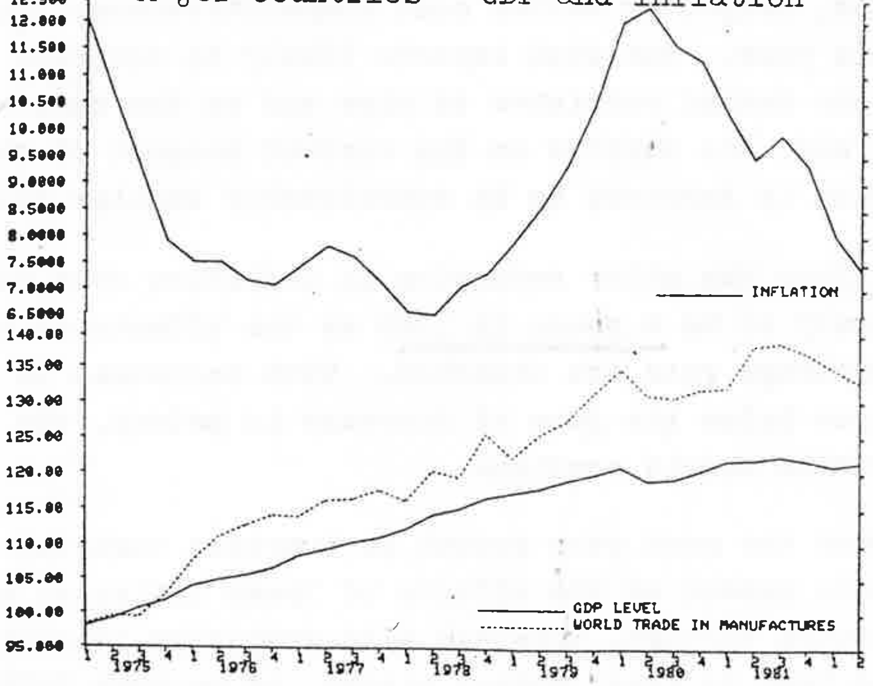
The world economy

7. Two years of slow growth in 1980 and 1981 reflected the 140 per cent rise in oil prices in 1979-80 against the background of policies designed to contain the impact on inflation. By early 1982 there was a widespread expectation that a lower rate of inflation - already falling significantly and expected to contribute to lower interest rates - would lead to a recovery in demand and output in the industrialised world. Instead there were declines in industrial demand and activity, partly reflecting the continuing effects of high real interest rates; while in many developing countries lower export earnings (as commodity prices fell), high interest rates and a strong dollar combined to raise doubts about creditworthiness.

8. In the course of 1982, inflation fell further, helped by continuing weakness in commodity prices (except oil). The reduction in inflation and the delay in economic recovery, combined with easier monetary policy in the United States, led to substantially lower interest rates (at least in nominal terms). In the Western economies, stocks were run down further until by the end of the year the level of stocks was if anything below normal. The developing countries were making some necessary reductions to their imports, while their overall debt position was benefiting from lower interest rates.

Chart 3.1

Major countries'* GDP and inflation



*USA, Canada, Japan, Germany, France and Italy

9. At the beginning of 1983, there is again a widespread expectation of a moderate recovery in activity, some evidence for which is provided by increases in industrial production and housing starts (in the US) and domestic industrial orders (in Germany). Both interest rates and inflation rates have come down sharply since early 1982 (Eurodollar rates for example fell from 15 per cent to under $9\frac{1}{2}$ per cent), and fiscal and monetary policies have become less tight; partly as a result, the stock rundown may now be largely over and final demand should rise further; and there is some prospect of an end to the decline in imports into developing countries although further reductions can be expected from oil producers.

10. In most of the economic cycles in the postwar years, the recovery of output has been followed by a rise in commodity prices. In the case of oil, prices are expected to be lower in 1983 not only because of the recession but also because of the lagged effects of earlier price rises. But other commodity prices are already at a low level in relation to world prices generally and rising demand from the industrialised countries will probably induce some increases by the first half of next year, allowing some recovery in profit margins. Indeed some commodities, particularly non-ferrous metals, may see a recovery in prices this year; there have already been scattered indications of this. The position up to the end of 1982 is set out in the chart below:

Chart 3.2

World oil and non-oil commodity prices

(relative to manufactured export prices)

11. The forecast points to a rise in activity from the first half of 1983: this can be expected to result in only a small increase between the average levels of 1982 and 1983, but to a rather faster rate of growth by the first half of 1984. UK export markets should share in the recovery, though the fall in oil revenues will reduce the OPEC market in which the UK has a well above average share. The forecast is summarised in the table below:

per cent changes on a year earlier

	1975-70	1980	1981	1982	1983	1984 First half
GDP *	3½	1	1½	-½	1½	3½
Consumer prices*	8½	12	10	7	5	5½
Trade in manufactures (UK weighted)	6	4½	3	-3½	1	6

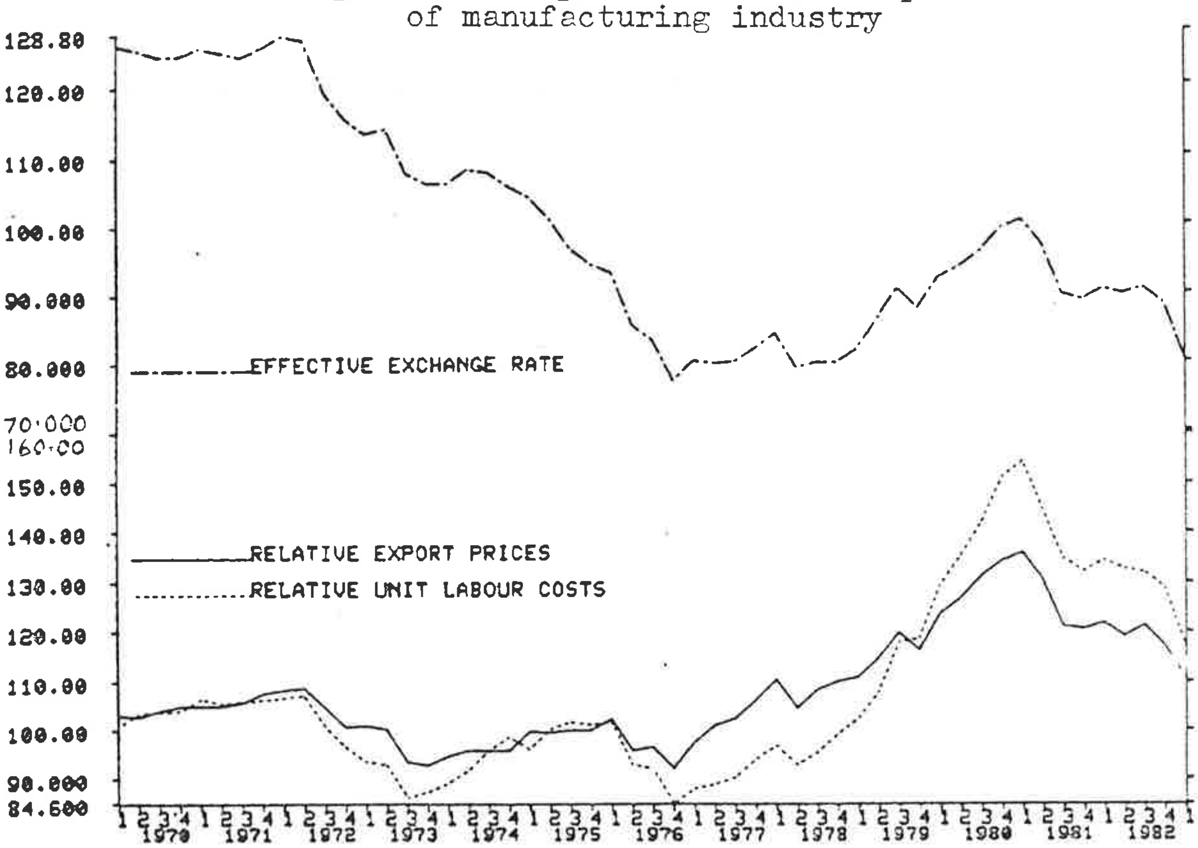
*Major 6: US, Germany, Japan, France, Italy, Canada

Exchange rate, competitiveness and trade

12. The value of sterling, measured against a basket of other currencies, fell more than 10 per cent in late 1982 and early 1983, after a period of little change lasting over a year. This forecast assumes no major change in the exchange rate from the level in early 1983. The prospect for inflation, which takes account of this assumption on the exchange rate, suggests that from now on there will be no substantial difference between inflation rates in the UK and in the average of our major competitors. On this basis, the level of cost-competitiveness in the UK over the forecast period should be appreciably better than in 1981 or 1982. The position up until early this year was as follows:

Chart 3.3

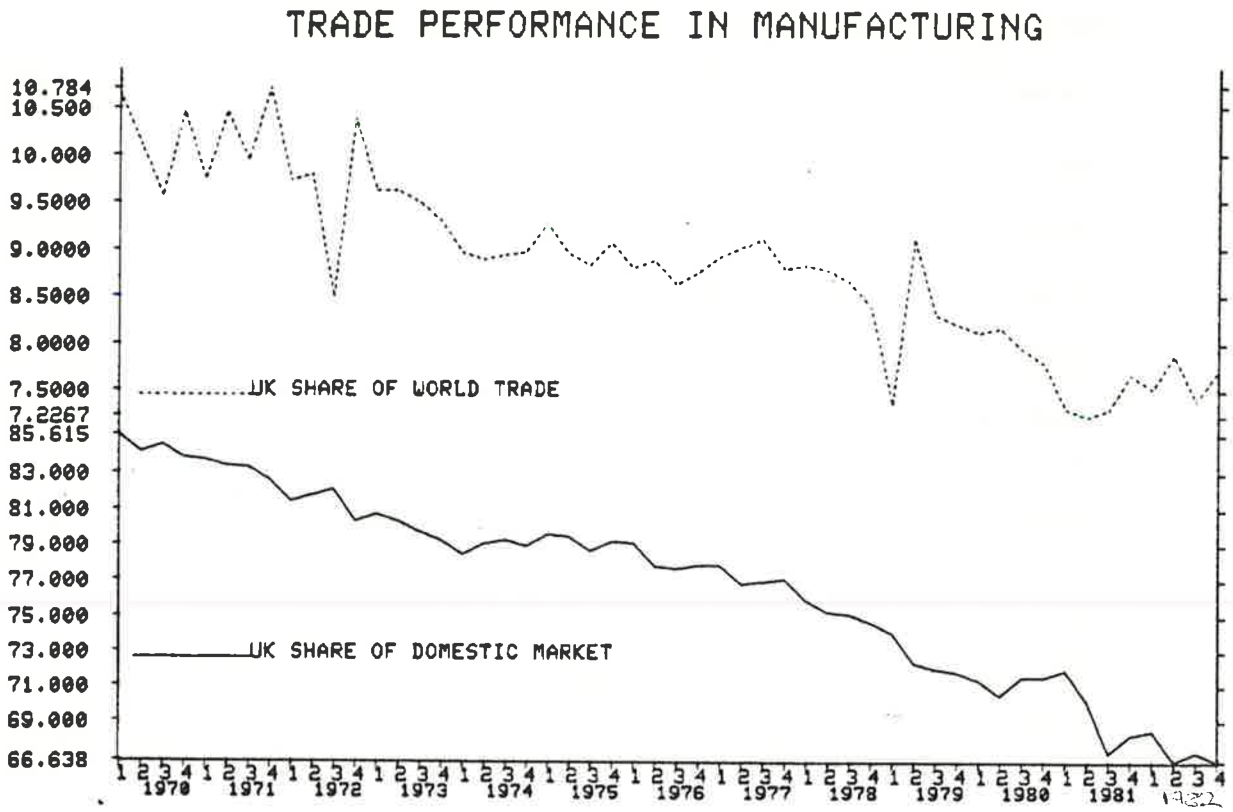
The exchange rate and price and cost-competitiveness of manufacturing industry



13. The effect of the recent change in the value of sterling on price competitiveness is not yet clear. The fall in sterling in 1981, from the exceptional level at the beginning of that year, was reflected in a substantial improvement in relative export prices, as exporters took most of the benefits on prices rather than on profit margins; but in a rather small improvement in import price competitiveness as importers cut their margins to a greater extent than usual. By the end of 1982, profit margins on goods supplied to the UK seemed, on average, to be little higher than elsewhere and hence the scope for further reductions in importers' margins now looks more limited than in 1981. This implies that rather more of the recent fall in sterling may feed through into prices charged in the UK. Even so, with low inflation in most other industrialised countries, a fall in oil prices and at least for a time no major recovery in other commodity prices, import prices as measured by the average value index for total goods may by the end of 1983 be little more than 10 per cent higher than a year earlier.

14. In manufacturing, the UK has lost shares by volume in both overseas and domestic markets in most years:

Chart 3.4



15. In 1982, when world trade in manufactures is estimated to have fallen 3 per cent, there was little change in UK exports. This rise in UK share represented a significantly better performance than the substantial loss of share between 1977 and 1981. In the domestic market, the fall in the share of domestic producers was halted temporarily at the time of heavy de-stocking in late 1980 and early 1981, and again in the second half of 1982.

16. For the first half of 1983, most of the short-term indicators of exports - including engineering orders and the replies to the CBI's questions on orders - suggest that the level of exports may well be no higher than the second half of 1982. As world recovery gets under way, and as the gains in competitiveness begin to be felt, then export growth should pick up (as the improvements in export optimism in the CBI survey also suggest). By the first half of 1984 exports of goods and services could be 5 per cent higher than a year earlier.

cf. EEF.

17. The volume of imports levelled off in 1982, despite the rise in final domestic demand, particularly personal consumption. That suggests and the latest figures confirm a stock rundown in the second half of 1982. When that comes to an end a fairly sharp increase in imports can be expected.

18. The current account of the balance of payments was again in large surplus in 1982, some £4½ billion on provisional estimates. The high surplus in the second half of the year was partly a result of an exceptionally large surplus on oil. The composition of the surplus in recent years has been as follows:

£ billion

	Visible Trade		Invisibles	Current Account
	Oil	Non-oil		
1980	+½	+1	+1½	+3
1981	+3	0	+3	+6
1982	+4½	-2½	+2½	+4½

19. With growth of demand in the UK forecast to be a little more than in other countries, and with some continued tendency of UK producers to lose share, there seems likely to be a further increase in the deficit on non-oil trade, partly offset by a growing surplus in invisibles - reflecting rising world activity and profitability, as well as the rising stock of overseas assets. The recent depreciation of sterling may not have much net impact on the current account in 1983 but should make for a higher surplus by 1984. In total, the current account is forecast to be in surplus of some **£1** billion in 1983.

Inflation

20. In January 1983 the Retail Prices Index was only 5 per cent higher than a year earlier. The corresponding figure for January 1982 was 12 per cent. Worldwide, the rate of inflation has been declining, with the level of many commodity prices actually falling. The reduction in inflation in the UK was nevertheless greater than in most other industrialised economies so that by early 1983 the UK inflation rate was well below the European average, though still rather above that of the United States, Germany and Japan.

21. The details of the changing inflation rate, as measured by the RPI, are as follows:

	Weight in total	per cent change over a year earlier	
		January 1982	January 1983
Retail Prices Index	100	12	5
Food	21	11	2
Housing (including mortgage rate)	14	23	-1
Nationalised industries	10	12	12
Other	55	10	6

Need to explain, comment,

Explain, define.

22. Other indices, for example, wholesale prices and the GDP deflator, also indicate a substantial fall in inflation though less marked. This is partly because of the greater weight in the RPI of housing costs and of seasonal foods both of which were lower in January 1983 than a year earlier. Wholesale output prices, on a definition excluding food, drink, tobacco and oil products (the latter omitted because extensive discounting has been causing bias in the list prices quoted in the index), were 7½ per cent higher than a year earlier in January 1982; by January 1983 the index was no more than 5½ per cent up on a year earlier.

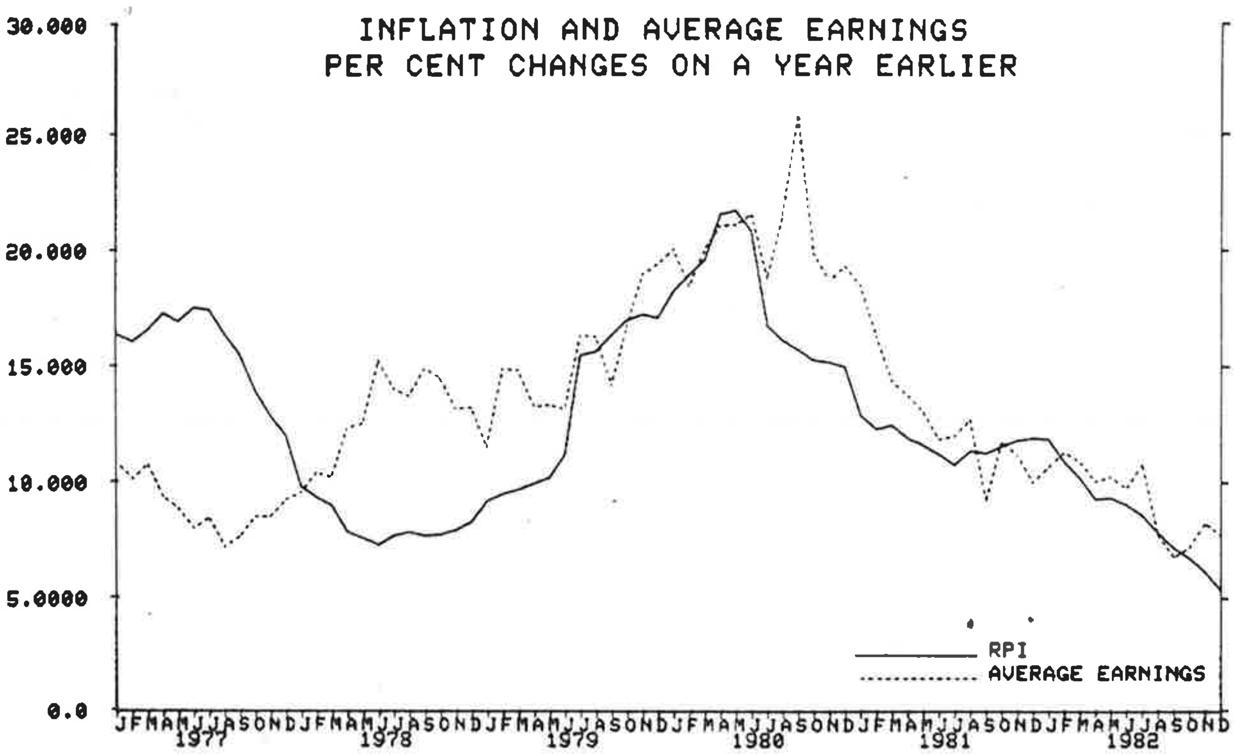
23. 1982 was a year in which inflation fell sharply but not at the expense of profit margins where in the non-oil sector there was some recovery from the low point in the second half of 1981.

Figures for 1982 are not yet complete, but whole economy costs changed as follows:

	per cent changes on a year earlier	
	1981 Q3	1982 Q3
Labour costs per unit of output	8	3½
of which earnings	10½	8½
productivity	3½	4
other labour costs including NIS	1	-1
Import prices (goods and services)	8½	4½
Expenditure prices (the deflator for total final expenditure)	10½	6

24. Settlements in the current pay round (since last autumn) have been running 1-2 per cent lower than in the previous round. The falling trend in wage settlements is reflected, with a lag, in the average earnings index: in December 1982, its year on year change was down to 8 per cent, from 11 per cent in the fourth quarter of 1981.

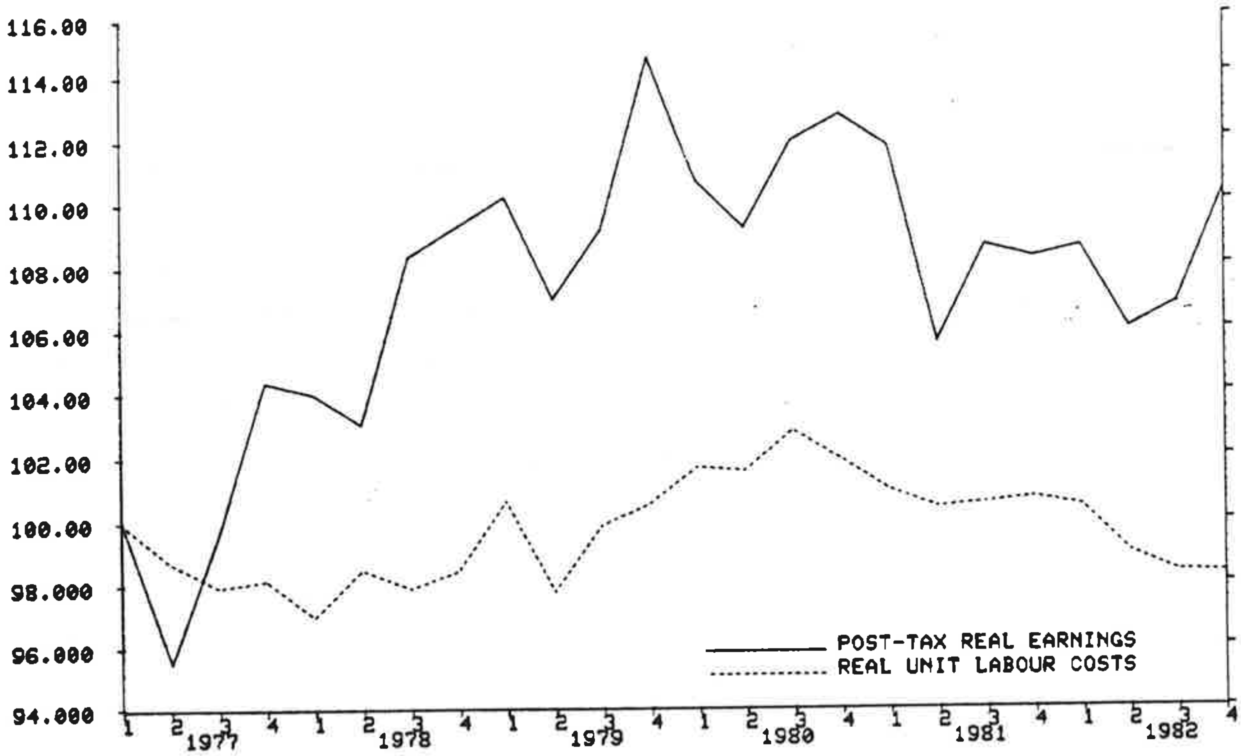
Chart 3.5



25. In 1982 the rate of price inflation came down faster than the growth of earnings. In consequence real after-tax take-home pay, as it affected the average employee, began to rise from about the middle of 1982. But employers must take account in addition of the selling prices of their goods and services, of productivity gains, and of taxes on employment. Continuing productivity gains in 1982, together with reductions in the National Insurance Surcharge, contributed to a fall in the average real wage, per unit of output, paid by employers:

Chart 3.6

Real earnings and labour costs, whole economy



Prospects

26. The sharp fall in the exchange rate since October 1982 is already being reflected in higher import prices.

While the extent to which this will affect other prices and costs is very uncertain, it is likely that on average import prices will rise faster than domestic costs or prices.

27. Profit margins in the UK have begun to recover, from a low level, but the moderate nature of the recovery and the low level of capacity utilisation in the UK and world economies will continue to restrain the rise in prices. The general rate of inflation in 1983, as measured by the rise in the GDP deflator, may therefore stay close to the 6 per cent level of last summer; although expenditure price indices which include a substantial direct weight on import prices are liable to show a slightly bigger increase for a time.

?

28. The movements in inflation are being reflected in somewhat exaggerated form in the RPI: the 5 points reduction in the mortgage rate between January and December 1982, and the substantial fall in seasonal food prices over the same period, are unlikely to be repeated. For the RPI in total, the inflation rate in the fourth quarter of 1983 may be about 6 per cent, much the same as in the fourth quarter of 1982. Noticeably lower figures will continue to be experienced for a time in between because of these special factors. By mid 1984, the world and UK recoveries should be well under way, with perhaps more pressure on commodity prices and firms better placed to improve profit margins; but on the other hand there may be benefits from a greater stability of the exchange rate. The RPI by mid 1984 could be rising at an annual rate of $6\frac{1}{2}$ per cent. Although a wide margin of error surrounds this forecast, the rate of inflation over the forecast period should be below the rates seen at any time since the early 1970s. This change reflects in large part the influence of monetary and fiscal policies in recent years.

PAUSE?

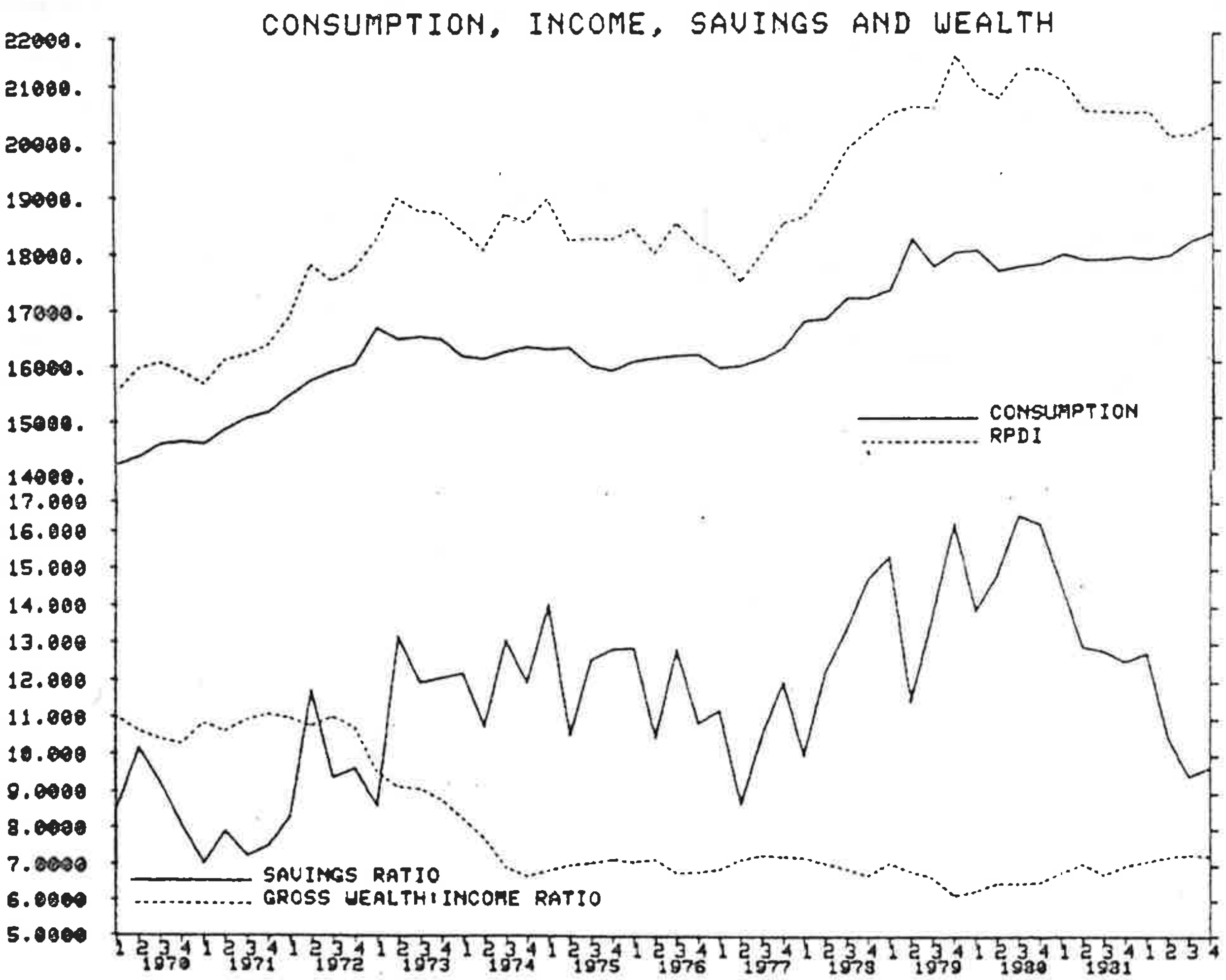
GDP deflator?

Demand and Activity

29. After little change for about three years, personal spending rose sharply in the second half of 1982. Durable expenditure in particular rose rapidly reflecting mainly the beginning of an upturn in real take home pay, lower interest rates, the abolition of HP controls in July and continued easy availability of bank credit. In addition, low purchases of durables during the previous two years had left stocks of durables held by consumers rather depleted.

30. The fall in real personal disposable incomes - estimated at about 4 per cent between 1980 and 1982 - was offset entirely by a fall in the savings ratio. This went beyond the usual tendency for savings to act as a cushion for fluctuations in incomes and helps to confirm that the need for saving was becoming less as the rate of inflation and interest rates moved down substantially. The chart also shows how the personal sector has been able to begin to rebuild its financial asset holdings: the ratio of gross financial wealth to income has risen since 1980, with capital gains, reflecting lower nominal interest rates, and high borrowing more than offsetting the fall in the flow of savings.

Chart 3.7



31. By the end of 1982, the real earnings of those in work were rising again; and in 1983 the real value of personal disposable income, taking account of the tax changes proposed in the budget, is forecast to rise about 2 per cent. The savings ratio having already fallen sharply in the course of 1982 is likely to remain below the 1982 average and consumer spending could rise 2½-3 per cent in 1983.

32. The rise in consumer spending in the second half of 1982 gave manufacturers and distributors an opportunity to run down their stocks, and by the end of 1982 the ratio of stocks to sales had fallen by comparison with a year earlier. Over the forecast period, it seems likely that distributors will want to rebuild their stocks of consumer goods. Manufacturers' stocks, however, could still be above desired levels, judging by the results of the recent CBI surveys; and with only very limited prospects of recovery in their output, the level of stocks in this sector could fall further for a time. In aggregate, the destocking in 1982, now put at nearly £1 billion at 1975 prices, could be followed by little change in stock levels for 1983 as a whole.

33. Fixed investment in total in 1982 is estimated to have been 3 per cent higher by volume than the previous year. In the private sector investment in new dwellings rose 8 per cent, in response to the ready available supply of mortgate finance and successive reductions in interest rates. In the distributive and service sectors of the economy investment also rose 8 per cent. Demand prospects have been stronger here than in the manufacturing sector, where investment fell a further 10 per cent. In the public sector, there were increases in the volume of fixed investment by central government and the nationalised industries. Investment by local authorities, apart from council house sales, was little changed.

34. The surveys carried out by the Department of Industry and by the CBI are consistent with a further rise in industrial investment in total, in 1983; within the total the fall in manufacturing investment may come to an end in the course of the year. Taking investment and consumption together, the volume of expenditure by the public sector on goods and services is forecast to rise slowly, consistently with the proportion of total public expenditure in the economy falling slowly.

35. In total, domestic demand is expected to rise further in 1983 and the first half of 1984. The prospect of world recovery and the effects of recent gains in competitiveness point to a strong rise in UK exports by the first half of 1984:

per cent changes on a year earlier

	1982	1983	1984 First half
Domestic demand	2½	3½	3
Exports of goods and services	0	0	5

The absence of any further rundown in stocks and the faster growth of total demand points to further rises in imports, together with a growth of domestic output:

	1982	1983	1984 First half
Imports of goods and services	4	4	5
Domestic production:			
Total (GDP)	½	2	2½
Manufacturing*	-1	0	2½

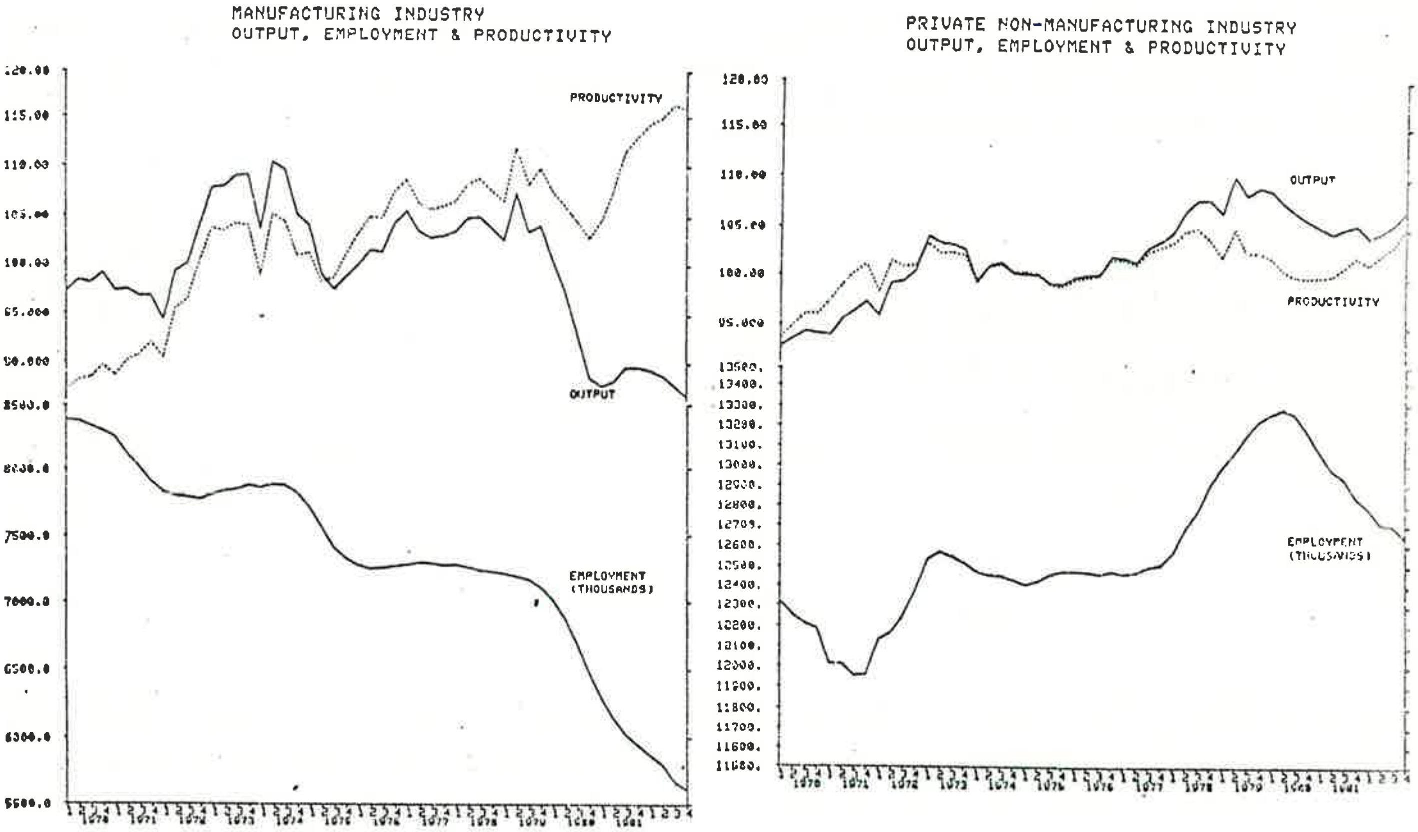
*Stock adjusted

36. The share of manufacturing industry in total output has been falling since the early 1970s, and particularly strongly since 1979. Official forecasts of manufacturing output have generally proved over-optimistic, to a considerable extent because the demand for manufactures in total was overstated. The forecast of manufacturing output in 1983 takes account of recent survey information. By the first half of 1984, helped by the improvement in cost competitiveness, output in the manufacturing sector could be rising at much the same rate as in the rest of the economy.

Employment, productivity and profitability

37. Total employment fell by some $1\frac{3}{4}$ million between 1979 and 1982, with a fall of nearly $1\frac{1}{4}$ million in manufacturing, where the problems of profitability and competitiveness have been greatest. In manufacturing, there is convincing evidence of an above average gain in productivity since 1980, though the extent of the fall in output makes the precise size of this gain difficult to assess. Outside manufacturing, the revised employment data up to mid 1981, and the less reliable indications available for 1982, do not suggest any improvement in productivity growth since 1979. Chart 3.8 shows the main features:

Chart 3.8



38. By the end of 1982 there was evidence that the period of exceptionally rapid productivity gains in manufacturing was giving way, as had been expected, to more moderate gains. Over the forecast period to the middle of 1984, growth of total output may be in the range 2-$2\frac{1}{2}$ per cent. This rate, if sustained and accompanied by no major shifts in financial pressures on employers, is probably consistent with little change in unemployment. The population of working age could rise by $\frac{1}{2}$-1 per cent a year.

39. Company profitability reached a low point in 1981: DOI estimates, based on necessarily very uncertain assumptions about obsolescence of capital and about tax, suggest that for industrial and commercial companies outside the North Sea the average real rate of return was about 3 per cent, compared to about 10 per cent a decade ago. Preliminary estimates for 1982 point to some recovery; and the forecast for inflation is consistent with some further increase in profitability in 1983. This, in turn, should help to ensure that a good part of the rise in demand is met from domestic supply.

Forecast and outturn

40. The table below compares the main elements of the forecast for 1982 published in the 1982 FSBR with latest estimates for the same period.

	Forecast	Provisional outturn
Total output, per cent change between 1981 and 1982	$1\frac{1}{2}$	$\frac{1}{2}$
Retail Prices Index: per cent increase between the fourth quarters of 1981 and 1982	9	$6\frac{1}{4}$
Current account of the balance of payments in 1982, £billion	4	$4\frac{1}{2}$
PSBR, 1982-83, £billion	$9\frac{1}{2}$	$7\frac{1}{2}$

41. GDP increased rather less than forecast in 1982. World demand and trade were substantially less than forecast, accounting for more than all the difference of $3\frac{1}{2}$ per cent on exports of goods and services: consumer demand (helped by lower prices) was a little higher than expected. But much of this was met out of stocks and with manufacturers keen to get stock levels down further there was another substantial fall in stocks in 1982. Much of this was reflected in lower imports. The current account surplus in 1982 turned out very close to the Budget estimate: both exports and imports were lower than forecast.

42. Retail prices in the fourth quarter of 1982 were nearly 3 per cent lower than forecast. Major contributing factors were the much lower increases than expected in housing costs (including the mortgage rate) and in seasonal foods. The general level of prices, as measured by the GDP deflator, was subject to a smaller margin of error: the GDP deflator in 1982-83 is estimated to have been 7 per cent higher than a year earlier, compared with a figure of $7\frac{1}{2}$ per cent expected at the time of the 1982 Budget.

43. The PSBR in 1982-83 is estimated at about £$7\frac{1}{2}$ billion. This is £2 billion less than the forecast made in March 1982 - more when allowance is made for the policy changes [including a lower rate

of NIS [,ending of RDG deferral, introduction of whisky duty deferment,]] announced in November. As always, when the flows on either side of the accounts are very large, there are a large number of partly offsetting differences, but the most an important element was the underestimation by some £1½ billion of the revenues from North Sea oil taxes. This reflected the recovery in oil prices after the dip between March and June 1982 and a higher than expected level of production. The errors on PSBR forecasts for 1981-82 and 1982-83 appear to be smaller than the average for earlier years.

Risks and uncertainties

44. No forecast is complete without some indication of error margins. Table 1 sets out the average errors from past forecasts, alongside the forecasts themselves. These average errors provide the best indication of possible errors in the current forecasts: while the size of errors will change over time as the economy fluctuates more or less, and as forecasting techniques change, in most cases the averages have not shifted very much since they were first published in 1976.

45. The forecasts of those items which represent the relatively small balance between large flows in either direction are particularly subject to error. For example, the flows on either side of the PSBR approach £200 billion; and for the current account of the balance of payments approach £100 billion. For the RPI, average errors are derived from a period of high inflation, averaging 14 per cent and subject to large fluctuations.

TABLE 1: SHORT-TERM ECONOMIC PROSPECTS

	Forecasts	Average errors from past forecasts+
A. Output and expenditure at constant 1975 prices		
Per cent changes between 1982 and 1983:		
Gross domestic product (at factor cost)	2	1
Consumers' expenditure	3	1
General Government consumption	1	1½
Fixed investment	3	2½
Exports of goods and services	0	2½
Imports of goods and services	4	2½
Change in stockbuilding (as per cent of level of GDP)	1	¾
B. Balance of Payments on current account		
£ billion:		
1982	4½	–
1983	1½	2
1984 1st half (at an annual rate)	1½	3½
C. Public Sector Borrowing Requirement		
£ billion; in brackets per cent of GDP at market prices:		
Financial year 1982-83	7½(2¾)	–
Financial year 1983-84	8¾ (3)	4 (1½)
D. Retail Prices Index		
Per cent change:		
Fourth quarter 1982 to fourth quarter 1983	6	2
Second quarter 1983 to second quarter 1984	6½	4

+The errors relate to the average differences (on either side of the central figure) between forecast and outturn. The method of calculating these errors has been explained in earlier publications on government forecasts (see Economic Progress Report June 1981). The calculations for the constant price variables are derived from internal forecasts made during the period June 1965 to October 1980. For the current balance and the retail prices index, forecasts made between June 1970 and October 1980 are used. For the PSBR , Budget forecasts since 1967 are used. The errors are after adjustment for the effects of major changes in fiscal policy where excluded from the forecasts.

(Pmf)

Liverpool (February) Forecast

Latest quarterly Bulletin is considerably more optimistic than other pre-Budget assessments on prospects for output, inflation and unemployment. Assumptions about fiscal/monetary policy, exchange rate, wages, etc also differ markedly from other forecasters. Liverpool call for tax cuts for lower income groups and/or reform of the benefit system to eliminate unemployment and poverty traps, thereby improving supply performance, and in a special article examine the SDP's proposals for social security and taxation. Liverpool argue that the monetary base should become a targeted monetary aggregate in 1983 MTFS as it is the best short run indicator of monetary conditions.

Assumptions. Net fiscal injection of £2 billion in 1983 Budget includes 15 per cent increase in income tax thresholds, over and above full indexation, and £1 per week increase in child benefit. PSBR in 1983-84 undershoots Autumn Statement (AS) illustrative figure of £8 billion by up to £2 billion, despite tax cuts assumed above, largely because activity is expected to recover much more strongly than in the forecast published with the AS. M1 grows at 7 per cent in 1983, 5 per cent thereafter. Short-term interest rates average 11 per cent in 1983 (8 per cent in 1984), remaining firm as political uncertainties continue until an assumed Conservative election victory late in 1983 or early next year. Effective exchange rate appreciates throughout averaging around 85 in 1983, 90 in 1984. World trade picks up in 1983 with 3 per cent growth, 5 per cent in 1984. World reference oil price falls to $25-28/bl range.

Main Points (see also table below)

- The outlook is one of relatively strong recovery and continued reduction in inflation. GDP (expenditure measure) increases 3¼ per cent in 1983 and over 5 per cent in 1984. Consumers' expenditure continues to increase, reflecting rapid fall in expectations of inflation. Private sector investment (including stockbuilding and durable personal consumption) rises strongly, increasing by 9½ per cent in 1983, 11½ per cent in 1984. Unemployment (UK adult sa, new basis) levels off during 1983, averaging 3.1 million for the year as a whole, falling gradually thereafter (the fiscal changes assumed in 1983-84 are calculated to reduce total unemployment by about 250,000 over five years) to 2.8 million in 1984, 2¾ million by 1986.

- 12-monthly increase in consumer prices falls further, despite the lower exchange rate and some recovery in commodity prices, averaging 4½ per cent in 1983, only 1½ per cent in 1984. Wage settlements in manufacturing average around 3 per cent during 1983 and 1984 implying some decline in real wages this year.

- Competitiveness improves sharply in 1983 partly reflecting cuts in NIS announced in AS. Current account surplus remains strong in 1983, at around £4 billion, falling to £½ billion in 1984.

Key Indicators (previous forecast in brackets)

	GDP (expenditure) % increase on year earlier		Unemployment (UK adult sa - new basis)		CPI (% increase on year earlier)		PSBR[1] (fy) £bn		Balance of payments, current account (£bn)	
1983	3.3	(2.9)	3.1	(3.0)[2]	4.4	(4.0)	4.5	(6.3)	4.1	(2.1)
1984	5.1	(3.0)	2.8	(3.0)[2]	1.5	(4.1)	1.9	(6.4)	0.6	(1.0)

[1] Figures for 1983-84 and 1984-85 are shown before assumed fiscal adjustment.

[2] Old basis

Phillips and Drew (March) Forecast

Pre-Budget forecast is a little more optimistic about prospects for output, inflation and the current account in 1983 than previous assessment but now envisages unemployment remaining on a firmly upward trend this year and next.

Assumptions. Public expenditure (cash) in line with revised planning total of £119½ billion included in 1983 PEWP. Net fiscal injection of £2 billion in forthcoming Budget, consistent with PSBR of £8 billion (2¾ per cent of GDP) in 1983-84, involves 14 per cent increase in personal tax allowances and ½ per cent cut in NIS. £M3 increases by 10 per cent in 1982-83, 9 per cent in 1983-84. P&D argue that firmer control of the growth of the targeted monetary aggregates may ease the pressure on sterling and suggest that 1983 MTFS should lower 1983-84 illustrative range for growth of the monetary aggregates from 7-11 per cent to 6-10 per cent. Effective exchange rate remains vulnerable reflecting political and oil market uncertainties, but P&D assume a gradual appreciation to 83½ by the end of 1983, with some easing during 1984 to around 82. World trade falls by around ½ per cent in 1983 as a whole (despite increasing slightly in 1983 H2), recovering by 3½ per cent in 1984. World reference oil price falls to $29/bl in 1983, rising to $30/bl in 1984.

Main Points (see also table below)

- Modest recovery continues with GDP(O) growth of around 1½-1¾ per cent in both 1983 and 1984. Manufacturing output picks up from the middle of this year, increasing ½ per cent in 1983 as a whole. Consumers' expenditure increases by 2-2½ per cent in 1983 but only around 1 per cent in 1984, slowdown reflecting a slight fall in RPDI as lower exchange rate squeezes real incomes. Fixed investment increases by around 2½ per cent in both 1983 and 1984 though public and residential investment rise more strongly. Modest restocking commences in 1983 Q2 and provides additional impetus to demand.

- Relatively strong import growth, at around 3½ per cent in both 1983 and 1984, reflects both the high import content of personal consumption and the stock turnround. Exports increase by 2 per cent in 1983, 4½ per cent in 1984. Balance of payments current account surplus falls to £1¼ billion in 1983, £1 billion in 1984 largely reflecting further substantial worsening in non-oil trade deficit from £2½ billion in 1982 to almost £6½ billion in 1983.

- P&D have revised their unemployment forecast slightly upwards, expecting UK adult unemployment (new basis) to remain on a firmly rising trend and exceed 3¼ million by the end of 1984.

- 12-monthly increase in retail prices falls to a low of 4½ per cent in 1983 Q2, increasing thereafter to around 6½ per cent by the end of 1983, reflecting the lower exchange rate and a gradual recovery in non-oil commodity prices.

- Non-oil industrial and commercial companies (ICC's) profits increase by 15-20 per cent in 1983 (10 per cent in 1982) partly reflecting the lower exchange rate. ICC's move into financial deficit of £2½ billion in 1983 after remaining in balance in 1982, as higher fixed investment and modest restocking in 1983 offset the recovery in profits.

Key Indicators (previous forecast in brackets)

	GDP(O) (% change on year earlier)		Unemployment (UK adult sa - new basis) Q4		RPI (% change on year earlier) Q4		PSBR (fy) £bn		Balance of payments current account (£bn)	
1983	1.7	(1.6)	3.21	(3.19)	6.6	(6.9)	8.0	(8.5)	1.3	(0.8)
1984	1.6	(1.8)	3.26	(3.17)	8.7	(8.7)	-		1.0	(-1.0)

London Business School (LBS) February Forecast

Pre-Budget forecast sees continued modest recovery in 1983 (with unemployment peaking towards the end of the year). Even after allowing for the lower exchange rate, LBS have revised down their forecast for inflation though "1983 is the low point in the present inflation cycle".

Assumptions. On basis of illustrative Autumn Statement figure of £8 billion for PSBR in 1983-84, LBS see little scope for fiscal adjustment in forthcoming Budget; this is mainly because LBS assume that public expenditure (cash) will exceed the revised planning total of £119½ billion in 1983 PEWP by around £1 billion. Nevertheless, LBS assume 1983 Budget proposes a 1p cut in basic rate of income tax, 12 per cent increase in personal tax allowances and only half revalorisation of specific duties. Assumed tax cuts (PSBR cost in 1983-84 of £1¼ billion) push PSBR up to £9¼ billion in 1983-84. £M3 growth slows down to around 8½ per cent in 1983-84, well within 1982 MTFS range of 7-11 per cent, but accelerates to 10½ per cent in 1984-85. Short-term interest rates fall gradually to around 8½ per cent by the end of 1983, following a gently upward trend thereafter. Effective exchange rate broadly stable at around 80. World trade (manufactures) in 1983 as a whole little changed from 1982 level, but strong recovery of over 5 per cent in 1984. World (reference) oil price averages $30/bl in 1983, increasing gradually thereafter.

Main Points (see also table below)

- GDP(O) grows at 1¾ per cent in 1983, 2 per cent in 1984; some recovery in manufacturing output which increases ½ per cent in 1983, partly reflecting a more favourable world background, but LBS comment that "a substantial proportion of the fall in manufacturing output relative to GDP...since 1979 is permanent". Consumers' expenditure increases 2-2½ per cent in 1983 (1½ per cent in 1984), partly reflecting a 1 per cent increase in RPDI; the savings ratio rises slightly in 1983 H2, though remaining at a historically low level. Fixed investment increases 3-3½ per cent in 1983 (4 per cent in 1984) with private residential investment particularly strong. Turnround in stock cycle provides an additional stimulus to demand, with modest restocking from 1983 H2.

- The "substantial improvement in competitiveness" following sterling's recent decline and (in 1984) strong world trade recovery contribute to 1½ per cent growth of exports in both 1983 and 1984. Strong import growth in 1983 at around 4½ per cent (2 per cent in 1984) partly in response to the ending of destocking. Balance of payments current account surplus falls to £1½ billion in 1983, moving into slight deficit in 1984.

- UK adult unemployment (new basis) increases steadily to 3.2 million peak by the end of the year, but moves gently downwards during 1984.

- 12-monthly increase in consumer prices reaches a low of 5½ per cent by the middle of 1983, rising gradually thereafter to about 7½ per cent by the end of 1984, as the recovery gathers pace and the effects of the lower exchange rate feed through. Wage increases "remain moderate" in 1983, public sector earnings growing less rapidly than private sector.

- Company profits (net of stock appreciation) increase substantially in 1983 (by around 20 per cent) partly reflecting the recent decline in the exchange rate. Company sector's financial position also impoves, a financial surplus of around £1¾ billion being expected in 1983.

Key Indicators (previous forecast in brackets)

	GDP(O) (% change on year earlier)		Unemployment (UK adult sa - new basis) Q4		CPI (% change on year earlier) Q4		PSBR (fy) £bn		Balance of payments current account (£bn)	
1983	1.8	(2.0)	3.2	(3.2)*	6.0	(6.7)	9.2	(9.7)	1.5	(1.5)
1984	2.0	(2.0)	3.1	(3.2)*	7.4	(9.2)	8.4	(9.8)	-0.0	(0.1)

* old basis

NUCLEAR DETERRENCE AND DISARMAMENT

BRIEFING NOTES

There has been much public discussion of late about the issues of nuclear deterrence and disarmament. The Government welcomes this discussion: it is right that everyone should be concerned about such vitally important questions. The attached notes are provided for those who want to understand more clearly the Government's policies. They cover not only nuclear deterrence, but also the closely related issues of arms control and disarmament (which are principally the responsibility of the Foreign and Commonwealth Office) and civil defence (which is dealt with by the Home Office).

Ministry of Defence
Main Building
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4th Edition

February 1983

NUCLEAR DETERRENCE AND DISARMAMENT

CONTENTS

I - BRITAIN'S NUCLEAR POLICY: THE KEY POINTS TO MAKE

1. GENERAL

a. The Government understands public concern about nuclear weapons; but they cannot be disinvented.

b. The Government shares the same aim as the unilateral disarmers to ensure that nuclear weapons are never used; but we differ on the means to achieve this.

c. We have avoided war in Europe for 37 years. Anyone who wants to tear up existing policy must show that their alternative will work as well.

2. THE CASE FOR DETERRENCE

a. The aim of deterrence is to prevent war - nuclear or conventional - by persuading anyone thinking of attacking us that it would not be worth their while.

b. As long as the Soviet Union possesses massive nuclear and non-nuclear forces, NATO needs sufficient of both to convince them that they could not hope to gain by using these forces.

c. But deterrence is not the whole story: in parallel, whilst a military balance is maintained, we are constantly seeking lower levels of forces on both sides through arms control and disarmament.

3. THE CASE AGAINST ONE-SIDED DISARMAMENT

a. One-sided nuclear disarmament by Britain would destabilise NATO and thus reduce the West's ability to deter aggression or the threat of force.

b. It would not make UK any less of a target for attack because Soviet systems would still be aimed at us as a member of the Alliance.

c. It takes no account of the existing Soviet conventional superiority (tanks, aircraft, guns) in Europe.

d. The Russians, who give such priority to their military power, would never follow our example: they have said as much.

e. It would cut no ice with countries thinking of acquiring nuclear weapons. Their actions will not be influenced by what the UK does, but by their own regional security interests.

f. It would undermine a number of important disarmament negotiations now in train aimed at reaching balanced multilateral force <u>reductions</u> and not merely limitations on growth. If the Russians believe that the West is going to disarm anyway this removes the incentive for them to negotiate seriously. In the START talks the US has proposed a dramatic cut of over 50% in the number of strategic nuclear missiles and a cut of a third in the numbers of warheads. At the Intermediate Range Nuclear Force talks in Geneva, the US has proposed the Zero Option which would eliminate an entire class of nuclear weapons from both sides. The Russians have submitted counter-proposals and both talks will take time. But there are signs that the Russians have accepted the aim of <u>reducing</u> as opposed to just limiting the numbers of nuclear weapons on <u>both</u> sides.

g. There is no moral merit in abandoning nuclear weapons yet remaining in NATO and relying on US nuclear forces.

4. <u>THE CASE FOR TRIDENT</u>

a. If the Russians ever mistakenly believed that the USA would not come to the aid of Europe if the latter were attacked the United Kingdom's nuclear force under independent control would still deter such an attack. Our Polaris force and decision to acquire Trident are welcomed by all our NATO allies.

b. Polaris will need to be replaced by about 1995; the Trident decision has been taken to maintain this capability. Failure to replace Polaris would be unilateral disarmament. Submarine launched cruise missile alternative would be more expensive.

c. During the period when it is introduced into service Trident will account, on average, for only about 3% of the defence budget per year. Trident is a more advanced system than Polaris. Its extra capability gives us an insurance against any advances in Soviet ABM defences well into the next century.

5. THE CASE FOR NATO INTERMEDIATE RANGE NUCLEAR FORCE (INF) MODERNISATION

a. Imbalance of 4 to 1 in intermediate range nuclear forces in or targetted on Europe. Soviet SS20s already being deployed; NATO's comparable capability ageing and increasingly vulnerable.

b. NATO needs cruise missiles to deter the Russians from threatening limited nuclear strikes on Europe in the expectation that the USA would stand aside. The need for them was pressed mainly by the Europeans to convince the Russians that the USA is firmly committed to Europes's defence. This is not to suggest that we have any doubts about the resolve of the US to protect Europe. Deterrence is a matter not of what we think but what any would-be aggressor might think.

c. The unanimous NATO decision to modernise its Intermediate Range Nuclear Forces (INF) was acompanied by a parallel offer to negotiate limitations with the Russians on these weapons. Negotiations began in 1981. The NATO aim is to eliminate INF land-based missiles of most concern to both sides (the zero option).

d. Cruise missiles are not:

- an American plan to fight a limited nuclear war in Europe; they are to deter the Russians from thinking they could do so.

- a new capability: US and UK aircraft based in Britain have been doing the same job for years.

- first strike weapons: their long flight time makes them unsuitable and the SS20s are mobile anyway.

- under sole US control. Matter for joint US/UK decision.

6. THE CASE FOR CIVIL DEFENCE

a. Deterrence can prevent war, but as long as the Soviet Union poses a threat to our security, any humane Government must cater for even the remotest possibility that war might come. Civil Defence is not specific to nuclear attack but relevant to any form of attack affecting the civil population.

b. No civil defence measures could make any kind of war acceptable. But Government at all levels has a duty to help people if we were ever attacked.

c. Any form of attack short of thousands of nuclear bombs would leave many millions of survivors whose numbers could be increased by even elementary civil defence measures. Their survival and recovery would depend largely on the plans which had been made in peacetime and on the implementation of plans by the surviving agencies of government.

d. Our civil defence arrangements, are not so good at, say, public shelter provision, as those of such countries as Switzerland and Sweden. But they are as good if not superior to that of many other major nations. Warning of enemy attack, monitoring of intensity of fallout radiation, plans for continuation of government and essential services, and public information in a crisis, are all areas where our arrangements are at least as good as other countries. However we are constantly considering what improvements should be made in the light of the risk, of war and available finances.

e. The Government is to stengthen the regulations placing civil defence functions on local authorties. The regulations will raise the standard of the nation's civil defence.

7. <u>THE SOVIET THREAT</u>

a. Soviet ideology seeks to impose communist values if necessary using force or blackmail backed by threat of force.

b. The Soviet Union has immense military power which is increasing all the time. In both nuclear and conventional forces it outnumbers NATO in Europe (Soldiers 1.2:1, Tanks 2.5:1, artillery 3:1, aircraft over 2:1) (Nuclear forces 4:1).

c. There is a proven Soviet willingness to resort to force to pursue its aims when they think they can get away with it (eg. Hungary, Czechoslavakia, Afghanistan).

d. The Soviet threat can be resisted provided NATO has sufficient modern conventional <u>and</u> nuclear forces to deter aggression at any level.

II - SPEAKING NOTES ON NUCLEAR POLICY

1. DETERRENCE

We in Britain belong to NATO, an organisation which was set up by the countries of Western Europe and North America after the Second World War, because of the fears caused by Russian expansion into Eastern Europe. NATO is a defensive Alliance; its members regard an attack on one as an attack on all, and are pledged to assist each other. The Alliance has no agressive intentions against the Soviet Union or any other country. It is, however, the countries of the Warsaw Pact and in particular the Soviet Union, which present the greatest threat to our security. The Soviet Union has immense conventional and nuclear forces - far more than could reasonably be required for purely defensive purposes. The invasion of Afghanistan is only the most recent demonstration that the Soviet Union is prepared to use military strength to achieve its political objective. While, of course, NATO does not need to match the Warsaw Pact weapon for weapon, we do need a range of forces, nuclear and conventional, so as to be able to show that we can defend ourselves against attack at any level. By demonstrating this we aim to deter such an attack from ever being mounted against us in the first place.

Deterrence is not an attractive way of ensuring peace. But at least it has worked: it has helped to keep Europe at peace for over 30 years, despite circumstances that were often difficult. To abandon our security system now, in favour of some alternative which would be quite unproven would be immensely dangerous. Deterrence provides the necessary stability to enable us to negotiate international agreements on disarmament measures which will really give us a safer world if they are verifiable and apply equally to both sides. The possession of nuclear weapons is an essential fact of deterrence: in a world where such weapons exist the NATO alliance must be able to deter their use by an enemy or to resist blackmail based on the threat of nuclear attack.

2. THE CASE FOR AN INDEPENDENT BRITISH NUCLEAR DETERRENT

Britain's nuclear forces are fully committed to the NATO Alliance, but they remain ultimately under the control of the United Kingdom Government. It is this independent control which makes their contribution to deterrence so important. Even if the Russians, perhaps some time in the future, thought they could take the risk of attacking the Alliance in the mistaken belief that the United States would not be prepared to use its nuclear weapons, they would also have to take account of those weapons - with enormous destructive power - in European hands. The risks and uncertainties they would face in starting a war would be so much greater. So therefore would the likelihood that they would be deterred. We have made this unique contribution to Alliance deterrence for over twenty-five years. Our Allies have repeatedly and clearly recognised its importance. To give it up, or let it fade away, would be an act of folly at a time when Soviet military power is growing at an alarming rate, and the disparity between the forces of NATO and those of the Warsaw Pact is continuing to widen.

The Decision to Acquire Trident

Our Polaris submarines first came into service in the 1960s. They will continue to provide a formidable deterrent for the next decade or so. But it will become increasingly difficult and costly to maintain both submarines and missiles in service beyond the mid 1990s. In addition to being fully under United Kingdom control, any replacement system must be able to pose a convincing threat. In other words it must be able to inflict damage on the Soviet Union out of all proportion to any gains they might hope to make by attacking us. It must also be invulnerable to surprise attack. The choice of another nuclear-propelled submarine, like the Polaris boats, as the vehicle to carry the weapons was essentially dictated by this need for invulnerability. Unlike any land-based system these submarines are almost impossible to detect once deployed in the deep oceans.

The choice of missile lay between another ballistic missile like Polaris, or a cruise missile. Cruise missiles cost less each. But much larger numbers are needed to provide an equivalent deterrent threat, and they are much more vulnerable to long-term improvements in Soviet defences. Because of the larger numbers, cruise missiles would need many more submarines, and these are the most expensive single component of a new force. A cruise missile force would therefore cost more. it would also be more uncertain than a ballistic missile force. For a deterrent capability intended to last well into the next century, Trident has clear advantages over any other ballistic missile system on both operational and cost grounds. Its purchase from the US, on very favourable terms, will allow us to continue the highly successful collaboration which we have over Polaris. The decision to go for the Trident II (D5) system rather than the previously announced Trident I (C4) system is to retain commonality with the US Navy and avoid problems of the UK having to operate a unique system. This will save money overall. It is <u>not</u> because we need the increased accuracy or capability of the D5 missile. The decision to process Trident missiles in the US is also to take advantage of commonality and save money. It will <u>not</u> lessen the independence of the UK deterrent.

<u>The Cost of Trident</u>

Trident will clearly be a major item in the defence programme. But it is similar to other major programmes like the Tornado aircraft, taking about 3% of the total defence budget on average during the period who it is introduced into service. Once in service it will, like Polaris, be very economical in running costs and its demand on skilled Service manpower. Over the last twenty-five years we have devoted between 2% and 10% of the defence budget to our strategic nuclear forces, so Trident does not represent any dramatic change. It should not be seen as an addition to the defence programme, but an integral part of it. The Trident programme will not prevent continued improvements in other areas of Britain's contribution to NATO. But it is hard to imagine any way in which this money could be spent on other defence uses which would make such a major contribution to the collective security of the Alliance. The most costly part of the system, the Trident submarines, will be built in the UK. Over its life, cost will be less than 20 pence per person per week.

3. GROUND LAUNCHED CRUISE MISSILES (GLCMs)

Both NATO and the Warsaw Pact have had intermdediate or medium range nuclear forces (INF) in Europe for many years, For over ten years NATO's forces have been the FIII and the Vulcan aircraft based in the UK. The Vulcans were retired in 1982, leaving approximately 170 FIII aircraft. The force is ageing and becoming increasingly vulnerable to new Soviet weapons. Over the period the Russians have been modernising and increasing their equivalent forces, so that they have some 850 INF missiles and aircraft aimed at Europe, including the formidable SS20 missile system. Over 300 SS20s have now been deployed, two-thirds threatening Western Europe. For NATO to do nothing could give the Russians the impression that they could use their growing nuclear arsenal to threaten limited strikes against Western Europe from a sanctuary in the Soviet Union - strikes which they would judge as being not sufficiently devastating as to provoke an all-out response by NATO's strategic weapons. For these reasons the Alliance judged that some modernisation of its capability was necessary to sustain deterrence. Therefore, in December 1979 NATO Ministers decided unanimously to introduce Pershing II and Ground Launched Cruise Missiles in Europe, starting in 1983.

In parallel with this decision to deploy GLCMs and Pershings the Alliance offered to negotiate limits on the numbers of intermediate range nuclear weapons. To show that NATO was not seeking an arms race, the US unilaterally withdrew 1000 nuclear warheads from Europe and have undertaken to withdraw further warheads on a one-for-one basis as the new missiles are deployed. In response to this offer, the Soviet Union initially refused to talk, but eventually they agreed to negotiations which began on 30 November 1981. Just before the start of these negotiations NATO proposed the 'zero option' solution, ie cancellation of the planned Pershing II and cruise deployments if the Russians would dismantle all their similar missiles, notably the SS20s. The limits must be on all missiles world-wide, The SS20 has sufficient range to strike targets in Europe when based east of the Ural Mountains.

NATO is pursuing the zero option as far and away the best solution to the problem of medium range missiles, but is not rigid. In the absence of zero we must have balanced numbers. The end of 1983, when the first cruise and Pershing II missiles will be installed, will be no deadline for the negotiations. They can continue. The programme to install NATO missiles stretches over five years and could at any stage be stopped, changed or reversed following success in the negotiations. But postponement or cancellation of NATO's plans to introduce Cruise and Pershing II missiles would certainly wreck the chances of agreement to reduce missile numbers on both sides.

If it could be achieved such an agreement would increase confidence between East and West and pave the way for further negotiations on other systems, such as medium range aircraft.

The NATO decision of December 1979 underlines the Americans commitment to the defence of Europe. It is not part of some plot to ensure that a limited war can be fought on European soil which will not involve the super powers. Nor does it mean that Britain is made of a target for nuclear attack. The Americans have never assumed that they could limit a nuclear war to Europe. It was in fact the Europeans themselves who wanted cruise missiles in Europe to deter the Russians from any belief that they could fight a nuclear war in Europe without putting Russian territory at risk. Cruise missiles do not give NATO a new capability. They simply modernise an existing capability hitherto provided by Vulcan and FIII aircraft.

4. ARMS CONTROL AND DISARMAMENT

Britain is committed to international negotiations for agreement on measures to limit and reduce the high level of armaments throughout the world. In the words of the Prime Minister at the second UN Special Session on Disarmament in June 1982, we are working for 'the balanced and verifiable reduction of armaments in a manner which enhances peace and security'. Britain, with its allies, was responsible for the zero option on INF. British delegations play a full role in negotiations in the Committee on Disarmament (CD) at Geneva, in the Mutual and Balanced Force Reductions

(MBFR) at Vienna, and the review meeting of the Conference on Security and Cooperation in Europe (CSCE) at Madrid. Britain takes part in regular disarmament discussions at the United Nations, in the European Community and in NATO.

We have now entered an important new phase of disarmament negotiations. The prizes are high and the path may be difficult; but there is no substitute for the patient work of diplomatic negotiation. The radical proposals which NATO has put forward offer an unprecedented opportunity for the nations of East and West to reach agreement on practical measures of nuclear arms control and disarmament. Serious negotiations are now taking place between the United States and the Soviet Union on reducing both strategic arms (START) and intermediate-range nuclear forces (INF). Britain is involved through the close consultations which take place in NATO.

For example, Britain strongly supports the so-called 'zero option' for long-range INF missiles, under which NATO would scrap its plans to deploy Cruise and Pershing II missiles in Western Europe, in return for the dismantling of the comparable SS4, SS5 and SS20 missiles targeted on Western Europe. This would be far and away the best solution. But in the absence of agreement on it, there would have to be balanced numbers, agreed at the negotiating table in Geneva.

Britain has warmly welcomed the opening of the US/Soviet Strategic Arms Reduction Talks (START) in June 1982. These concern the central strategic systems of the two sides: Inter-Continental Ballistic Missiles (ICBMs), Submarine-Launched Ballistic Missiles (SLBMs) and long-range bombers. Britain has given its backing to the radical proposal made by the US for deep cuts in strategic ballistic missiles, by one half in the first stage. The Soviet counter-proposal of a 25% cut in strategic systems does not go so far, but signifies a willingness to move towards substantial reductions.

Success in these negotiations would be helpful to progress in other areas of arms control, such as achieving a ban on nuclear weapons tests. Our negotiations with the US and USSR from 1977 to 1980 failed because the three parties could not agree on measures to prevent cheating. The verification problem is being studied by a working group in the Committee on Disarmament, to which British experts are contributing idea.

Preventing the spread of nuclear weapons to further countries is essentially a political problem which must be tackled by international cooperation. Efforts in recent years have concentrated on making the safeguards system of the International Atomic Energy Agency (IAEA) more effective. Britain plays a leading part in these efforts to improve access to the peaceful benefits of nuclear energy, while minimising the risk of transferring sensitive technology. We also support the setting up of nuclear-weapon-free zones (NWFZ) by international agreement in areas against which nuclear weapons are not delpoyed, as in Latin America.

5. ONE-SIDED DISARMAMENT

Against this background of multilateral effort, the Government do not accept that unilateral disarmament is a rational policy. NATO's strategy of deterrence has helped keep the peace in Europe for nearly 40 years. To abandon our security system now, in favour of an untried and unproven alternative would be immensely dangerous. Unilateral nuclear disarmament by the UK would do nothing to reduce the risk of war - indeed by undermining NATO's ability to deter aggression, such a move might make war more likely. Proposals of unilateral nuclear disarmament overlook the existing inbalance in conventional forces in Europe in favour of the Warsaw pact. Without the restraint imposed by nuclear weapons, there would be greater uncertainty and instability.

There is no evidence to suggest that unilateral nuclear disarmament by the UK would persuade others to follow suit. Mr Andropov has said quite clearly that they would not do so. Indeed the whole history of unilateralism is of succession of unrequited gestures. To take but a few examples: the events of the 1930s showed only too clearly that restraint by one side in the face of rearmament by the other led to disaster. After the Second World War, Britain unilaterally destroyed its offensive capability in chemical weapons and the US has allowed its capability to decline (NATO as such does not possess chemical weapons); by contrast the Soviet Union has continued to build up its CW capability (estimated as at least 300,000 tonnes of chemical agents, much of it in forward areas with modern delivery systems) and to develop a chemical war-fighting doctrine. Between 1968 and 1974 the US carried out a planned reduction of its defence budget, whereas the Soviet Union proceeded with a programme of military expansion. While NATO's collective military expenditure fell in real terms by 9.4% between 1969 and 1978, that of the Warsaw Pact rose by by 31.5%. Since 1968 when the super-powers agreed to start negotiations on nuclear disarmament, NATO has deliberately refrained from deploying new Intermediate Range Nuclear Forces (INF) in Europe. In 1976 - within one year of signing the Helsinki Final Act on Security and and Co-operation in Europe - the Soviet Union began to install the new SS-20 missiles targeted on European cities. In 1981 the US completed a unilateral withdrawal of 1000 nuclear warheads from Europe, the response from the Russians has been nil.

The weight of evidence shows that unilateral action by one side removes the incentive for the other to negotiate. There is a danger that talk of one-sided disarmament moves - however well intentioned will encourage the Russians to block present multilateral negotiations in the belief that if they wait long enough the West will disarm on its own, damaging its security interests, without obtaining Soviet concessions in return.

6. CIVIL DEFENCE

NATO and the UK seek to avoid war through deterrence. That policy has succeeded and will continue to do so provided the Alliance maintains its unity and strength. But as long as we believe that the Soviet Union proves a real threat to our security any humane Government must cater for even the remotest possibility that deterrence might fail and that war might come. If that ever happened our basic civil defence arrangements could save millions from the effects of attack. These arrangements include an effective warning of attack and fallout radiation, practical advice to help people survive the attack, stockpiles of vital supplies, arrangements for medical care and the continuation of government at all levels to organise recovery. No civil defence arrangements could possibly reduce the consequences of a large scale nuclear attack to a level which would make nuclear war acceptable to the UK. But it is the Government's duty to be able to help survivors if we were ever attacked, remote as that possibility is.

For this reason the Government is to strengthen the regulations placing civil defence functions on local authroties, which will be required to arrange for the peacetime training and exercising of staff and volunteers. Local authorties (including district councils and London boroughs) will also have to provide emergency headquarters. The new regulations will raise the standard of the nations civil defence.

III - QUESTIONS AND ANSWERS ABOUT NUCLEAR POLICY

Q1. ISN'T HIGH EXPENDITURE ON NUCLEAR WEAPONS UNACCEPTABLE AT A TIME WHEN SPENDING ON, FOR EXAMPLE, HEALTH, EDUCATION AND SOCIAL WELFARE IS BEING DRASTICALLY REDUCED?

A1. The Government understands and sympathises with the feelings of those people who believe that money devoted to defence would, at a time of economic stringency, be better spent on other areas of public expenditure. No Government in a democratic state wants to pile up weapons which are unnecessary. There are many ways of spending money which would be more popular with the electorate. The Government of the Soviet Union - which is not responsible to any electroate - spends twice as high proportion of its resources on defence as we do. However, the first responsibility of the Government must be the security of the nation, and if they were to put that security at risk by inadequate precautions they would inevitably endanger all the things such as health, education and social welfare, which we quite rightly value in our society. We, and a good many others, learnt that lesson the hard way in the 1930s and World War II. Unilateral disarmament was tried then, and failed. It must not be allowed to fail again. Our nuclear forces cost us well under one half of one per cent of total government expenditure.

Q2. ISN'T IT BETTER TO BE RED THAN DEAD?

A2. You say that you would rather be "red" than "dead". It would be a miserable choice to have to make; but fortunately it is not one that any of us has to face. The main object of the defence policy of this and preceding Governments is to ensure that we shall never have to do so. We belong to NATO, and we are committed with our Allies to the strategy of deterrence. The aim of this strategy is to make it clear that <u>any</u> attack on <u>any</u> NATO member would involve risks to the aggressor out of all proportion to the advantages which he might hope to gain. This firm defence strategy of deterrence has kept peace and maintained freedom in Western Europe for some 38 years now. As long as we maintain deterrence, there is no reason why the British people should ever have to decide to be "red" or "dead".

Q3. ISN'T 'DETERRENCE' AN OBSOLETE EXCUSE FOR THE ARMS RACE?

A3. Deterrence means preventing war. We have to accept that nuclear weapons, including the knowledge, technology and materials necessary to make them, exist in both East and West. The policy of all British Governments in recent times, and all our Western Allies, is based on nuclear deterrence: to ensure that the Soviet leadership can never calculate that any possible gain from starting a war against us would be worth the risks. But that is not the end of it. No-one especially from within the ethical traditions of the free world - can rest comfortably on such a policy alone as the basis of international peace for the rest of time. That is why we have to search unremittingly for better ways of ensuring a stable world. Vital amongst these is the Government's commitment to pursue effective measures of arms control and disarmament. But in the meantime, for deterrence to remain effective, we must from time to time modernise our equipment as existing systems become obsolete.

Q4. AREN'T YOU NOW PLANNING FOR A LIMITED NUCLEAR WAR?

A4. The West does not believe that nuclear weapons could be used to achieve a military victory in any meaningful sense; and once nuclear exchanges began there would be an appalling risk of escalation into all-out nuclear war. We and our Allies need no convincing of this.

But we also have to convince the Russians that they could not hope to win a limited nuclear war either. With the deployment of accurate modern weapons like the SS20 missile system, the Russians have greatly improved their ability to mount limited nuclear strikes on our military bases and war-ships. The purpose of, for example, mobile cruise missiles is to demonstrate that we have the means of responding to such attacks (and of evading them) without having to resort immediately to all-out retaliation.

We have no desire to fight a limited nuclear war and no belief that we could in any sense win one; our aim is simply to ensure that the Russians do not believe that <u>they</u> could win one.

(See also A8)

Q5. WHY HAVE YOU DECIDED TO BUY TRIDENT AND IN PARTICULAR THE D5 MISSILE?

A5. The existing Polaris force entered service in the 1960s. By the 1990s it will be approaching the end of its useful life - in particular the submarine hulls and associated machinery will start wearing out. To fail to plan to replace it - which means taking decisions now because of the long time it takes to get defence equipment into service - would be to give up unilaterally our independent deterrent - which has helped keep the peace in Europe for over 30 years. It could make war more likely, not less. Trident, which is again a submarine based ballistic missile system, is the most effective way of ensuring the UK has a credible strategic deterrent until well into the 21st century.

It was originally intended to adopt the Trident I C4 system, which would be adequate to meet the UK's deterrent needs. However this will be phased out of US service earlier than expected. So as to retain commonality and avoid problems of the UK having to support a system which only it operates ("uniqueness") the Government has decided to go instead for the Trident II (D5) system. This will be cheaper in the longer run, and it will still only cost on average about 3% of the defence budget over the next 18 years. D5 was <u>not</u> chosen because of the increased accuracy or capability of the missile system. Neither are needed and the latter will never be used.

Q5A. WHY DID YOU DECIDE TO PROCESS TRIDENT MISSILES IN THE US?

A5A. Again, to take advantage of commonality with the US Navy System and to save money (several hundred million pounds compared with earlier plans). This decision will not increase the UK's dependence on US facilities; modern technology means that the missiles will remain at sea in the submarines for much longer periods than is the case with Polaris.

Q6. CRUISE MISSILES ARE "FIRST STRIKE" WEAPONS - HOW DO YOU RECONCILE THIS WITH A POLICY OF DEFENCE AND DETERRENCE?

A6. NATO concepts of deterrence do not envisage any type of "first strike" - the main aim is to maintain the peace. But in any event, as the Soviet Union can see quite clearly, the West has not and is not developing the physical capability for a "first strike" strategy even if we wanted one.

A "first strike" means a surprise attack intended to destroy an opponent's nuclear weapons and, hence, remove his ability to retaliate. Cruise missiles are neither intended for a "first strike" role, nor are they capable of it.

Cruise missiles, because of their slow speed, would take 3-4 hours to reach the Soviet Union from the UK. Any kind of mass attack by cruise missiles would be detected in plenty of time for the Soviet authorities to mobilise their own nuclear forces before it arrived. The number to be deployed in Europe is much smaller than the number of Soviet missile silos, many of which are beyond the range of cruise missiles based in Europe, and in addition the Russians have now deployed over 300 <u>mobile</u> SS20 ballistic missiles, of which over two thirds face Western Europe. These are invulnerable to attack once they have deployed away from their main bases. Like the West, the Soviet Union also has missilefiring submarines with nearly 1,000 ballistic missiles which provide the ultimate guarantee against any attempt to mount a first strike attack.

These factors were a consideration in the NATO decision to deploy cruise missiles, it was intended that they should be clearly deterrent and defensive rather than aggresive systems.

Q7. YOU SAY THAT NATO DOES NOT PLAN A FIRST NUCLEAR STRIKE, BUT SURELY THAT IS NOT WHAT MEMBERS OF THE AMERICAN GOVERNMENT HAVE SAID?

A7. NATO is purely defensive Alliance and its leaders have pledged that none of its weapons conventional or nuclear would ever be used except in response to attack. NATO leaders solemnly committed themselves to this in Bonn in June 1982. NATO's strategy of flexible response makes clear that, faced with the possibility of overwhelming defeat at the conventional defeat at the conventional level, the Alliance reserves the right to use nuclear weapons in its defence. The purpose of this strategy is to create the strongest doubt in the mind of Soviet planners about their ever being able to limit the extent of a war to Europe. The fact that the Alliance has necessarily thought through all its possible courses of action in the worst possible case should not be interpreted to mean that such an outcome is regarded as probable or even likely; nor should it be allowed to obscure the fact that NATO's strategy remains essentially one of deterrence.

[Note: Essential for questioner to recognise 'first strike' and 'first use' are technical terms which often become confused. As explained in the answer to Q5 'first strike' means a surprise nuclear attack designed to destroy an opponent's nuclear weapons and hence its ability to retaliate. It forms no part of any NATO intentions. 'First use' means using nuclear weapons first in an existing conventional conflict. NATO recognises this is a course which cannot be ruled out in advance, for example, in a situation where the Alliance was facing defeat at the conventional level. This is not to say that it would not be a course involving a very great degree of risk.]

Q8. WHY SHOULD WE TRUST THE UNITED STATES WHEN THEY CLEARLY INTEND TO LIMIT ANY FUTURE WAR TO EUROPE?

A8. If the US wanted to limit any future war to Europe without themselves being involved, the last thing they should do would be to station their forces and their nuclear weapons in Europe. The decision to deploy US Pershing II and cruise missiles in Europe enhances deterrence by demonstrating to the Russians that the US see the defence of Europe as indissoluble from the defence of their own country. The Russians would know very well that the US President had agreed to any decision to fire the missiles and in fact they have stated that they would regard any attack by US nuclear weapons in Europe as coming from the US itself. There can be no illusion therefore on either side that Europe can be fought over in a limited war, away from superpower sanctuaries.

Q8A. WHY IS NATO UNWILLING TO FOLLOW THE SOVIET UNION'S PLEDGE NOT TO BE THE FIRST TO USE NUCLEAR WEAPONS?

A8A. NATO has given a far more comprehensive undertaking-its leaders have pledged, in underlining the defensive nature of the Alliance that it will never be the first to resort to force (Bonn-June 82). No NATO weapons, conventional or chemical, will ever be used except in response to attack. NATO is a totally <u>defensive</u> alliance and threatens no one. This pledge in part reflects Soviet confidence in their superior strength in conventional weapons. NATO cannot follow suit because such a policy would undermine NATO's strategy of deterrence and ability to convince a potential attacker that, whatever level of attack he might be contemplating, the risks to him would far outweight any gains he might hope to make. A NATO no first use declaration would remove the uncertainty and risks facing the Soviet Union should they ever consider an attack and undermine the strength of deterrence. Because the Soviet pledge is selective it does not rule out aggression with conventional weapons, and is of doubtful value since it could never be sufficiently relied on should war ever break out.

Q9. WHY DO WE NEED CRUISE MISSILES?

A9. At the beginning of NATO's history it was assumed that any serious Soviet attack on the West would be met by the full strength of the Western nuclear strategic force. This was called the doctrine of 'massive retaliation'. It was the agreed strategy of the Alliance for several years. It became, however, steadily more clear that this was not an entirely credible deterrent, particularly as the Soviet Union acquired its own strategic nuclear arsenal. The Russians might well doubt whether the Alliance would in fact respond with a full nuclear strike against Soviet use of its massive superiroity in conventional forces. Thus, there came into being the present Alliance stratefy of Flexible response. This strategy does not mean that we need to match the Russians exactly at all levels of armaments. It does mean that if we are to have an effective deterrent, that deterrent must operate at all levels, and not just at the level of strategic nuclear forces.

It is because of this thinking that the European allies become worried in the late 70s that the Soviet Union was building up medium-range nuclear forces (the SS20s) whereas NATO had nothing comparable. It was feared that this growing imbalance in this particular range of weaponry night tempt the Soviet Union into adventures in Europe. The Russians might well believe that their medium range nuclear forces would enable them in a crisis to bring coercive pressure to bear on Europe with impunity. Hence the 'double track' decision by NATO in December 1979. We agreed that we would, if necessary, modernise our intermediate medium-range forces by introducing Cruise and Pershing to replace out-of-date weaponry thus reasserting the NATO deterrent at every level. At the same time, however, we would try to open negotiations with the Soviet Union which would make this INF modernisation unnecessary by persuading them to get rid of the SS20s. This NATO decision has how led to the negotiations in Geneva. Without that NATO decision there would have been no negotiations, and if we now abandon the decision to modernise if necessary, then it is clear that the negotiations would not succeed. The Russians may agree to a workable arrangement at Geneva, provided they are clear in their own minds that without such an arrangement we have the determination to modernise our own forces.

Q9A. WHAT ARE THE ARRANGEMENTS FOR CONTROL OF CRUISE MISSILES IN THE UK?

A9A. The use of the cruise missile bases would be a matter for joint decision between the British and US Governments. (Important to recognise this joint decision: not just consultation, not US decision alone). This is exactly the same arrangement under which US nuclear forces have been based in this country for many years. The Prime Minister and the Secretary of State for defence have assured the House of Commons that the Government have satisfied themselves that the current arrangements remain effective.

Another useful point can be made:

These arrangements are reviewed every time either Head of Government (US President or British Prime Minister) changes.

There is no point of principle here; the option of having a "dual-key" was open to us. We could have taken it up if we had purchased the missiles and supporting equipment and provided British servicemen to man them, with the United States providing only the nuclear warheads. But this would have cost hundreds of millions of pounds and required over 1,000 additional British servicemen. Given that we are satisfied with existing arrangements we judged that this was not the best way to use our limited defence resources.

Q9B. IF THE EXISTENCE OF SOVIET SS20's WITH NO CORRESPONDING WESTERN SYSTEMS TO MATCH THEM CONSTITUTES AN UNACCEPTABLE THREAT TO THE WEST, HOW HAVE WE LIVED SAFELY THROUGH THE LAST FEW YEARS?

A9B. NATO's earlier LRINF eg British Vulcan bombers and US FIII's have either been phased out of are ageing and increasingly vulnerable to Soviet air defence. Meanwhile Soviet SS20s have grown to their present level of 1000 warheads. As men like Helmut Schmidt and Henry Kissinger have pointed out, this situation risks becoming very unhealthy for European security and stability. Even in peace-time we have seen the effect of the SS20 programme on public confidence. In the event of major crisis it could give rise to dangerous Soviet miscalculations or at the very least a temptation to apply coercive pressure on Western Europe. The price of freedom is eternal vigilance and a continuous readiness to keep the deterrent in good repair.

Q10. HAVEN'T CRUISE MISSILES TURNED THE UNITED KINGDOM, ESPECIALLY GREENHAM COMMON AND MOLESWORTH, INTO A PRIME SOVIET TARGET?

A10. Soviet missiles have been targetted on Western Europe including the UK, for many years. In the unlikely event of conflict our political, geographical and industrial importance inevitably makes the United Kingdom a primary target. But there is no reason to suppose that the cruise missile peacetime bases at Greenham Common and Molesworth would be priority targets. The missiles would be moved from their bases to secret locations in times of tension to prevent the enemy being able to make a direct attack on them. These dispersal locations do not need any advance preparation since the only requirement is for a reasonably level piece of ground with some concealment against air attack. Cruise missiles can be moved from one site to another at frequent intervals. However the key point is that the presence of cruise missiles will strengthen deterrence and make a war less likely in the first place. Nuclear weapons have been based in the UK for more than 30 years with precisely this aim.

The only way to remove this threat is to remove the Soviet missiles themselves.

Q10A. WHY HASN'T PARLIAMENT BEEN CONSULTED?

A10A. You allege a lack of democratic involvement in the decision to site cruise missiles in the UK. Parliament has in fact been kept fully informed of the Government's policy on this issue. Mr Pym who was then Defence Secretary told the House of Commons on 19 December 1979 of NATO's 'double decision' to deploy cruise and Pershing II missiles from the end of 1983 and to offer the Russians negotiations to limit this class of weapon. In January 1980 he initiated the first debate on nuclear weapons in the House of Commons for 15 years. This debate covered the whole field of Britain's nuclear defence policy, including of course the prospect of the deployment here of cruise missiles, and in the vote at the end of the debate the Government's policy was clearly endorsed. Since then the House has on three major occasions debated nuclear defence issues, the latest debate being on 15 December 1982, which again focussed on the NATO 'double track' decision of December 1979. There will be other occasions for Parliament to express itself on these matters.

NATO's programme to deploy the new intermediate range missiles in Europe is of course not irreversible. It is to be spread over 5 years and could at any time be amended, stopped or reversed if agreement in the arms control negotiations warranted it. The choice therefore lies with the Russians, if they are prepared to negotiate seriously and in good faith about the missiles in question. But it is only because NATO has remained firm and united that the Russians have been brought to the negotiating table at all.

Q11. PRESIDENT REAGAN'S ZERO OPTION?

A11. The United State - on behalf of NATO and with the support of all the NATO Governments - has offered to cancel all plans for Pershing 2 and Cruise Missiles in Europe if the Russians will dismantle their similar missiles (the older generation of SS4s and SS5s and the notorious SS20s). This radical proposal to cut nuclear weapon levels is argueably the most important arms control offered since the SALT negotiations began. It would eliminate an entire class of nuclear weapons. Bilateral US/Soviet negotiations about these missiles opened in Geneva on 30 November 1981 and the fourth round began on on 27 January 1983.

While the zero option is far and away the best solution to improve East/West stability NATO has always said that it would consider any serious and fair proposal from the Russians. In the absence of agreement on the zero option NATO would be guided by the principle of seeking, across the negotiating table, balanced reductions for both sides.

Q11A. MR ANDROPOV'S OFFER TO REDUCE SS20s?

A11A. The Russians original proposals (reduction to 300 of what they call "medium-range systems" on each side) would have left them with all their SS20 missiles but permitted NATO no installation of Cruise of Pershing 2 missiles to counter the Soviet threat. In December 1982 Mr Andropov offered to reduce the numbers of SS20s in Europe - a step in the right direction if the Russians are finally acknowledging the special threat posed by SS20s, and an offer to be probed at the negotiations. But the offer is, like the Russians original proposals, conditional upon no installations of Cruise or Pershing 2 missiles by NATO and so would leave the Russians with a monopoly in this type of missile. Clearly this would not amount to fair or balanced arms control.

The Soviet claim that Soviet SS20s match the independent forces of Britain and France is no excuse. The British force is a submarine force, excluded from the negotiations by definition, just in the same way as US and Soviet submarines. These missiles are in no way comparable to the SS20s.

Q12. WHAT ABOUT STRATEGIC ARMS NEGOTIATIONS AND WHY AREN'T BRITISH FORCES INCLUDED?

A12. You ask why the British strategic nuclear deterrent is excluded from the current negotiations on nuclear arms control. The first point to make is that the British nuclear deterrent is very small in proportion to the forces of the superpowers. This will still be the case once Trident replaces Polaris. Our Polaris force of four submarines has 64 missiles. This compares with the Soviet Union's 2,350 missiles of strategic range (to say nothing of almost 2000 Soviet nuclear missiles of lower ranges including over 300 SS20s). Secondly the British force of four submarines is the minimum required to provide an effective deployment: we could not reduce from this number.

There are two negotiations on nuclear arms control in progress in Geneva at the moment. The Russians are now demanding that our nuclear weapons should be taken into account in the negotiations on Intermediate range Nuclear Forces (INF). This is a curious demand. The INF talks are specifically <u>not</u> about strategic weapons. British Polaris submarines (like Trident to come) can no more be part of INF negotiations than the American and Russian missile-firing submarines of comparable type. The reason for the Russians' demand is not hard to discover. Despite the fact that there are no NATO counterparts to their SS20 missiles targetted on Europe, they have been trying to claim that there is a balance between the two sides' intermediate range weapons. IE, to justify this they make the claim that our strategic weapons are INF. They are trying to compare apples with oranges. (If further proof were needed you would only have to look at the SALT I Agreement in which the Russians added a unilateral footnote to the effect that they believed that the British and French nuclear deterrents should be counted in agreements as <u>strategic</u> weapons.) There is a further important point. What the Russians are in effect demanding is that they should be allowed the same number of intermediate nuclear missiles as the rest of the nuclear powers together thus codifying a Soviet superiroity over the United States. This would be quite wrong and damaging to East/West security. Furthermore it is difficult to see how any US administration (or Congress) could agree to it.

A12 cont.,

As for the other set of talks in Geneva - which are on strategic (intercontinental) nuclear missiles and bombers, the first priority is to reduce the huge Russian and American armouries. The Americans have made proposals which would reduce the number of intercontinental missiles by more than one half. These negotiations are of course bilateral between the Russians and the Americans and it would not only be wrong but it would be a distraction for them to seek to put limitations on British (or French) forces. But if the threat that Soviet forces posed to Britain posed to Britain were substantially reduced we would of course be prepared to review our position on arms control and the British deterrent. This point would seem to be a long way off; the first aim is to get agreement between the Americans and the Russians.

Q13. ISN'T THE POSSESSION OF NUCLEAR WEAPONS IMMORAL?

A13. The whole question of nuclear weapons raises grave and difficult ethical issues just as much for pacifists as for anyone else. The most central issue is whether it is morally wrong to threaten to use nuclear weapons in order to prevent others using them. The greater good is undoubtedly served by preventing nuclear war.

We accept of course that there is room for differing views about the morality of nuclear deterrence just as there have always been different views about the morality of war itself even in defence of justice and freedom. But in an imperfect world political responsibility often means choosing the least of several evils. The Government does not accept that it is immoral to retain nuclear weapons to prevent other using them against us. Since 1945 up to 10 million people have died in well over 100 wars by so-called conventional weapons. During that time there has been no war in Europe. We belive that stable nuclear deterence remains the policy most likely to prevent the outbreak of war of <u>any</u> kind between East and West (including nuclear war). There is therefore a moral duty not to abandon that policy, except for one which makes the risks of war evenless. We continue to strive for more lasting power and justice in the world. Short of that goal, the Western Alliance remains the best guarantee of the values we seek to defend.

In addition, unilateral disarmament by Britain would not prevent others from using nuclear weapons against us; if it increased the risk of nuclear war, then many would argue that unilateral disarmament would be morally wrong itself. Nor is it likely to persuade any other nuclear weapon state to give up their weapons, or influence any non-nuclear weapon power determined to acquire a nuclear capability from doing so. What they do will be determined by regional security cosiderations - not by anything Britain does. [See also Chapter IV - The Ethical Aspects], Britain is working through the Non-Proliferation Treaty (NPT) to prevent the spread of nuclear weapons but should other countries acquire nuclear weapons in the future then that is hardly an argument for giving up ours.

A13. cont.,

Speaking in November 1980, the Arch Bishop of Canterbury said that unilateral disarmament by Britain "might serve to destablize a balance which has undoubtedly contributed to the peace of Europe for 35 years".

Q14. THE NEUTRON BOMB IS A PARTICULARLY HORRIFIC WEAPON WHICH KILLS PEOPLE AND LEAVES PROPERTY INTACT. SURELY WE SHOULD HAVE NOTHING TO DO WITH IT?

A14. The 'neutron bomb' which is more correctly known as the enhanced radiation weapon (ERW) differs from current nuclear warheads only in that a greater proportion of energy released is in the form of radiation, with correspondingly smaller effects from heat and blast. In other words, there is no difference in principle to nuclear weapons already deployed by both NATO and the Soviet Union. ERWs offer one way of deterring a massed armoured attack by the Warsaw Pact against Western Europe - they currently have an advantage over NATO in Central Europe of approaching three to one in main battle tanks. Of course, there are other ways - both nuclear and conventional - to deter such an attack, and the task of NATO is to find the most efficacious.

It is a gross distortion of the facts to claim that ERWs can destroy people but not property. The point is that they could knock out a Soviet tank attack on the territory of Western Europe without causing massive damage and civilian casualities nearby.

The US decision to proceed with the production of ERWs does not represent a change in the direction of US policy - indeed, when President Carter deferred a decision on the production of ERWs in 1978 he stated that his ultimate decision would be influenced by the degree to which the Soviet Union showed restraint in its own arms programmes, and his Administration continued the production and stockpiling of ERW components in advance of this.

No proposals have been made for the deployment of ERWs outside the United States, and the US Administration have made it clear that they will consult within the Alliance on any proposals of this kind.

Q15. WOULDN'T UNILATERAL DISARMAMENT BE THE FIRST STEP TOWARDS MULTILATERAL DISARMAMENT?

A15. One-sided nuclear disarmament is not a step towards multilateral disarmament; it is a step away from it. The one is the enemy of the other. For Britain to give up its nuclear weapons unilaterally would do nothing to reduce the dangers of war. Indeed by undermining NATO's ability to deter aggression it might make war more likely. There is no evidence to suggest that any other country would follow our example. In particular the Russians have made it clear that they would not give up their nuclear weapons. Britain is the only nuclear power in Europe which is committed to the common defence of NATO countries. We are an integral part of the balance of power within Europe. The Government would certainly like to see a world in which nuclear weapons for deterrence were not needed. Our approach however is to work towards a steady reduction in both conventional and nuclear armaments on <u>both</u> sides. The Soviet Union has made it clear that it will not disarm unilaterally; neither does it expect unilateral disarmament by the West.

Q15A. WHY DOES NATO NOT IMPLEMENT A BATTLEFIELD NUCLEAR WEAPON-FREE ZONE AS SUGGESTED BY THE PALME COMMISSION AND OTHERS?

A15A. There are a number of difficulties with the Palme Commission's proposal of a 150km Battlefield Nuclear Weapon Free Zone (BNWFZ) in Central Europe.

Militarily a BNWFZ would be of little value, because targets inside it could still be attacked by accurate longer-range systems stationed outside it. Moreover, shorter range systems or warheads could easily be moved back into the zone in time of crisis. A BNWFZ would not as it its proponents claim raise the "nuclear threshold". This threshold would be determined by the strength of NATO's conventional defences.

Verification of a BNWFZ would be extremely difficult because the systems concerned are mobile and relatively small and because some are also "dual capable" - that is, aircraft and artillery which have nuclear roles as well as essential conventional ones. But without effective verification a BNWFZ could hardly be expected to build up mutual confidence: on the contrary an inadequately verifiable zone would only increase mutual suspicion.

NATO is concerned to maintain strong conventional forces in order to enhance deterrence and maintain the nuclear threshold as high as possible. That was the primary objective of the Long Term Defence Programme initiated in 1977. In addition NATO is currently reviewing the numbers and types of its short-range nuclear weapons to see if any changes are needed. The unilateral establishment of a BNWFZ by NATO would do nothing to enhance deterrence, would imply that the territory concerned was less important to NATO than other areas, and would not help current efforts in the Geneva negotiations to reduce (rather than redistribute) nuclear weapons.

Q15B. WHY NOT TRY UNILATERALISM SINCE MULTILATERALISM HAS FAILED?

A15B. Multilateral disarmament is a slow process. There have been successess in the past. The Americans and Russians reached the important SALT I agreement in 1972 which for the first time fixed agreed ceilings on nuclear weapons. At the same time they agreed the Anti-Ballistic Missile Treaty which put an effective stop to any destabilising competition in strategic defensive systems. The Nuclear Non-Proliferation Treaty of 1968 has been signed by well over a hundred countries and has limited the proliferation of nuclear weapons beyond the five existing nuclear weapon states. Between 1961 and 1979 the multilateral arms control process produced some 18 separate agreements on subjects such as nuclear testing, hot lines, reducing the risk of nuclear war by accident, arms control in outer space, on the seabed and in the Antarctic. There is of course much more to do, but these were all important steps along the road to greater international security and stability. Britain will continue to play an active part in there endeavours as we have all along. Now there are negotiations aimed at <u>reducing</u> not merely controlling nuclear weapons. In both the INF and

A15B. cont.,

START talks the Soviet Union has accepted the idea of reductions in its nuclear forces. The fact that the multilateral road is a difficult one is not an argument for abandoning it.

Q16. WHAT ABOUT THE WARSAW PACT'S WIDE-RANGING DISARMAMENT INITIATIVES?

A16. The NATO Head of Government issued a historic statement after their summit meeting in June 1982: the Bonn Declaration. In it they reaffirmed their policies on non-aggression, on the preservation of peace, on the relaxation of tension and the bulding of confidence in Europe, on the improvement of East/West relations, and on proposals for the balanced reduction of forces and weapons. They called on the Warsaw Pact to make a positive response.

In January 1983 the Eastern side responded with the Prague Declaration, issued after a Warsaw Pact meeting. This lists a number of measures which the Warsaw Pact has supported in the past: many of them were agreed by the United Nations in 1978 as desirable features of a long-term disarmament programme, and are under discussion in various arms control fora. Britain has welcomed the Prague Declaration as a possible indication of Eastern willingness to move towards the goals set by NATO in the Bonn Declaration.

An older proposal revived in the Prague Declaration is for a non-aggression pact between NATO and the Warsaw Pact. NATO has no difficulty about a commitment not to use force except in response to an attack. It made one at the Bonn summit in June 1982. We are willing to consider proposals for new agreements provided we can be convinced that these will strengthen rather than weaken existing obligations, eg the United Nations Charter and the Helsinki Final Act. But there is already a busy international arms control agenda which concentrates on priority areas: strategic and intermediate-range nuclear missiles, conventional forces, chemical weapons etc. So any new proposals must take their place in the queue. If substantial progress is made in key areas like START and INF, that would be the best incentive for considering what the next stage in negotiated arms control agreements should be. Meanwhile we shall have some questions to put to the Warsaw Pact. In particular we should wish to know whether the offer of non-aggression extends to countries outside the two alliances, like Afghanistan, or to members of the Warsaw Pact itself, like Poland.

Q17. IS NUCLEAR WAR BECOMING MORE LIKELY?

A17. Far from it. Since the Cuban missile crisis of 1962, there has never been an occasion when the use of nuclear weapons has been remotely likely. Deterrence is not an attractive way of keeping the peace, but it has worked. The ability of both sides to retailiate from invulnerable submarines), the agreements between West and East on preventing nuclear war by accident or miscalculation, the existence of a broad parity between the super-powers at the strategic level, and an awareness of the consequences of the use of nuclear weapons have all contributed to a lowering of the risk of nuclear war. in addition the West has now made major proposals at the INF and START talks aimed at reducing the number of nuclear weapons held by both sides and further reducing the risk of war. These include:

i. reducing strategic ballistic missiles by over half, with particular emphasis on the most destabilising weapons;

ii. eliminating the most threatening weapons in Europe (long-range INF missiles);

iii. strengthening East/West confidence building measures (eg extension of notification of test missiles firings).

The Soviet Union appears to have accepted the concept of reductions, and serious talks have begun aimed at preserving peace at lower levels of forces on both sides.

Q17A. ISN'T THERE A DANGER THAT FAILURE OF WARNING SYSTEMS WILL PLUNGE US INTO ACCIDENTAL NUCLEAR WAR?

A17A. All complex detection systems can produce ambiguous data, and early warning systems are no exception. However, highly trained personnel are constantly on watch to evaluate such data and cross checks would be made with other systems. Also, the decision to use nuclear weapons would have to be taken at the highest political level. They could never be used automatically in response to an early warning system alone.

There are agreements between the Governments of the United Kingdom and the Soviet Union (and between the United States and the USSR) specifically to prevent the outbreak of accidental nuclear war: there are also 'hot lines' for communication.

Neither the US or the UK has a policy of launching nuclear weapons purely on early warning evidence, nor do we need any such policy; this is one of the many advantages of having strategic deterrent weapons at sea in submarines, which are virtually invulnerable to attack.

Q17B. SHORT FLIGHT TIME OF PERSHING II WILL CAUSE SOVIET UNION TO ADOPT LAUNCH ON WARNING POLICY?

A17B. The flight time of the Pershing II - approximately 14 minutes (not the 6 minutes claimed by the Soviet Union) - is certainly short. But the flight times of the SS20s are of the same order. The shortness of flight time could be destabilising <u>if</u> a "first strike" was a viable risk or if either side had a "launch-on-warning" policy NATO has not adopted a launch-on-warning policy in response to Soviet deployments of SS20s since 1977; and there are no grounds for the Soviet Union doing so because of the much smaller planned deployments of Pershing II.

Q18. WHY NOT AGREE TO A FREEZE ON NUCLEAR WEAPONS?

A18. You advocate a freeze in nuclear weapons. A freeze would remove much of the incentive for the Soviet Union to agree to recent United States proposals, made at the START and INF talks in Geneva, for radical cuts in nuclear weapons levels. It is hard to imagine that the Soviet Union would have responded, in the START talks, with a proposal to cut the superpowers' strategic forces by 25% had they not been faced with the prospect of the United States' Trident and MX missile programmes. What may prove to be the first Soviet concession in the INF negotiations, Mr Andropov's offer of 21 December to reduce the numbers of SS20 missiles in Europe, would have been far less likely had the Russians not foreseen the introduction of cruise and Pershing II missiles to Europe from late 1983. A nuclear freeze would also confirm the current imbalances, including the massive Soviet superiority in intermediate range nuclear forces.

A freeze would in any case be difficult and time consuming to negotiate, and difficult to verify. it would also divert effort away from the urgent and important task of seeking the negotiate <u>reductions</u> in the levels of nuclear forces of both sides (as is happening in talks in Geneva) rather than merely seeking to hold forces at <u>existing</u> levels.

Q19. WHY DON'T WE SPEND MORE ON CIVIL DEFENCE?

A19. The whole purpose of the Government's defence policy is to prevent war. So long as the NATO Alliance maintains a strong deterrent, the risk of a war in Europe at any level will remain a remote possibility. The Soviet leadership know that if they used nuclear weapons against us they would be running a very grave risk of massive retaliation against Soviet territory. But should such an attack take place, even though the consequences would be appalling, there would still be millions of survivors. No one pretends that survival is possible near the centre of a nuclear explosion. But the further away you are, the better would be your changes of survival with some form of shelter and basic precautions. It is therefore the duty of any humane Government to make some provision for such an eventuality, however remote it might be. However, the Government do not believe that it is necessary to spend large sums on civil defence as long as we maintain our deterrent policies. The purpose of civil defence is to enable our civil resources to respond if peace is broken and there is an enemy attack. The amount of money we spend on it reflects this aim. The introduction of the new civil defence regulations will confer additional functions on local authorities. To meet these, the Government proposes to increase the area of local authority civil defence expenditure entitled to 100% grant aid (instead of 75% at present). Total expenditure on civil defence in 1983/84 will increase to about £67m.

Q20. HOW COULD ANYTHING BE DONE IF WE HAVE ONLY FOUR MINUTES WARNING?

A20. It is extremely unlikely that the first hint of Soviet aggression would be a few minutes warning from the Fylingdales Early Warning System. In such circumstances, it is true, we would have no time to activate our civil defence arrangements. But while a missile attack 'out of the blue" is theoretically conceivable, the Soviet Union would have to calculate that Western response to such an attack might be massive retaliation by an invulnerable submarine-launched strategic missile. There is no likelihood that war could start without some sort of political crisis and at least a short warning period of some days during which Soviet military preparations were apparent. Such a warning period might well be followed by a conventional conflict lasting for some days, possibly weeks, before the war either stopped or escalated to some level of nuclear exchange. During all this time the government would be implementing its plans for advice to and protection of the public, for the continuation of essential services, and for the continuity of organised government. If, during a period of conventional war, the Soviet Union attacked us with missiles, people would be prepared and ready to take the immediate selfprotective action necessary in response to broadcast public announcements and the sounding of the attack sirens.

Q21. BUT WHY NOT BUILD MORE SHELTERS?

A21. Successive Governments have accepted that the low risk of war in Europe balanced against the enormous cost (billions of pounds) does not not justify a programme of purpose-built shelters. Our civil defence policy represents an insurance policy against such a risk, which will remain remote provided we maintain our policy of deterrence. Our major Allies follow a similar policy, including the United States, the Federal Republic of Germany and Italy. However, we are by no means complacent and within the inevitable financial constraints ways of improving our arrangements are constantly under review. In particular we intend that local authorities should conduct a survey of their areas to identify existing structures suitable for adaptation in crisis as communal shelter for the public.

Q22. SURELY THE ARRANGEMENTS MERELY ENSURE THE SURVIVAL OF A GOVERNING AND MILITARY ELITE?

A22. Certainly not. Senior Ministers, officials and Service officers would remain in London should a war break out. The Ministers and staffs of decentralised or regional government in emergency headquarters are essentially reserves in the event of a nuclear attack on Central London. The Armed Forces have similar arrangements. The aim would be for local authorities to continue to provide essential services, and for a form of regional government until central control could be resumed. But control would remain firmly in civilian hands and law and order would be administered under regulations approved by Parliament before an attack took place. The whole purpose of the surviving administrations would be to help the survivors by providing emergency services and information.

Q23. WHAT WILL THE GOVERNMENT DO IF LOCAL AUTHORITIES REFUSE TO CO-OPERATE IN CIVIL DEFENCE PLANNING?

A23. The Government is confident that the great majority of local authorities will continue to discharge their statutory obligations. The new civil defence regulations will confer additional functions on them to make provision in peacetime for the protection of the public and the continuation of essential services in war and to participate in civil defence activities. The Government hopes that, in a matter so closely related to the nation's vital defence interest, of which the Government is elected to be the judge, local authorities will wish to follow the policy determined by central government and make use of the additional resources which central government has decided to allocate to local civil defence planning.

IV - THE ETHICAL ASPECTS

The following is the text of a letter written by John Nott, Secretary of State for Defence, to Mr Michael Latham MP, on 2 March 1981.

"Thank you for your letter of 16th January with copies of the resolution carried by the British Council of Churches at their General Assembly on 24th November, and of the speeches by Dr Greet and the Archbishop of Canterbury.

I am most keenly aware of the grave ethical issues raised by nuclear weapons, with their appalling power. But we face these issues in a world where nuclear weapons inescapably exist. They cannot be disinvented. The Soviet Union is a huge power of totalitarian ideology, with a massive and growing military strength and a proven willingness to use that strength when it thinks it can get away with doing so. It makes no secret of its determination to impose its ideology and its political dominance upon others. In such a world Western Governments are not merely entitled but positively bound to protect their peoples' right to peace and freedom by something more substantial than just good motives and hoping for the best. As Christians, surely we are bound to uphold the essential dignity of individuals against the contempt of human rights demonstrated by the Russian leadership?

Deterrence has helped to keep Europe at peace for over thirty years, despite circumstances that were often difficult. It is still very stably keeping the peace, and the occasional speculation one hears that somehow nuclear war is closer upon us now seem to me quite baseless. To abandon our security system now, in favour of some alternative one which would be quite unproven and which indeed one seldom hears coherently or concretely described, would be immensely dangerous; and accordingly it is not obvious - to put matters mildly - that such abandonment would be of compelling ethical merit. I yield to no-one in my abhorrence of war, especially nuclear war; where I part company with the unilateralist is in my judgement of how war can be most surely prevented.

The hard truth is that without a nuclear capability the Alliance would be unable to deter attack or to resist blackmail based on the threat of attack. Given that, the possession of nuclear weapons by NATO as part of deterrence seems to me plainly justifiable. Its central desire and aim is that nuclear weapons should never again be used, by either side.

So far as the United Kingdom's own nuclear contribution is concerned I would see no integrity in any ethical position which demanded abandonment of our own weapons as fundamentally immoral, while remaining content to shelter under the nuclear umbrella of the United States through membership of NATO. I am, of course, aware of other sorts of arguments urged against British capability, like cost, or the non proliferation considerations which I believe may have underlain the view expressed in the British Council of Churches' resolution in December 1979; but these, with respect, are matters of practical judgement and political opinion, not ethical principle. I adhere to the view taken by all post-war British Governments and re-endorsed recently in public by our Allies, that our capability contributes valuably to the assurance of Western deterrence.

No-one can view these matters as easy, in ethical or any other terms. I note that in their recent statement the Roman Catholic Bishops were unable to reach a clear conclusion. I have much sympathy with the view put recently, in an article from a Quaker viewpoint, by Mr Sydney Bailey: 'Today there is no policy about the threat or use of nuclear weapons which does not pose appalling moral and practical dilemmas' - and he was speaking equally of unilateralism and of NATO deterrence. For myself, I come out where I see the Archbishop of Canterbury does on the fundamental issue: I cannot see unilateral renunciation as the right or responsible course. Like him, too, I look to arms control as a path of improvement. But in the real world, where business has to be done with the Russians, the West will not secure arms control by giving them what they want before negotiation starts.

I deplore, like the Archbishop and Dr Greet, the amount spent on arms. I would like to spend far less, if we could do so without making war more likely. But to ignore that condition - as so many people did in the 1930s - may bring down on us costs, above all in human life and freedom, far exceeding those of any peacetime provision for defence.

Perhaps I could pick up one other point from Dr Greet's speech. He talks of 'a defence policy that envisages a pre-emptive first strike with nuclear weapons'. If by this is meant a policy that would attempt to disarm an adversary by destroying his nuclear capability, then I can assure Dr Greet that the West has no such policy; nor does it either possess or plan to acquire the sort of capability that could make disarming strikes a real option. Fears to the contrary can rest only on misunderstanding or misrepresentation of the nature of modern nuclear armouries and technical developments."

Ministry of Defence
2nd March 1981

In a message to the Second United Nations Special Session on Disarmament in June 1982, Pope John Paul II said:

"In current conditions deterrence based on balance, certainly not as an end in itself, but as a step towards a progressive disarmament, may still be judged morally acceptable ..... I reaffirm my confidence in the power of true negotiations to arrive at just and equitable solutions. Such negotiations demand patience and diligence and must notably lead to a reduction of armaments that is balanced, simultaneous and internationally controlled."

V - THE BALANCE OF NUCLEAR FORCES

It is difficult to make a simple comparison between the nuclear forces of NATO and the Warsaw Pact. Any numerical "balance" cannot take account of such factors as age, operational capability, and numbers and yields of warheads. Comparisons of warhead numbers are particularly difficult since many delivery systems can carry different numbers of warheads and neither side publishes figures about the total number of warheads in its stockpiles.

Moreover since there is plainly little sense in attaching the same weight to an inter-continental ballistic missile and a short-range howitzer, any attempt to draw up a nuclear balance must involve placing the systems into various categories, and these necessarily must to some extent be arbitrary. Overleaf is a diagram showing the total number of systems deployed at the end of 1982, broken down in strategic systems (such as those defined as such in the SALT agreements) and longer and shorter range intermediate nuclear forces(INF) and short range systems based in Europe. Although the presentation of the figures can be varied, it can be seen that the Soviet Union has a marked superiority both in the total number of systems and in almost every individual category.

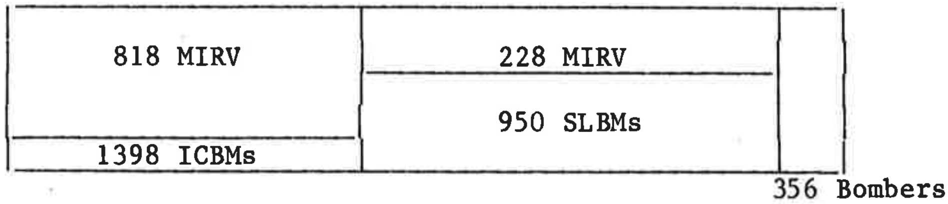
Despite this the Russians have claimed that a broad parity already exists in "medium range" systems, and that NATO will be upsetting this balance by its programme to modernise its longer-range INF systems. However the figures they have produced to support this claim make it clear that their balance has been constructed by selective inclusion and exclusion of systems on either side. Thus they include NATO strategic systems (eg Polaris) but not Soviet equivalents; US aircraft based in the United States but not Soviet aircraft based in the Far East; NATO aircraft (F4, A6, A7) but not equivalent Soviet aircraft (Fitter, Flogger, Fencer). Although it is possible to argue about where the line should be drawn, any objective balance must include systems of approximately equivalent capability on both sides. If only the longer range INF land based systems on both sides are counted, the Soviet Union has a superiority of about 5:1. If shorter range INF systems are added to the comparison, the ratio is more than 3:1.

It is also worth noting that the Soviet Union first made the claim that parity exists in 1979. Although since then they have withdrawn about 175 of their older SS4 and SS5 missiles, each with one warhead, they have deployed more than 200 of their new and formidable SS20s, each with three warheads - an overall increase of about 500 warheads. A total of over 300 SS20s is now in service. Meanwhile NATO has not made any increases in its own systems, so, if there was party in 1979, it cannot exist now. Additionally the Soviet claims about the NATO modernisation programme ignore the fact that the US unilaterally withdrew 1,000 warheads from its European stockpile in 1980/ 81; that Pershing II will replace Pershing I on a one-for-one basis; and that NATO will withdraw a further warhead as each new cruise missile is deployed. Moreover the first of the new NATO missiles will not be deployed until the end of 1983; by which time some 350 SS20s can be expected to have been deployed.

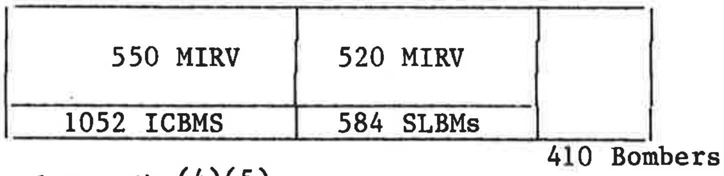
THE BALANCE OF NUCLEAR FORCES - END 1982 (1)(2)

STRATEGIC SYSTEMS (3)

Soviet Union



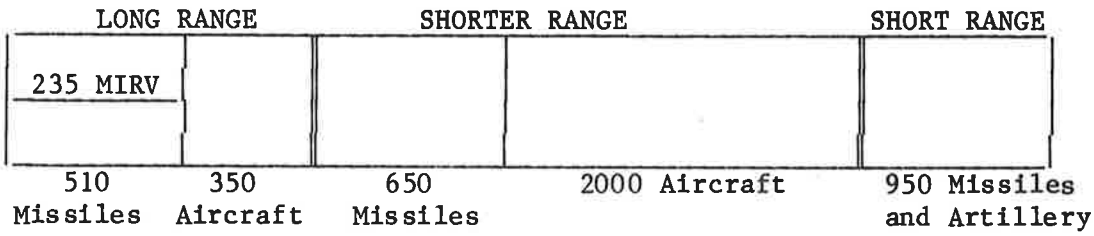
NATO (excluding France)



EUROPEAN SYSTEMS (Land Based) (4)(5)

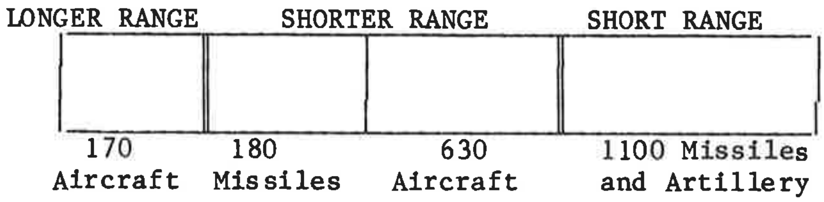
INF

Soviet Union



INF

NATO (excluding) France)



NOTES: ICBM = Intercontinental Ballistic Missiles.
SLBM = Submarine Launched Intercontinental Ballistic Missiles.
MIRV = Multiple Independently Targettable Re-entry Vehicles.

(1) French systems are not included in this diagram. They comprise 64 SLBM, 36 Mirage IV bombers, 18 S3 missiles and shorter range Mirage IIIA and Jaguar aircraft and Pluton missiles.

(2) The diagram does not include defensive systems such as ABM or air defence missiles and aircraft.

(3) The diagram of strategic forces covers operational strategic delivery systems of the types defined in SALT as well as Soviet Backfire and US FB111 bombers which have intercontinental capabilities.

(4) The European figures do not include some 250 aircraft of the Soviet Naval Air Forces or some 20 aircraft of NATO Air Forces which have an antiship capability; nor do they include sea-based nuclear capable systems on both sides which are normally deployed in the European theatre and which have a land attack capability, eg 18 SS-N-5 on Soviet Golf class submarines in the Baltic and 20 A6 and 48 A7 aircraft on US carriers in the Mediterranean.

(5) It is difficult to define precisely the exact ranges of many INF systems particularly aircraft. These categories are therefore necessarily somewhat arbitrary. For the purpose of this diagram longer range INF systems have been taken as those with an approximate range exceeding 1000 kms; shorter range INF as those with an approximate range between 150 kms and 1000 kms; and short range forces as less than 150 kms. (Note: some authorities refer to LRINF as medium range systems to distinguish them from the longer range strategic systems.)

VI - GOVERNMENT FACT SHEETS AND BROCHURES ON NUCLEAR POLICY ISSUES

Copies of MOD and FCO brochures are available on request. The following list describes some of them briefly.

DEFENCE FACT SHEET 1 - ARMS CONTROL AND DISARMAMENT

DEFENCE FACT SHEET 2 - NATO

DEFENCE FACT SHEET 3 - DETERRENCE

DEFENCE FACT SHEET 4 - THE NUCLEAR BALANCE

The Defence Fact Sheets are designed for background information, rather than 'handout material'.

'NUCLEAR WEAPONS AND PREVENTING WAR' Essay on the deterrent philosophy which was first published in the Statement on Defence Estimates 1981.

'A NUCLEAR FREE EUROPE - Why it wouldn't work' This explains the fallacy of the European nuclear free zone proposal and includes a map showing how Russian SS20s can strike at the whole of Europe from behind the Ural Mountains.

"CRUISE MISSILES - Some Important Questions and Answers" covers the reasons behind the 1979 double decision modernization and arms control), and issues such as whether Britain has become more of a target, cost and control.

'ARMS CONTROL AND SECURITY' - Essay reprinted from the Statement on Defence Estimates 1982 explaining the Government's attitude to arms control and disarmament.

'NUCLEAR DEFENCE: KEY POINTS' - Aide Memoire for speakers.

'THE FUTURE UNITED KINGDOM STRATEGIC NUCLEAR DETERRENT FORCE' Defence Open Government Document 80/23 July 1980. A memorandum setting out the rationale for an independent strategic deterrent and the reason for choosing Trident to replace Polaris. An additional Open Government Document 82/1 'THE UNITED KINGDOM TRIDENT PROGRAMME', dealing with the decision to purchase the Trident II D5 system, was published in March 1982.

Copies of the above material can be obtained from

Ministry of Defence (PR)
Room 0366
Main Building
Whitehall
SW1 2HB
Tel 01-218-2386

Arms Control and Disarmament (Quarterly) - Review of Developments in the INF negotiations
The Balanced View - Nuclear Weapons and Arms Control
Peace and Disarmament - a short guide to British Government Policy
The Nuclear Debate - sets out the two schools of thought (unilateralism and multilateralism)
Britain and Arms Control - Summary of proposals supported by the UK.

Copies of the above brochures, and further information, including a quarterly newsletter on arms control and disarmament can be obtained from

Arms Control and Disarmament Research Unit
Foreign and Commonwealth Office
Downing Street
SW1
Tel 01-233-3907

A short audio-visual presentation of the deterrence strategy entitled 'A Better Road to Peace' is available to clubs, groups, etc from:

Central Film Library
Central Office of Information
Chalfont Grove
Gerrards Cross
Bucks SL9 8TN
Tel: Chalfont St Giles (02407) 4111

A film entitled 'The Peace Game' and explaining how the West has kept the peace, is available from the same source.

Civil Defence is the responsibility of the Home Office and Scottish Home and Health Department. Copies of official background material on civil defence including a free pamphlet "Civil Defence - why we need it" can be obtained from

Emergency Services (F6) Division
Home Office
50 Queen Anne's Gate
SW1H 9AT
Tel 01-213-4018.

MANAGEMENT IN CONFIDENCE

ANNUAL REPORT ON STAFF INSPECTION IN C & E : 1982

Introduction

1. The 1980 measures to strengthen staff inspection included a requirement to produce to the appropriate Minister and the Permanent Secretary an annual report for each staff inspectorate. This is the third such report for this Department and it follows the pattern of its predecessors. It reports the results of inspections completed in 1982, records the position on implementation at the year-end, refers to other work done by the inspectors and deals with related matters. As previously, "completion" of an inspection is the date the report is sent to the Head of Office concerned.

2. The overall management, aims and objectives of the Department's Staff Inspection and Evaluation Branch (SIEB) remain as before.

Reviews

3. Early in the year, following field work in 1981, the SIEB published its report on the feasibility of producing guidelines for local complementing of VAT non control work. Guidelines have since been issued for assessing the resources needed in VAT Local Offices for work, other than control visiting which is assigned centrally. The system will be operational in April 1983 and the results of local assessments will be subject to staff inspection later in the year.

4. No other formal reviews were undertaken during the year.

Staff Inspections

5. Five inspections were completed during the year: three in Collections, and two in Headquarters.

6. Inspections in the Outfield were restricted by work being undertaken there in preparation for the implementation of the 1981 Review of Provincial Collections (ROPC). There were inspections of London North and West and

London City and South Collections after the reorganisation resulting from the 1980 Rayner scrutiny. These were followed by an inspection of a Customs District at Dover, and a period during which SIEB resources were concentrated on HQ inspections of the Customs and VAT Control Directorates.

7. Separate reports were produced for each of the Divisions of the VAT Control Directorate, as shown at Annex A. In the case of the Customs Directorate however the reorganisation of the Directorate proposed by the staff inspectors made it more appropriate to produce a single report for the Directorate as a whole.

8. At the end of the year inspections of two large Collections not affected by ROPC were in progress. These were London Airports Collection, and London Port Collection.

9. The results of the staff inspections reported in 1982 are summarised in Annex A. This shows that net savings recommended amounted to 357, nearly 14% of the posts inspected. This total includes some 150 savings which had previously been identified by line managers and/or in the course of a Rayner scrutiny.

10. Three Treasury staff inspectors were involved in the London North and West and London City and South inspections, and one each in the HQ Customs Directorate and VAT Control Directorate inspections.

Implementation

11. Annex C of last year's annual report showed an implementation rate of nearly 80%. Annex C of this report shows the latest position. Three recommended reductions have been dropped and a reduction of 30 posts now remains to be achieved. Implementation will continue to be slow because of the high proportion of non-mobile grades involved.

12. Progress in the implementation of the 1982 staff inspection recommendations is summarised by grade at Annex B of this report. To date, net reductions of 211½ have been agreed for implementation by 31 March 1983 and a further 75 reductions have been agreed for implementation in 1983-84. This implementation rate of 80% represents a small improvement on that reported last year. It has not proved practicable to achieve a higher

figure at this stage because the substantial reductions recommended in the VAT Control Directorate are partly dependent on organisational and other changes; and the report on the Customs Directorate recommended a major restructuring of the Directorate, which needs more detailed work in conjunction with the senior managers of the Directorate before changes can be put into effect. Once again implementation has been assisted by line managers anticipating some of the staff inspectors' findings by blocking posts.

13. Annex C summarises the position in the form now required by the Treasury. The changes agreed are those at 31 December 1982, and the "basic staff cost" column of the Treasury Ready Reckoner has been used to calculate the cost figures. SIED have agreed that the "ceiling" column is not appropriate to this department and that the "s.i.p." column can be left blank this year because of the amount of work involved in assembling the figures retrospectively.

Wider Issues

14. Throughout the year particular attention has been paid to the following aspects of the staff inspectors' role highlighted in the Treasury letters of 23 August and 7 December 1982:

a. questioning the need for work to be done at all;

b. seeking to eliminate unnecessary management levels; and

c. tightening up on grading standards.

15. During inspections we have continued our practice of identifying unnecessary work and in co-operation with local management have recommended changes and reorganisations, such as that in the Customs Directorate, designed to achieve staffing economies.

16. In respect of management posts, this year's inspections have resulted in recommendations for the withdrawal of 4 Senior Principal and 37 SEO posts. None of the Senior Principal posts and only 9 of the SEO posts were in the Outfield however: for reasons of geography and technical involvement we have found the scope for removing management posts to be much more restricted in the Outfield than in Headquarters.

17. The 89 grading changes listed in Annexes A and C include 40 additional CA posts matched by an equivalent reduction at higher levels.

18. A number of wider issues arising out of our inspections have been taken up outside our published reports. Among these were:-

a. the management span of the SEO grade in the Excise and in VAT;

b. arrangements for inspection visiting by management in the Outfield;

c. means of providing relief other than by use of Collection Officers; and

d. the scope for employing the CO grade on certain Outfield visiting work currently performed by EOs.

Departmental Code of Practice and relations with Trade Union Side

19. The revised Code of Practice negotiated in 1981 has generally worked well and we have enjoyed a period of full co-operation from staff being inspected. However, as forecast last year, the Trade Union Side have switched their emphasis during 1982 from trying to impede the conduct of inspections to trying to frustrate implementation of our recommendations.

Branch Staffing

20. The Branch's complement has remained unchanged at 1 Senior Principal, 3 Principals, 18 SEO, and 1 CO. In the summer 1 Principal retired: his replacement will be trained and fully effective by Spring 1983. The 6 SEO vacancies brought forward from last year were filled in March but two of the recruits left during their trial period. A further recruitment exercise in the Autumn attracted 12 applicants of whom 4 were found to be suitable and have taken up post. For the first time in two years the Branch has a complete complement, although some of the inspectors are still being trained.

Liaison

21. Two of our inspectors have spent short secondments with other departmental SIEBs to their mutual benefit, and one Principal staff inspector

was loaned on repayment to the Manx Government to inspect their Customs Service. We in turn have received one inspector from the Inland Revenue SIEB. We propose to continue these working exchanges as opportunities arise.

22. To supplement the continuing informal liaison between SIEB, Management Services Division and Internal Audit Unit, joint reviews of future programmes have been held under the direction of the PEFO to ensure integration of effort and avoidance of overlap.

Future programme

23. Our policy over the past 3 years of selecting areas which we considered likely to bear most fruit, and recent delays to the Outfield visiting programme caused by ROPC, have resulted in the inspection cycle being extended in places beyond 6 years. In 1983 and 1984, therefore, we shall concentrate on the areas which have fallen furthest behind, aiming to establish a secure 6 year cycle. Also, as indicated in paragraph 3, inspections in Local VAT Offices will be resumed.

24. The Treasury are to audit the Department's complementing standards by a series of staff inspections starting in March. These inspections will be Treasury-led and additional to the Departmental programme.

ANNEX A

STAFF INSPECTIONS COMPLETED IN 1982

Area Inspected	Report Published	No. of Posts Inspected	Regrading Recommended	Net Increases Recommended	Net Reductions Recommended	Net Effect on Complement
Dover East 'C' District	Apr	48	Nil	7	Nil	+ 7*
London City and South Collection	Apr	302½ ⊕	4	11	33	- 22
London North and West Collection	Apr	348 ⊕	4	5	49	- 44
VAT Control Division 'A'	May	32	1	Nil	4	- 4
VAT Control Unit	Aug	736	55	6	148	- 142
VAT Control Division 'B'	Oct	488	2	2	97	- 95
VAT Control Division 'C'	Nov	178	Nil	19	13	+ 6
VAT Control Division 'D'	Nov	111	Nil	Nil	17	- 17
Customs Directorate	Oct	371	23	5	51	- 46
TOTAL:		2614½	89	55	412	- 357

Key:

* No increase to Collection complement authorised. Additional staff provided from local re-allocation of posts.

⊕ Excludes all VAT posts below Principal level.

A N N E X B

STAFF INSPECTIONS COMPLETED IN 1982

NET CHANGES BY GRADE

	Net Changes Recommended	Not Proceeded with	Implemented 1982-83	To be Implemented 1983-84	Outstanding Recommendations
Assistant Secretary	- 3	- 1	-		- 2
Senior Principal	- 4		- 2		- 2
Principal	- 7		- 4	- 1	- 2
SEO	- 37		- 17	- 5	- 15
HEO	- 62		- 39	- 9	- 14
EO	- 91		- 49	- 20	- 22
CO	- 96		- 42	- 49	- 5
CA	- 36½		- 43½	+ 11	- 4
REV. ASST.	- 4		- 3	- 1	NIL
OTHER	- 16½		- 12	- 1	- 3½
NET CHANGE	- 357	- 1	- 211½	- 75	- 69½

ANNEX C

RESULTS OF STAFF INSPECTION OF 'COUNTED' STAFF

1. Changes in numbers

Period	Staff position at time of inspection			Recommended Changes against complement			* Recommended Changes agreed		
	Complement	Ceiling	SIP	+	−	Net	+	−	Net
1981	1806½			34½	251	- 216½	27	210½	-183½
1982 Jan-Sept	1466½			29	234	- 205	20½	188	-167½
Oct-Dec	1148			26	178	- 152	25	144	-119

2. Changes in gradings (ONE - FOR ONE)

Period	Upgradings		Down gradings		Recommended Changes agreed		
	Number	Cost (£)	Number	Saving (£)	Up	Down	Net Saving/cost
1981	2	100	43	126,917	2	39	115,056
1982 Jan-Sept	9*	24,012	55	153,449	13*	48	96,679
Oct-Dec	1	5,166	24	77,014	Nil	12	33,562

* Includes 4 additional upgradings agreed for VAT HQ telephone enquiries section to cover increased workload subsequent to the staff inspection.

BUDGET SECRET

FROM: D R NORGROVE
DATE: 11 MARCH 1983

1. MR ~~KEMP~~
2. CHANCELLOR

I think it is very useful to have this written down. It is easy to go astray with these numbers. [illegible]

V. useful. Please note [illegible] [illegible] Column - [illegible] Lobby

C.

No problems here.

[illegible]

cc Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Littler
Mr Middleton
Mr Bailey
Mr Moore
Mr Cassell
Mr Evans
Mrs Lomax
Mr Allen
Mr Hall
Mr Ridley
Mr French
Mr Harris

THE BUDGET ARITHMETIC

The Budget speech (eighth draft) makes various statements about the overall arithmetic of the Budget and the autumn measures. People may find it helpful to have a more precise description of how these figures are derived than is possible in the speech itself.

A. "Last autumn, I announced measures with a revenue cost in 1983-84 ~~approaching~~ of some £1 billion" (Public borrowing, paragraph 9)

	1983-84 £m revenue	
This is:		
NIS 1% cut	700	
Costs of holding down NIC by 0.3% in total	200	("a little over 200")
	900	

B. "Most of this [autumn measures] was directed to reducing the burden on private industry and commerce". (also paragraph 9)

	1983-84 Revenue cost
NIS 1% cut	700
Cost of holding down employers' NIC by 0.15%	100
	800

So 800 out of 900 gives "most".

C. PSBR of £8 billion in 1983-84 "permits further real tax cuts with a cost to the PSBR of some £1½ billion" (pargraph 10 of "Public Sector Borrowing").

"real" here means above indexation.

	£m 1983-84 revenue cost
Cost of tax measures (table 1.1 FSBR first column)	1,670
Cost of expenditure measures scored against fiscal adjustment (not mentioned in FSBR but can be revealed if necessary)	140
	1,810

Then adjust from revenue cost to PSBR gives near £1.6 billion but say "some £1½ billion".

D. Budget and autumn together will "provide help for business and industry that is worth around £1¼ billion in a full year". [Present draft of the speech says "more than £1¼ billion". See separate minute proposing change.] (People and Business, paragraph 2).

OK. I've changed the words [illegible] from "more than" to "around"

We worked that one out for ourselves!

Autumn Measures

	£m Revenue Cost 1983-84
Lower cash burden of NIS and NIC	450

Chancellor said on 8 November: "As a result of the changes in national insurance contribution and national insurance surcharge, the total reduction in the cash burden on employers in the next year will be £686 million, about £450 million of which will be a reduction wholly to the benefit of the private sector." [Note that this estimate takes account of rising earnings, higher NIC, lower NIS etc. It is of course on a different basis from the figure shown in B above. B looks at the changes from the government's point of view ie the cost of the measures compared to what would otherwise have happened. The above calculation looks at the position from the point of view of the amount of cash having to be found by employers.]

Thanks OK

1983 Budget

	Full year £m revenue cost	
Corporation tax	70	
NIS	390	
Small firms and enterprise	190	
Technology and innovation	120	
North Sea oil	100	(full year estimate not shown in FSBR)
	870	

Note that this assumes revalorisation of the excise duties is not a charge to industry (the CBI sometimes imply that it is) though on the other side the housing and construction measures have not been scored as helping business. The cash cost to business of revalorising petrol, derv and VED is about £170 million; the housing etc package is worth £115 million.

	Full year £m revenue cost
So Autumn and Budget together say "around £1¼ billion"	1320

E. "The cost to the PSBR [of the increases in allowances, thresholds and bands] above indexation, will be over £1 billion". (Personal tax, paragraph 6)

Revenue cost £1,170 in 1983-84 and £1,490 in a full year (table 1.1 FSBR). Then adjust to PSBR cost.

F. "Including indexation, the total revenue foregone [by raising the allowances, thresholds, and bands] will amount to some £2 billion in 1983-84 and £2½ billion in a full year." (Personal tax, paragraph 6).

£2,000 million in 1983-84 and £2,545 million in a full year (table 1.1 FSBR).

2. There are some rough edges to these figures (combining full year and 1983-84 figures in D for example). But these seem unavoidable and generally defensible. The numbers themselves will be checked yet again on Monday.

D R Norgrove

D R NORGROVE

FROM: R W L WILDING
11 March 1983

CHIEF SECRETARY

cc PPS
FST
EST
MST(C)
Sir D Wass
Sir A Rawlinson
Mr Bailey
Heads of Expenditure Groups
Miss Brown
Mr Mountfield
Mr Starkey

FMI: LAST BATCH OF PRELIMINARY ASSESSMENTS

Mr Gieve's minute of 8 March recorded your reaction to these assessments.

2. You wrote to all the Ministers concerned on 2 March. You decided in discussion with us on 10 March to write to Mr Heseltine about defence underspending as soon as we have firm figures in early April.

3. As you say, the FMI reports do not show explicitly how better systems will feed through into more sensible and cost-effective administration and programme expenditure. This will be an important point for the White Paper. We shall need to make clear that what this is all aimed at is providing better tools for the taking of decisions and motivating people to use them.

4. Once this is clearly pointed out, it will not be difficult to grasp. If:-

(a) objectives are regularly clarified and brought into line with Ministers' changing priorities;

(b) responsibilities are clear and costs are known;

(c) better means of assessing what will be and what has been obtained for money can be devised;

(d) managers feel, and are held, responsible for getting the job done at least cost;

then there will be certain, even if unquantifiable, benefits for the taxpayer.

4. In the messy world we all inhabit, that statement has a slightly utopian flavour. In practice, objectives conflict and Ministers often have good reasons for preferring not to state them too precisely or not to publish with excessive clarity the paucity of the result; there are obvious limits to departments' ability to plan, control and monitor the expenditure of other agencies (especially local authorities); and techniques are primitive (eg output measurement). These facts should tinge the White Paper with a suitable sobriety, not only where the Health and Safety Executive is concerned. But there is still a lot that can be done; what is encouraging is that this fact too is now much more widely recognised.

5. I very much agree that the existence of better systems will not of itself guarantee good results. Thus, for example, the DOE think they must supplement their MAXIS system for controlling administrative costs with periodical selective examinations of the cost effectiveness of particular units. In addition to ensuring the continuing health and effectiveness of the Rayner scrutiny system, it will be necessary to stimulate the regular review of policies and procedures more widely.

6. Who should carry out the reviews? For the most part, departments should do it for themselves. The need for regular review arrangements was one of the themes of the paper which we circulated, after discussion with you and Lady Young, last December, and some departmental reports show a good awareness of it. Treasury Expenditure Divisions should continue to stimulate such reviews where it appears necessary, and take part in the review process where appropriate. Departments' own arrangements for consultancy, inspection and review are to be the subject of an MPO-led multi-department scrutiny starting later this year.

7. That is all inside the Government machine. What about external review? For that, it seems to me that the E and AD (National Audit Office) should be the main instrument. That gets the constitutional arrangements right, and the NAO will not now (with

luck) get distracted by having to take on the nationalised industries.

8. A final point here is that the publication of more and better information, whether from departmental information systems or from improvements to the PEWP, will help departmental select committees (as well as the Treasury) to ask better and sharper questions. This will strengthen the external element referred to in Mr Gieve's minute.

RW

R W L WILDING

FROM: JILL RUTTER
DATE: 11 March 1983

PS/FINANCIAL SECRETARY

cc: PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Robson
Mr Hall
Mr Godber
Mr Ridley

Mr Corlett)
Mr Battishill) IR
PS/IR)

ASSURED TENANCIES ALLOWANCE: PARTNERSHIPS AS APPROVED BODIES

The Chancellor has seen your minute of 10 March reporting the difficulties that have arisen over partnerships and the assured tenancies allowance.

2. The Chancellor has commented that he certainly supports the FST's general position, but he believes that many people are likely to find the DOE position attractive, including perhaps No 10.

3. The Chancellor would like clarification on two points:

i. did the Department of Environment last year know or agree beyond doubt that partnerships were excluded?

ii. can we not achieve clarity on the "taxation policy case" for the exclusion of partnerships?

/4. The Chancellor feels

4. The Chancellor feels it is probably best to risk an open-ended provision in the Budget resolution - unless this can be cleared up today.

JKR

JILL RUTTER

BUDGET CONFIDENTIAL

FROM: JILL RUTTER
DATE: 11 March 1983

PS/MINISTER OF STATE (R)

cc; Chief Secretary
Financial Secretary
Economic Secretary
Sir D Wass
Mr Middleton
Mr Moore
Mr Robson
Mr Turnbull
Mr Peretz
Mr French
Mr Graham - Parly Counsel
Mr Crawley - IR
Mr Stewart - IR
PS/Inland Revenue
Mr F Martin

TAX TREATMENT OF INTEREST PAID BY COMPANIES TO NON-RESIDENTS

The Chancellor has seen your Minister's minute of 9 March. He is happy to go ahead as your Minister proposes.

JR

JILL RUTTER

2.57

pl. type

FROM: JILL RUTTER

DATE: 15 March 1983

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Kemp
Mr T Burns
Mr Harris
Mr Allen
Mr Hall
Mr Williams
Miss Deyes

MR STUBBINGTON

PARLIAMENTARY QUESTIONS: FIRST ORDER, THURSDAY 24 MARCH 1983

The Chancellor has seen the provisional allocation attached to your minute of 11 March. He feels that questions 3 and 6 which are allocated to him should be grouped together. Otherwise he has no comments.

JILL RUTTER