PREM 19/701

The 1982 Budget.

ECONOMIC POLICY.

PART 7.

Part 1: May 1979.

Part 7: Feb 1982.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~5-2-82~~							
~~8.2.82~~							
~~12.2.82~~							
~~18.2.82~~							
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~~26.3.82~~							
~~2.4.82~~							
~~13.4.82~~							
25.4.82							
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PREM 19/701

Dd 533270 5M 2/78 8362633 JET

PART 7 ends:-

25.4.82

PART 8 begins:-

7.6.82

Published Papers

The following published paper(s) enclosed on this file have been removed and destroyed. Copies may be found elsewhere in The National Archives.

1. House of Commons Hansard, 9 March 1982, columns 726 - 757 "Budget Statement"

2. H.C. Fourth Report from Treasury and Civil Service Committee: The 1982 Budget. HMSO, 31 March 1982

3. Financial Statement and Budget Report 1982-83, HMSO, 9 March 1982

Signed OHWayland Date 14 August 2012

PREM Records Team

YDS

Gen Pt

Prime Minister

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MLS 26/4

DEPARTMENT OF HEALTH & SOCIAL SECURITY

Alexander Fleming House, Elephant & Castle, London SE1 6BY

Telephone 01-407 5522

From the Secretary of State for Social Services

The Rt Hon Leon Brittan QC MP
Chief Secretary
Treasury Chambers
Great George Street
London SW1

April 25 1982.

Dear Leon.

REDUCTION IN NI SURCHARGE : LOCAL GOVERNMENT IMPLICATIONS

Thank you for copying to me your letter of 15 April to Tom King. I have also seen the letters to you from Keith Joseph and George Younger. I should have liked to discuss this with colleagues as George Younger suggests, but I believe the Finance Bill timetable is now very tight.

The overriding concern, I entirely accept, is to ensure that the reduction in the NIS does not put extra money at the disposal of local authorities. If there is no other way of achieving this equitably then I must acquiesce in the solution proposed through the NI system. The practical difficulties, as I conceded in my letter of 13 April, are not insurmountable. This course is, none the less, a thoroughly unwelcome and retrograde complication of a contributory system which we had committed ourselves to simplifying. In agreeing to settle for it, I must register two points firmly.

First, we can cope with the practical difficulties on this occasion only because local authorities are a limited category which both we and Inland Revenue can identify without too much difficulty. As I made clear in my earlier letter, I am particularly concerned with the problems that would arise if this was taken as a precedent for wider concessions to other employers. We should be in difficulties of a quite different order if we had to operate similar dispensations for other special categories - for example to give special reliefs to particular industries or regions. That would involve us in quite unacceptable additional complexity, and problems of staffing, policing and adjudication. I must insist, therefore, that no extension of this concession should be conceded, if there is pressure in Parliament; and it must not be taken as a precedent for introducing this complication into the system for other categories.

Second, because of the problems created, it is most desirable that this should be a one-off exercise, to sort out the problem that has arisen this year. If there is any possibility of the same issue arising in a future year, we should

E.R.

plan in advance to withhold the benefit from local authorities by other means, rather than try to retrieve the situation after the event by this kind of unwelcome device.

I am copying this letter to the other members of MISC21, to Tom King and to Sir Robert Armstrong.

Yours ever
Norman

NORMAN FOWLER

BF to MCS o/c Them 15/4

MAP

cc AW
JV

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
ALEXANDER FLEMING HOUSE
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4

Prime Minister

MCS 15/4

The Rt Hon Leon Brittan QC MP
Chief Secretary to the Treasury
Treasury Chambers
Great George Street
LONDON
SW1

13 April 1982

Dear Mr Brittan

will request is required

REDUCTION IN NATIONAL INSURANCE SURCHARGE: LOCAL GOVERNMENT IMPLICATIONS

Tom King copied to me his letter to you about possible ways of clawing back from local authorities the benefit of the reduction in the national insurance surcharge (NIS) in the current year.

Let me say at once that I do of course share your and our other colleagues' concern that we should stand by the principle which Geoffrey Howe set out in his Budget Speech, that local authorities should not make a gain as a result of the change in the NIS. However, I am afraid that the approach which Tom King set out in his letter would present serious difficulties of both principle and practice for my Department.

You will know that we have steadfastly resisted over the years any attempt to apply a differential rate of surcharge (apart from the very special and easily operated exception of registered charities), on the grounds that it would create appalling difficulties of policing, classification and adjudication. It would also introduce an unwelcome complication into an already overburdened national insurance contributions scheme by creating a large number of new contribution rates and categories. This was why, when I wrote to Geoffrey Howe before the Budget, I made it clear that while I wholeheartedly supported any blanket reduction in the surcharge, I would have to oppose any suggestion that it should be applied selectively. I remain convinced that this is right, and I am worried that Tom King's proposal, although limited to the current tax year, would inevitably give rise to fresh demands for a selective application of the surcharge. Indeed, even the arrangement that he put forward would add 11 new rates of contribution to the existing 33; once we had been seen to accommodate these within our system, however briefly, it would be that much harder to resist pressure for a continuing system of selectivity. Tom's solution would in any case only be possible if we amend the Finance Bill, and to do so on those lines would, I fear, be to declare open season for anyone who wished to introduce further amendments to give specific reliefs - or the reverse - to particular groups. The consequences of this could be serious.

E.R.

While the practical difficulties of accepting Tom King's approach are not insurmountable, they are nevertheless greater than he suggests. I think that we should get the scale of the problem into perspective. It is true, as Tom said, that there are only 420 authorities in England, but my social security responsibilities do of course extend to the whole of Great Britain, so that we should not exclude the Scottish and Welsh authorities from consideration (apart from the implications for Jim Prior on the Northern Ireland system). In addition, many of these authorities operate separate payrolls for the various services for which they are responsible, so that we could find ourselves involved with perhaps 2,000 or more different "schemes" (ie grouped documents for particular payrolls sent to my Newcastle office), each subject to special sorting and checking arrangements to make sure that the authorities concerned had not benefited from the surcharge reduction. I do not want to burden you with the detailed administrative problems involved, but the identification of relevant schemes and the introduction of new programs to cater for them would undoubtedly call for some extra staff both here and in the Inland Revenue. While I cannot put a precise figure on how many people I would need - and you will be in a better position to quantify the Inland Revenue requirements - you will know of the difficulties that we already face in coping with a backlog from last year's industrial action, without imposing fresh tasks on our contributions checking and policing system.

I am afraid that the upshot of this is that I regard Tom King's suggestion as providing a solution to the particular problems that face him during the current year at the expense of creating new and longer-term ones for me. My main worry is that it could lead to a most undesirable permanent feature in the basic structure of the national insurance contributions scheme, and I have to say that I do not think that the game is worth this candle. I therefore hope very much that Tom will find it possible to think again about ways in which the clawback of the NIS reduction might be achieved through DoE funding machinery, even if the solution which it can provide is less finely-tuned than that which could be achieved by the kind of arrangement which he suggested but at the price which I have tried to set out in this letter.

I am copying this letter to members of MISC 21, Jim Prior and Tom King, and to Sir Robert Armstrong.

yours sincerely

B O'Gorman

pp. NORMAN FOWLER

(letter approved in draft by the Secretary of State and signed in his absence)

13 APR 1982

Econ. Pol.

BACKGROUND ECONOMIC BRIEFING

MINISTERIAL STATEMENTS

Compiled by
EB Division
HM Treasury (Tel 01-233 3364)

2 April 1982

The extracts below are taken from speeches and interviews up to the end of March beginning immediately following the Budget. There was also a First Order Question Time on 11 March.

Extracts include the Chancellor's clarification of the combined impact of NIC and income tax in 1982-83 (p.9) and his comments on when he started pointing out the need for a decade of applying the Government's economic remedies (p1/2).

BACKGROUND ECONOMIC BRIEFING

MINISTERIAL STATEMENTS

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EB Division
HM Treasury (Tel 01-233 3364)

2 April 1982

Macro-Economic Measures

Overall approach to the Budget

'The Budget has been designed to sustain the increase in economic activity that is already taking place. The scale of this increase continues to depend to a large extent on the actions of companies and employees in improving productivity and moderating wage increases.' Chancellor at Question Time 11.3.82 Hansard col 958

Is it deflationary or not?

'The public sector borrowing requirement in the year ahead is intended to be lower in cash and real terms than [in] the years gone past. On another view, it is intended to be larger than it would otherwise have been on the standard assumptions. Neither of those changes can sensibly be described as 'deflationary' or 'reflationary'.

If inflation continues to come down as we maintain an improving control over the money supply and excessive public sector borrowing, if firms and those offering their labour for employment reduce the price at which those things are sold or made available, so the volume of real output and of real employment will increase. It is for that reason that the response of a controlled economic environment depends crucially on the performance of those trying to sell their goods and services in it.

... it is quite unhelpful to talk about Budgets being reflationary or deflationary. This Budget is likely to have a beneficial effect on inflation and interest rates, and is therefore liable to improve the prospects for output and employment.' Chancellor at Question Time 11.3.82. Hansard cols 958 and 959

Timescale for Government's economic policies

'When this Government was first elected nearly 3 years ago, we made one thing very clear. Putting Britain back on course was going to be a long haul, it would take more than one Parliament. We'd been saying that long before we were elected and most people, I think, realised that we were right because they knew that the economy had been going downhill for a very long time.

Twenty or 25 years ago our living standards were amongst the highest in Europe and by the last election it was very much the other way round so it was bound to be a long job to reverse that trend. What's more, we had to tackle it just when the world was hit by the second huge increase in the price of oil ...

... we've got to go on applying the tough lessons we've learned in the last 2 or 3 years. The chances of higher living standards and lower unemployment don't depend on how much Chancellors "give away" but on how much we are all prepared to put into the future of Britain. I said last year that we faced a long uphill climb. We still do but/week by week and month by month we have been gaining ground; this Budget will help us gain a lot more.'
<u>Chancellor</u> in Budget night broadcast 9.3.82.

<u>Reply to query about time-scale</u>

'I am surprised that [Mr Jack Straw MP] should have failed to note how often and emphatically we stressed before the Election that Britain's deeply rooted and long standard economic problems would not be instantly or easily solved ... And I am puzzled at [his] apparent failure to find any mention of the need to sustain, over the life-time of more than one Parliament, the effort to reverse the national economic decline. [He implied] that, contrary to what I said on Budget Day, this was a startling new thought.

This is just not so. 'The Right Approach' - widely regarded at the time and since as the most important statement of our policies in Opposition - was published as long ago as October 1976. It said:

> "... it is sustained recovery that is needed. For the troubles of our economy are by now long-standing and deep-seated. To make the structural changes that are necessary to restore the dynamic of a mixed economy will need a settled approach over a long, hard haul. It is idle to talk, as so often before, of an economic miracle that is round the corner. The foundations of economic health will not be relaid <u>in less than a decade</u>."

That "decade" began in May 1979. ' <u>Chancellor</u>'s letter released 29.3.82

Compiled by
EB Division
HM Treasury (Tel 01-233 3364)

2 April 1982

Industrial/Regional Policy

How the Budget helps industry

[Budget is designed to assist industry to emerge from the recession;] it's going to do that in a variety of different ways. Firstly, it's going to reduce the National Insurance Surcharge for the whole of the year 1982-83 - which will mean that business costs, the costs of employing people, will actually go down. Secondly, it's going to help some parts of industry which are suffering from difficulties with energy costs on quite a substantial scale. Thirdly it's going to help, in particular, the construction industry. You will have heard about the home improvement programmes and insulation programmes which more money are going into, and a variety of other measures affecting the construction industry. Then it's also going to give assistance to the development of new technology on which our industrial future depends, and also there are a variety of more detailed tax measures to encourage investment in industry. And it is upon the future of industry and its ability to emerge from the recession that our success in dealing with the problem of unemployment depends.' CST on BBC radio 9.3.82

Not enough to help industry?

'... the thinking is absolutely clear. It is to concentrate the assistance on helping industry, while, at the same time, helping private individuals by reducing the burden of taxation and making 1,200,000 people not pay tax who otherwise would be paying it. I don't think you can call that a flea-bite.

But you've got to remember that at the same time, the Chancellor has got to be sure that we don't simply move out of recession into inflation and that's why he's been able to do what he's had to do and announce today but, at the same time, keep public borrowing down. The purpose of that is to enable interest rates to stay down and to go lower down if at all possible, and also for inflation to continue to be pressed constantly down. And that's the main form of assistance to industry, quite apart from the specific tax·

and spending measures that the Chancellor has announced today.' CST on BBC radio 9.3.82.

Regional Policy in perspective

'Every government wants to have a more even distribution of employment in the country and this requires action on a wide front. It involves regional incentives, like regional development grants, as well as getting actively involved in things like road planning, infrastructure, communications and all the things that will help to attract industry to the assisted areas.

Of course, the best way we can help industry is by creating the right economic environment in which all industry can prosper, grow and be competitive, but on top of that regional assistance can help-provided it works with rather than against the grain of market forces.

But I should emphasise that regional differences cannot be reduced by the provision of government money alone. Nothing does more for an area than a reputation for good labour relations, high productivity and effective work, so there is a sense in which the answer to regional problems lies also with the people in the areas themselves.' Industry Minister Mr Lamont in British Business 26.3.82.

Completion of reorganisation of regional assistance

'We inherited a system under which over 40 per cent of the entire working population were in designated assisted areas. We believe that this was not an effective use of resources and indeed there is quite a lot of evidence that, in the past, the more widely spread regional policy has been the less effective it has proved to be, whereas it has actually created more jobs when it has been geographically concentrated.

So we decided to do just that, and it involved altering the status of assisted areas in two stages and reducing the total number. The effect of these changes is that, when they are completed later this year, only 26 per cent of the working population will then be in areas that are assisted.

We also decided to sharpen and improve the cost-effectiveness of the aid itself by cutting back on regional selective assistance. The completion of these changes will come when the final stage of the changes take effect on 1 August.

Obviously we keep the policy under review and we are always prepared to consider new evidence of a change in an area's circumstances relative to the rest of the country. But our objective has been to concentrate the aid where it seems to be most needed because we think that makes it more effective.' Industry Minister Mr Lamont in British Business 26.3.82

The regional aid package - and continuing services to other areas

'The main regional aids are: firstly, the regional development grants - 15 per cent in a development area or 22 per cent in a special development area - for investment in buildings, works plant and machinery; secondly, regional selective assistance under section 7 of the Industry Act, which is related to the fixed and working capital costs of investment projects and also associated training costs; and thirdly, but very importantly, there is the availability of advance factories.

Then on top of this, there is the range of small schemes and science and technology assistance which can make an important contribution to the assisted areas.

... in those areas which are or have become non-assisted, the DoI regional offices will still be available and indeed will be very keen to give advice about, for example, the use of section 8 of the Industry Act, or about the use of the product and process development scheme.

All the national schemes that we have will still be actively pursued by our regional offices.' Industry Minister Mr Lamont in British Business 26.3.82

Compiled by
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2 April 1982

Employment & Pay

Latest [March] unemployment figures

'I think we've still got some bad weather to go through before we get to real summer ... Later on this year, for example, when the school-leavers come on to the unemployment register as they initially leave school, then the figures will go up quite a bit again. But I think the really good news is that this month there are over 52,000 less people who are unemployed in Great Britain and in the United Kingdom than there were last month. That's absolutely good news and it's the best March figure that we've had since the war in that respect.

... when the youngsters leave school this year, in September particularly, we will have another peak. I'm not sure how high that peak will go. But I think the encouraging thing is that the underlying trend of the figures over recent months has been steadily pointing in the right direction. That is, the rate of increase is slowing. We haven't got to the point where we've got a real long term fall yet but I think that's now credible to say that it's in sight.' Employment Secretary on BBC TV 23.3.82

Unemployment assumption in Public Spending White Paper

'... sets out an assumption, necessary for the purposes of the Government's Actuary's report ... it says that for the purposes of the calculation it has been taken as an assumption that the figures of unemployment will average the same figure for this year and for each of the subsequent years of the survey. ...
It is not a prediction. ...

[One should] add the crucial point, contained in the White Paper, that:

> "if developments on pay and the world economic recovery are favourable, there is a reasonable prospect that unemployment levels in the later years may turn out to be somewhat lower than has been assumed"' Chancellor at Question Time 11.3.82:

Hansard col 959

'We're not actually projecting, as some people have said, a big jump from last year to this; the figures that have been quoted are our best estimate of the average level this year and the average level of last year. If in fact people go on behaving as sensibly as they have been behaving - taking moderate pay settlements, improving productivity - and if the world is reasonably hospitable - the fall in oil prices is a good thing - then, at some time not too far away, I hope we shall see the unemployment figures beginning to go down rather than up. I can't say when. It's certainly going to be a long haul but it's one of our most important objectives.' Chancellor on BBC radio 12.3.82.

Unemployment and Government economic policy

'The measures in the Budget directed to the continued conquest of inflation and to helping British trade and industry are much the most secure foundation for the reduction in unemployment to which we all look forward ... It is quite absurd to suggest that a significantly different economic policy would have a more rapid and effective impact on the dole queue.' Chancellor at Question Time 11.3.82 Hansard col 963

'.... a Budget that reduces the direct costs to industry of employing people by reducing the national insurance surcharge, and that gives assistance to the construction industry, enterprise and new technology, cannot do other than improve employment prospects, not make them worse.' CST at Question Time 11.3.82 Hansard col 956

BACKGROUND ECONOMIC BRIEFING

MINISTERIAL STATEMENTS

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2 April 1982

Prices & Inflation

Price movements in the public sector

'If there is one single thing that infuriates businessmen more than any other, it has been the rate of inflation in the public sector in the last couple of years. To many it has appeared that the private sector was taking far too much of the burden of recession and adjustment.

There are however now signs that public sector inflation is beginning at last to slow down, though the snake is only "scotched" - not yet dead. In the twelve months to December and January last, the prices of goods and services produced by the nationalised industries rose 1 per cent less than the rate of inflation. In the twelve months to February they rose marginally more.

The latest figures may overstate the position slightly because of rises in the pipeline, but the general downward trend is unmistakable. It would be surprising if this were not the case. The original, very large, price increases in the energy sector following the oil price hike have now nearly worked their way through the system. And now the whole energy market is slack again ...

The only sure way of knocking public sector inflation on the head is to introduce competition into as many areas of the public sector as possible, especially in the case of monopolies. And here the Government is bringing about a quiet revolution with its actions on British Telecom and transport, and its proposals for the gas industry.' Minister of State, Industry in Kidderminster 26.3.82

Industrial energy costs

'The Government's concern about industrial energy costs has been demonstrated by the Chancellor who announced a substantial package of energy measures in the Budget for the second year running.'
Minister of State, Industry in Kidderminster 26.3.82

BACKGROUND ECONOMIC BRIEFING

MINISTERIAL STATEMENTS

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2 April 1982

Fiscal

The Budget brings 'substantial decreases' in taxation

'... the biggest one, is, of course, the cut in the National Insurance Surcharge which is costing the Exchequer £640 million net: that's a very substantial cut in taxation. Similarly, the increase in the personal allowances means that 1,200,000 people won't be paying taxes who otherwise would. Quite apart from compensating for inflation, it actually is an increase of a further 2 per cent and, therefore, that too is a substantial tax change. If you then add the particular measures affecting particular industries, the total is substantial and the net effect in a full year for the Exchequer in terms of both tax and spending is over £3 billion.' CST in BBC TV 9.3.82

Impact of combination of income tax and NIC charges in 1982-83

'The various changes made by my statement on 2 December and in my Budget Statement on Tuesday will have an effect on people's incomes at different times during the year.

At the beginning of the financial year, in April, pay packets will be reduced as a result of the higher national insurance contributions.

However, as soon as the Budget changes take effect after 26 April ... the public will find that their income tax will be reduced. ... for most families the income tax reductions will be greater than the extra national insurance contributions. ... there will be a net gain for married men on earnings of up to £170 per week ...

As the year moves on and people receive wage increases, they will pay more tax and higher national insurance contributions. ... where, for example, a person's earnings rise by 7½ per cent ... [Table 9 of the Treasury Press Notice shows that] the proportion of income going in tax and national insurance contributions will be somewhat higher in 1981-82. That will not be so for those on the very lowest or the very highest levels of earnings.

Families with children will benefit at a later stage in the year from the increases in child benefit and one-parent family benefit.' Chancellor at Question Time 11.3.82 Hansard col 955

Effect of Budget on widows incomes

'The Budget provided full price protection of widows' penions and also a tax threshold increase for widows of 14 per cent, which is bigger than the pension increase. As a result, fewer widows will now pay tax than in 1981-82. Those who pay tax will have a lower tax burden, and widows over 65 can have over £9 a week in addition to pension, before they are liable for tax, as a result of the age allowance increase. Those are not insignificant benefits.' EST at Question Time 11.3.82. Hansard col 962

Prospects for a 25p income tax basic rate

'I am sure the Chancellor would like to see that. It is quite a different matter to make a statement about what you intend to do ... what progress towards that can be made, at what pace, is a matter that has to be determined on a year-to year basis; all I can say is that the Chancellor explained in his Budget speech yesterday why he thought that priority should be given to increasing the allowances, rather than for a change in the basic rate.

... We have to see how we go, but I do not think it is much of a secret that obviously we want to bring tax down when and if we can and the extent and possibility of doing that will obviously depend on the circumstances in future years.' CST at Press Conference on Public Expenditure White Paper 10.3.82

Timing of publication of spending plans and Budget

'... there is no magic answer to those things and there is a real problem. The object of the exercise in the past has been to announce the broad nature of the public expenditure decisions as soon as they have been taken, which is what we did in December - very broadly but as fully as was known at the time - and then to publish the White Paper on Budget Day, which would give a chance to put the thing as fully as possible.

Normally, the public expenditure White Paper is pretty accurate, with perhaps one or two small changes that are announced in the Budget or changes that occur in estimating since between literally the printing of the White Paper and Budget Day ... This time, it so happens that the nature of the Budget announcement is one that spills over into the public expenditure on a much greater scale - but not as a matter of principle; I mean, as a matter of detail, simply because of the handling of the NIS. Now, that is something that happens to have happened this year, which illustrates ... that the concept of looking at everything altogether and announcing it altogether is nice to state in principle, easy to acquiesce in principle, but a ... sight more difficult actually to implement ... The Select Committee is looking at all this "Armstrong" argument and we will want to hear what they have to say.' CST at Press Conference on Public Expenditure White Paper 10.3.82

Prospects for local authorities spending and rates in 1982-83

'... with the extra provision in the White Paper for local authority current expenditure that was contained in the announcement in December, I think that local authorities are presented with realistic targets which they ought to be able to meet, certainly by making savings on some of their plans in the cases of some local authorities, but they ought to be able to do that ... I am certainly calling for significant real economies, yes.

... within the context of the extra amount of money provided last December, it should be possible for the local authorities to make reasonable economies and have modest rate increases.

It is obviously up to them to draw up a balance, but I think that that is in no sense an unrealistic thing for them to do and indeed, it is why we increased the provision for local authority current expenditure in 1982-83 when we went through our survey last year.' CST at Press Conference on Public Expenditure White Paper 10.3.82

Declining ratio of public expenditure to GDP

'The estimate of outturn in 1981-82 has gone down in the light of the most recent information and is now some £105¼ billion or 45 per cent of GDP. We expect the ratio to fall to around 44½ per cent in 1982-83 and further, to 41 per cent by 1984-85. The exact figure depends crucially, of course, not only on what happens to public expenditure but on the growth of GDP.' CST at Press Conference on Public Expenditure White Paper 10.3.82

BACKGROUND ECONOMIC BRIEFING

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2 April 1982

Monetary

Re-affirmation of the medium-term financial strategy

'[As] I said in my Budget Statement ... the strategy has served and will continue to serve a most important purpose. That is why it is important to retain it.

I emphasise that the adjustment in the monetary target that I announced does not imply any relaxation of purpose. It represents a realistic restatement of our determination to maintain a responsible monetary policy.' Chancellor at Question Time 11.3.82 Hansard col 954

Formulation of monetary targets

'The Chancellor explained in his [Budget] speech, that there have been changes in the operation ... of the banking system, and that sterling M3 alone is now joined, as it were, ... by other aggregates to be looked at. I think that what is important in terms of the expectations ... is a commitment to a continuing downward path and that remains. But it is stated in a form that takes account of the adjustments that have to be made in the light of past experience and, in my view, I think it increases the credibility of it, because instead of it just being tucked away, the Chancellor has analysed very fully in the Red Book - less fully necessarily in the Budget speech - exactly what he thought happened in the last year in relation to monetary targets, and the basis for a readjustment of them.' CST at Press Conference 10.3.82.

This year's target period compared with last?

'I do not think there has been a change. It is the same: from February 1982 to April 1983.' CST at Press Conference 10.3.82.

Interest rates

'I think that this Budget enables interest rates to be lower than they otherwise would be. There are a lot of other factors which determine interest rates, not all of them domestic, but I think that this Budget is the best way of having the highest possible chance of interest rates coming down ...' CST on BBC 2 9.3.82

The confidence factor

'The most crucial observers of the Budget and what it's doing are the world's market places - the people from whom we have to borrow money on behalf of Government - and if they [were to] see us beginning to set out once again on borrowing too much, they [would] begin saying "oh, oh, there they go again" and they [would] begin raising their interest rates to us and to the rest of British industry. It's that key balance of judgement that we have to get right and I hope I have got it right.' Chancellor on BBC radio 12.3.82

CONFIDENTIAL

ccbl JR

Econ Pol

10 DOWNING STREET

From the Private Secretary 26 March 1982

TAXATION OF BENEFITS IN KIND - CARS AND PETROL

The Prime Minister is grateful for the Chancellor's minute of 24 March on the taxation of benefits in kind.

The Prime Minister is content with the Chancellor's proposals.

Miss Jill Rutter,
HM Treasury.

MS

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

TAXATION OF BENEFITS IN KIND - CARS AND PETROL

In my minutes of 17 and 24 November 1981 I told you of my decisions to postpone for one year the proposed change in the method by which tax on these benefits is collected and the introduction of a scale charge for free petrol.

2. The Inland Revenue have now carried out further extensive consultations with employers' representatives. They looked to see whether our aim of reducing the number of civil servants engaged in this work could be reconciled with the need to avoid placing an undue burden on employers, many of whom were strongly opposed to our original proposals. It has become clear that we cannot devise proposals, even if we simplify them considerably, which will satisfy the employers. Bodies such as the Institute of Directors and the Association of British Chambers of Commerce have continued to emphasise the problems employers could have faced in taking on this task. So, in order to avoid imposing undue additional administrative burdens on employers, I have decided that we must withdraw the proposal to require employers to apply PAYE directly to these benefits. The Finance Bill will be amended accordingly.

3. However, I have decided to proceed from 1983-84 with the introduction of the scale charge on free petrol, although that will involve additional staff costs for the Inland Revenue. We could not go on tolerating this increasingly widespread abuse. The petrol scale will follow the first three points of the car scale.

4. This decisions is certainly a setback in our efforts to cut civil service numbers. But, unlike the proposal for the deduction of mortgage interest relief at source, the savings in the public

sector could only have been achieved at the expense of imposing much greater additional costs on private employers. The numbers (some 150 staff savings lost, some 150 additional staff needed to deal with petrol) are small in comparison to MIRAS. We shall look elsewhere to find offsetting savings.

5. I propose to announce these decisions in a written answer on Friday (26 March) to coincide with the publication of the Finance Bill. The Bill as published has, for technical reasons, to reflect the terms of the Budget Resolution passed on 15 March, which predates my final decisions on all this and simply provides for postponement. The changes will now be introduced by amendment at Committee Stage.

6. At the same time I propose to announce for 1983-84 a 20 per cent increase in the car benefit scales, in line with the increases we have made in each of the last two years. Nonetheless this is still far short of the sort of increase that would be needed to bring the scales into line with the true value to the individual of having a car available. The new figures will be the subject of a Treasury Order, again following precedent. The main scales would then become:-

	1983-84	(1982-83)
1,300 cc or less	£325	(£270)
1,301 to 1,800 cc	£425	(£360)
Over 1,800 cc	£650	(£540)
£14,000 to £21,000 (£11,500 to £17,300)	£950	(£780)
Over £21,000 (£17,300)	£1500	(£1260)

The typical Cortina driver liable at the basic rate will pay tax in 1983-84 of £10.63 per month (compared with £9 in 1982-83) and if he gets free petrol too, then that figure will be doubled. If he uses his car 'predominantly' for business purposes (i.e. more than 18,000 miles a year) both the car scale and the petrol scale will be halved.

7. I believe that the withdrawal of the PAYE proposal will avoid further controversy in this area and that the proposals on the car and petrol scales will be generally seen as fair.

(G.H.)
24 March 1982

CONFIDENTIAL

Prime Minister

(1)

The top copy of this is still with you. Are you content with this approach?

MCS 25/3

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

Yes mt

TAXATION OF BENEFITS IN KIND - CARS AND PETROL

In my minutes of 17 and 24 November 1981 I told you of my decisions to postpone for one year the proposed change in the method by which tax on these benefits is collected and the introduction of a scale charge for free petrol.

2. The Inland Revenue have now carried out further extensive consultations with employers' representatives. They looked to see whether our aim of reducing the number of civil servants engaged in this work could be reconciled with the need to avoid placing an undue burden on employers, many of whom were strongly opposed to our original proposals. It has become clear that we cannot devise proposals, even if we simplify them considerably, which will satisfy the employers. Bodies such as the Institute of Directors and the Association of British Chambers of Commerce have continued to emphasise the problems employers could have faced in taking on this task. So, in order to avoid imposing undue additional administrative burdens on employers, I have decided that we must withdraw the proposal to require employers to apply PAYE directly to these benefits. The Finance Bill will be amended accordingly.

3. However, I have decided to proceed from 1983-84 with the introduction of the scale charge on free petrol, although that will involve additional staff costs for the Inland Revenue. We could not go on tolerating this increasingly widespread abuse. The petrol scale will follow the first three points of the car scale.

4. This decisions is certainly a setback in our efforts to cut civil service numbers. But, unlike the proposal for the deduction of mortgage interest relief at source, the savings in the public

sector could only have been achieved at the expense of imposing much greater additional costs on private employers. The numbers (some 150 staff savings lost, some 150 additional staff needed to deal with petrol) are small in comparison to MIRAS. We shall look elsewhere to find offsetting savings.

5. I propose to announce these decisions in a written answer on Friday (26 March) to coincide with the publication of the Finance Bill. The Bill as published has, for technical reasons, to reflect the terms of the Budget Resolution passed on 15 March, which predates my final decisions on all this and simply provides for postponement. The changes will now be introduced by amendment at Committee Stage.

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7. I believe that the withdrawal of the PAYE proposal will avoid further controversy in this area and that the proposals on the car and petrol scales will be generally seen as fair.

(G.H.)

24 March 1982

010

SECRET

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

15 March 1982

Michael Scholar Esq.
10 Downing Street
LONDON
SW1

LC AW 15
Econ Pol
(2)

Prime Minister

I understood you were asking today about market reaction to the Budget and the prospects for the derestricted indexed gilt tender.

This note seems to me to complement Alan's (attached).

MCS 16/3

Dear Michael,

The markets have now had almost a week to digest the Budget; the Prime Minister might like to see a note on how we interpret their reactions.

The overall tone has been very positive. The exchange rate has remained firm, despite the occasional moment of uncertainty; sterling closed today at 90.3. This is encouraging, given the falling oil price, and the fact that interest rates here are appreciably lower than in the US. Eurodollar rates are about 1½ per cent above UK interbank rates. The money markets have confirmed their pre-Budget disposition to come down. The clearers delayed announcing a base rate reduction of ½ per cent until after the Bank had dealt at lower rates on Wednesday: this was a satisfactory outcome, confirming our cautious approach and helping to allay any suspicion of a lax policy stance. Since then rates have firmed slightly, but the new structure - base rates at 13 per cent, seven day interbank at around 14 per cent, and three month interbank at 13½ per cent - has been consolidated.

The half per cent base rate drop, plus the reduced competition from National Savings foreshadowed by the lower target announced in the Budget and the withdrawal of the 23rd issue certificate, caused the Building Societies to reduce their mortgage rate by 1½ per cent. This was the largest ever drop in the rate. It will have an immediate beneficial impact, and will also contribute to a good RPI performance over the next few months.

The new monetary control arrangements worked well over this period. We succeeded in steadying the market before the Budget, and afterwards it was able to think out its own reaction, which provided us with a secure foundation for a new pattern of dealing rates. The reduction in base rates reflected a combination of market approval of policy together with a light restraining hand from the authorities. This sort of posture seems appropriate at a time when we still have to deal with a

/difficult monetary

difficult monetary situation, at least as far as the wider aggregates are concerned. The continued strong growth of bank lending means that our new target range will be vulnerable in the coming months. And there is, of course, always a risk on the exchange rate as we approach the end of the taxpaying season.

The capital markets have been firm. The two main changes announced in the Budget - the indexation of CGT and the derestriction of indexed gilts - were very well received. The former will certainly give encouragement to the equity market over time, though the effects seem likely to build up slowly. The latter had, as we expected, a more dramatic impact on prices in the short run. Both were well-kept secrets, not foreshadowed in any pre-Budget press speculation.

The market in conventional gilts opened very strongly after the Budget and has remained strong since. (Low-coupon stocks, which could be expected to suffer most from the derestriction of the indexed stock, have been the exception.) We went ahead on Wednesday with the £500 million of tranchettes which we had in reserve. This steadied the market a little and demonstrated that we intended to pursue a mixed funding programme. The market in indexed stocks has been very strong, and there has been a considerable amount of trading. The principal feature has been sales by gross funds (pension funds) to net funds (insurance companies). The price has risen very sharply, by over 10 per cent in the case of all three stocks. The real yield has fallen from well over 3 per cent to around 2.35. This augurs well for Friday's auction of the new stock. We have seen no complaints yet about unjustified capital gains - presumably because the beneficiaries are pension funds, though the Economist referred unhelpfully to "Amersham-style" profits, and also picked up some of the external implications.

It is too early to judge the effects of derestriction with any confidence but on the evidence we have so far it seems that conventional long-dated stocks and indexed gilts can live side by side and that the prices of both can improve together in a market with good expectations about the future and, in the case of conventionals, expecting much less of this type. The modest change in interest rates after the Budget will help keep these expectations in place.

The equity market has taken a while to digest the news. It moved ahead quite strongly on Thursday but fell back slightly on Friday and today. It may be that derestriction has had a short-term depressive effect. Bank shares have moved down a little in response to the references to bank profits in the Speech. But the general tone remains quite bullish.

This all amounts to a most encouraging response. We have succeeded in moving interest rates down to a new level with no adverse effects elsewhere and leaving the market still optimistic about the next few months. The principal threat

/to this new

to this new equilibrium is, as before, renewed upward pressure on rates from the US. The prime rate drop which seemed to have started last Monday was stopped in its tracks. One of the five main banks to move down has gone back up to 16½ per cent, and this afternoon broker loan rates have started to rise again -often an indication that prime rates are on the way up. Sterling has shrugged off developments of this kind in recent weeks, but we cannot be certain that it will continue to do so.

Yours ever,

J.O. Kerr.

J.O. KERR
Principal Private Secretary

16 MAR 1982

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UNCLASSIFIED [CULL]   AMENDED DISTRIBUTION 15·3·83
FM BONN 121500Z MAR 82
TO ROUTINE FCO
TELEGRAM NUMBER 217 OF 12 MARCH

PRESS REACTIONS TO THE BRITISH BUDGET

1. THERE IS MUCH FACTUAL REPORTING ON THE BUDGET AND PUBLIC EXPENDITURE PLANS BUT SO FAR RELATIVELY LITTLE COMMENT.
2. THE LONDON CORRESPONDENT OF THE FRANKFURTER ALLGEMEINE ZEITUNG, RUDOLPH, HAS THE FULLEST AND MOST SYMPATHETIC ANALYSIS. THE BRITISH ECONOMY IS, WITH 3 MILLION UNEMPLOYED, IN A STATE IN WHICH GERMAN POLITICIANS WOULD BE DEMANDING THAT SOMETHING SHOULD BE DONE. BUT THE THATCHER GOVERNMENT KEEPS UNSWERVINGLY TO ITS COURSE AIMED AT FIGHTING INFLATION , REDUCING STATE INTERFERENCE IN THE ECONOMY, AVOIDING INCOMES POLICIES , REDUCING DIRECT TAXES AND INTRODUCING LEGAL REMEDIES AGAINST STRIKES. GIVEN THAT A GENERAL ELECTION IS ONLY 2 YEARS AWAY ONE CAN ONLY ADMIRE THE GOVERNMENTS CONSISTENCY AND GRANT THAT ITS POLITICAL INTEGRITY IS HIGH IN RESISTING CALLS FOR STIMULATION. WITH ITS CURRENT ECONOMIC, EXCHANGE RATE AND FISCAL POLICIES, ENGLAND (SIC) CAN BECOME A STRONG COMPETITOR. GERMAN POLITICIANS COULD LEARN A THING OR TWO. BUT IF MRS THATCHER LOSES THE NEXT ELECTION ENGLAND WILL RETURN TO ITS OLD MUDDLING THROUGH.
3. THIS LAST POINT IS ECHOED IN THE WEEKLY RHEINISCHER MERKUR. ANOTHER CONSERVATIVE PAPER, DIE WELT, THINKS THE CHANCELLOR HAS MANAGED TO SPREAD A CHRISTMAS SPIRIT WITHOUT ACTUALLY GIVING MUCH AWAY. BONHORST, WRITING FROM LONDON IN GENERAL ANZEIGER ACKNOWLEDGES THAT THE STRENGTH OF THE BUDGET IS IN ITS POLITICAL ARTFULNESS IN SILENCING THE WETS. THE PRIMARY CONDITION FOR AN ELECTORAL VICTORY HAS BEEN RESTORED: INNER PARTY UNITY. BUT THE MORE LIBERAL SUEDDEUTSCHE ZEITUNG IS LESS SYMPATHETIC. POINTING OUT THAT INFLATION IS STILL 12 PER CENT AND THE NUMBER OF UNEMPLOYED IS 3 MILLION, IT SAYS THE WEAKNESS OF THE BUDGET IS IN ITS WISHFUL THINKING ON THE EXTERNAL RELATIONSHIPS OF THE BRITISH ECONOMY. THE OVER-EMPHASIS ON THE EXCHANGE RATE IN FUTURE MONETARY POLICY INDICATES THAT INTERNATIONAL INTEREST RATES WILL DETERMINE BRITISH MONETARY POLICY MORE THAN THE BORROWING REQUIREMENT. EVEN IF IT SEEMS THAT IN REDUCING SPENDING THE STATE HAS ALMOST SUCCEEDED IN CREATING THE CONDITIONS FOR AN UPSWING, OTHER CAUSES OF THE DECADES-LONG BRITISH ECONOMIC DECLINE HAVE BEEN NEGLECTED, EG THE UNIONS ARE STILL UNDEMOCRATIC. IF 3.5 MILLION BRITONS ARE JOBLESS AT THE END OF THE YEAR THEN MORE BASIC THINKING ABOUT FUTURE ECONOMIC POLICY WILL HAVE TO BE DONE AND A BEGINNING MADE TO SOCIAL REFORM.
TAYLOR

FINANCIAL DISTN
WED

THIS TELEGRAM
WAS NOT
ADVANCED

2.

Econ. Pol.

PRIME MINISTER

THE BUDGET AND THE CBI

I think that the CBI spoke up well about the Budget yesterday and I presumed to speak to Sir Raymond Pennock this afternoon to thank him, on your behalf, for what he and Sir Terence Beckett had said.

He mentioned that he would be making a major speech in Bristol tomorrow when he would have the opportunity to ram home what the Chancellor had done for industry and in particular to emphasise that something like two thirds of the concessions in the Budget were intended to benefit industry. He is going to do all he can to ensure that his speech is covered nationally by the media.

10 March 1982

"DAILY TELEGRAPH"

Moves in right direction, says the CBI

By ROLAND GRIBBEN Business Correspondent

INDUSTRY gave the Chancellor "two cheers" last night after Budget cuts in industrial and energy costs, a stimulus for construction firms and a new package of measures for small concerns.

Sir Terence Beckett, Director-General of the Confederation of British Industry, said: "We have not got all we wanted, but these are moves in the right direction."

Industrialists believe that with a further cut in interest rates now imminent the Budget has provided a better platform for economic recovery after two years of recession.

But they were cautious about forecasting how far unemployment would fall.

Extra £640m

The Chancellor lived up to his promise of a "help industry" Budget with a one per cent. reduction in the National Insurance surcharge paid by employers.

The cut, from $3\frac{1}{2}$ per cent. to $2\frac{1}{2}$ per cent. in August, will mean companies will have an extra £640 million for investment and expansion in a full year.

Local authorities and State industries, who also pay the surcharge, will not benefit because the Government fears it would only encourage higher wage settlements. Their grants and cash limits will be altered to take into account the surcharge relief.

The CBI made a surcharge cut its main Budget priority and estimated that a full 2 per cent. cut in a tax introduced by Mr Healey, Labour's Chancellor, could reduce unemployment by 200,000.

Further help

The Government is also going some way towards meeting industry's case for further help to reduce power bills and reduce the gap with Continental competitors. But there is no relief for domestic consumers facing a 23 per cent. rise in gas prices this year and 9 per cent-10 per cent. in electricity charges.

Around 100 of the biggest energy users, including British Steel, independent steel producers and chemical companies will be the main beneficiaries of a reduction in electricity tariffs totalling 16 per cent. over a three-year period.

The firms benefitting will have to agree to accepting interruptions in supplies of up to 60 hours over a set period to qualify for the concession.

The price of gas will be frozen for large industrial customers after April 1, until the end of the year. It means they will be relieved of a 2p a therm increase.

The freeze on the price of

Continued on Back P, Col 3

Continued from P1

By ROLAND GRIBBEN

Industry's 'two cheers'

foundry coke will be extended to the end of the year, and the Government is extending its £50 million scheme to encourage firms to convert boilers from using oil to include service companies.

The construction industry described aid for the industry, worth £240 million in 1982-83 as a "modest tonic."

But a badly needed stimulus to housebuilding is expected to result from the £5,000 increase in the thresholds for stamp duty payments. The starting point from March 22 for home sales will be £25,000 against £20,000 at present.

The concession will cost £70 million in 1982-83 and should help first-time buyers and, the Government hopes, encourage job mobility.

A total of £100 million is being added to local authorities' capital spending allocations to increase grants for home improvement and insulation.

The Government is meeting its commitment to provide further help for inner city regeneration with £70 million for joint development projects between the public and private sectors. Grants for land reclamation are going up from 50 per cent. to 80 per cent.

Capital allowances are being introduced for property built and used wholly for letting under the private rented accommodation scheme.

The industrial buildings allowance is being extended to include buildings used for service, repair and warehouse operations and will also cover the small industrial workshop aid programme.

The new series of measures for small firms will be worth £28 million in 1982-83 and £80 million in a full year, according to the Treasury.

The Government is introducing improvements in existing schemes, including the business start-up venture and profit sharing and share option arrangements.

There are new tax arrangements for unquoted companies to buy their own shares and businesses' contributions to local enterprise agencies.

New technology

The Government is also stepping up assistance to encourage new technology with a £130 million three year programme for a series of measures, including additional assistance for space technology and production engineering.

A special scheme to assist small engineering firms is also being introduced and the 100 per cent. first year allowance for leased television sets with a teletext facility will be extended for a further year beyond June.

" THE TIMES "

Budget of threads and patches, says Foot

By Staff Reporters

A Budget of threads and ıtches which failed to measure ɔ in any sense whatsoever to ıe reality of the country's probıms was the verdict of Mr ſichael Foot, the Opposition ader.

The Chancellor's package re-ːived a cautious and measured ːsponse from industrial leaders ːspite its content being heavily eighted towards a platform for dustrial recovery. And from ade union leaders the reaction as predictably sour as they re-ˈfirmed their determination to ſock the Cabinet's economic rategy in the hope of forcing change of course.

Mr Foot's traditional off-the-ıff reply to the Budget statement was one of the mildest om any Opposition leader to ıy Budget of recent years.

His comments, clearly pre-ıred well in advance of Sir eoffrey's statement, consisted mainly of an attack on the Government for its record on unemployment. The proposals, the Labour leader said, took no account of the huge real total of unemployed. He stated that to make good what had been taken out of the economy in the autumn there would have had to have been an expansion of about £5,000m.

The Budget, he said, would provide nothing like the total amount that should have been made available and, on balance it was a deflationary package.

Conservative MPs, however, were in a joyous mood over the Chancellor's proposals and it seemed that after months of doom and gloom they would at last have something to shout about in their constituencies.

Mr Foot described the Chancellor as a wandering minstrel who, in the end, would be the only person who would be enthusiastic about the Budget.

Industry and commerce were cool although the Confederation of British Industry saw the measures as a number of important steps that would help business.

Sir Terence Beckett, director general of the CBI, which had been pressing for a £2,590m reflationary package, said that the moves—the cut in employer's National Insurance Surcharge, help for the construction industry, and concessions on energy prices—were moves in the right direction.

"The tight borrowing stance is justified only if it enables us to get interest rates down this year. But with the measures outlined in this Budget, lower world oil prices and industry's improving competitiveness, business can now show the will to win," he said.

The right-wing Institute of Directors, which has been at loggerheads with the CBI over the course that the Governmen should follow, however, though that the balance was about righ

Mr Walter Goldsmith, it director general, said: "We ar grateful that Sir Geoffrey ha disregarded the many Peter Pa reflationary packages that hav been bombarding the Treasur in recent weeks — businessme can now look forward to a pro gressive lowering of interes rates."

Insufficient and misconceivec was the cool pronouncemer from the Association of Britis Chambers of Commerce, repre senting 57,000 member con panies through its 87 chamber.

The TUC Economic Commi tee meets this morning to mak a more detailed assessment c the Chancellor's measures, bı the initial response froı Congress House was: "Thre wasted years behind, and looks like another wasted yea ahead".

'Now we can get industry moving'

INDUSTRIALISTS saw the Budget giving industry confidence, bringing down costs and creating more jobs — 'a step in the right direction'.

But the TUC complained of 'a missed opportunity' that would do nothing to reduce the dole queues.

Sir Terence Beckett, Director General of the Confederation of British Industry, said: 'A one per cent. reduction in the National Insurance Surcharge represents £640 million of help.

'We are delighted with the long overdue help for the construction industry and we welcome the concessions on energy which will help industries like chemicals, paper and steel.'

But the Association of British Chambers of Commerce said: 'Industry is still caught between the anvil of low orders caused by high interest rates, and the hammer of excessive costs.'

Mr Walter Goldsmith, director general of the Institute of Directors, said the Chancellor had got the balance right — no return to inflation and some encouragement to both personal taxpayers and business.

"DAILY MAIL"

"DAILY EXPRESS"

Bosses hail boost for trade and jobs

By BARRIE DEVNEY Industrial Editor

INDUSTRY was split from boardroom to work-bench over the Budget last night.

The Confederation of British Industry hailed the decisions to slash the pay-roll tax and other measures as a step in the right direction.

But gloomy union chiefs dismissed Chancellor Sir Geoffrey Howe's package, and predicted another wasted year for Britain.

Despite their complaints, there is no doubt the Budget will slash dole queues and help business men.

The desperately sought cut in payroll tax, or National Insurance Surcharge, will reduce industry's costs by £640 million.

In addition, energy charges are to be pegged.

The construction industry, which the Cabinet has recognised is in a serious situation, is to be helped with work to restore inner-city areas, mend roads, and repair outdated sewage systems.

And the small businesses which the Prime Minister has said are the keystone to future prosperity have also been given a helping hand.

Sir Raymond Pennock, the CBI president, described the Budget as "ingenious and intelligent."

The CBI's director general, Sir Terence Beckett, said the Chancellor had taken constructive steps that will help business.

And he predicted: "The measures outlined, lower world oil prices, and industry's improving competitiveness, mean business can now show the will to win."

The Chancellor's bumper-bundle was also welcomed by the **Institute of Directors**. Mr Walter Goldsmith, the director general, said last night: "The Chancellor should be supported by business men and given credit for resisting the temptation to take the country once again down the road to inflation and false expectation."

The Budget would, he said, reinforce economic recovery in a responsible way without "foolishly throwing away the sacrifices made by the private sector over the last two years."

So depressed is the construction industry that any help is welcome. Mr Derek Gaulter, director general of the **Federation of Civil Engineering Contractors** said the Budget showed "some signs the Chancellor is at last trying to recognise the plight of the industry.

Increases

There was a much more muted reaction from the **Association of British Chambers of Commerce**. Its leaders claimed the Budget would make no real difference to industrial prospects.

FOR THE BOSSES

Sir Terence Beckett, director-general of the Confederation of British Industry, said: "The Chancellor has taken a number of important steps that will help business."

"SUN"

"MIRROR"

His cleverest yet

By GEOFFREY GOODMAN
Industrial Editor

SIR Geoffrey Howe's fourth main Budget—his seventh including the 'mini-budgets'—is probably his cleverest.

He has offered packages of varying help across industry—to the big corporations and the small companies; to the older, established industries and the tiny, new firms.

No single item will be sufficient to change the course of Britain's economy or to affect unemployment by more than a small margin.

But if the Chancellor is lucky, the collection of his latest packages could help toward a slow revival in some industries.

That was certainly the view taken last night by the Confederation of British Industry.

CBI Director General Sir Terence Beckett welcomed the Budget especially for the cut in the National Insurance Surcharge. Which the CBI have called a "jobs tax."

This will save British industry about £640 million a year which—they say—will go into investment and job creation. That remains to be seen. It could go in higher pay or boardroom perks.

Sir Terence also predicted that the Chancellor's measures to help the building and construction industries would boost house-building and jobs.

The CBI believes that the package, including the freeze on some gas, electricity and industrial coal prices and the special aid to small engineering firms and new technology industries, will "get business moving."

That is NOT the view of the TUC chiefs—nor the Labour Party leaders.

TUC's chief economic spokesman David Basnett, of the General and Municipal Workers, described the Budget as "demoralising."

Unemployment, he predicted, will go on rising and the poor will get poorer.

And former Chancellor Denis Healey viewed the whole operation as a kind of economic standstill, with little or no hope for the jobless.

Yet that was not the feeling around the financial world

At least, they believe, Sir Geoffrey has not made things worse. . .

CH/EX. REF. NO. B(82)21

COPY NO. 34 OF 36 COPIES

BUDGET SECRET

Shown to Sir R Armstrong 4/3/82

Budget Sppech: Fifth Draft
Noon: 3 March

Section 1 : INTRODUCTION
THE CONTEXT, THE STRATEGY

I have one overwhelming impression of this speech - it is so detailed that the general shape and purpose of the budget is lost. I would suggest a summary somewhere of the total benefits to industry. Also that someone goes through the speech to cut the detail by at least 1/3. I remember the House going very restless at last year's detail. See also the several comments throughout. N

1. I propose this afternoon to depart somewhat from tradition, by making plain at the outset the character and purpose of this Budget.

2. It is designed to sustain the economic recovery that began, as we foresaw, in the middle of last year, partly as a result of the action taken in my last Budget. It is a Budget which maintains the prudent financial policies that are essential to a further fall in inflation. As a result of the progress made over the last year, I am in a position this afternoon to propose to the House significant tax reductions, yet at the same time to reduce somewhat further the demands we make upon the nation's savings. In this way, we will bring effective help to business and industry, while making further progress on the road back to stable prices. This is the precondition for that lasting recovery in

/employment

H. M. TREASURY

Parliament Street, London SW1P 3AG, Press Office: 01-233-3415
Telex 262405

9 March 1982

INCOME TAX AND INDIRECT TAX : THE MAIN PROPOSALS

INCOME TAX : ILLUSTRATIVE TABLES

The Income Tax Proposals

1. In his statement today the Chancellor announced increases in income tax allowances and higher rate bands which go beyond those needed to compensate for inflation over the past year.

2. The Chancellor's main income tax proposals are :

(i) Increases in the main personal allowances of around 14 per cent compared with 1981-82. The proposed increases are :

	1981-82 level £	Proposed increase £	1982-83 proposed level £
Single person's allowance (and wife's earned income relief)	1375	190	1565
Married man's allowance	2145	300	2445
Age allowance (single)	1820	250	2070
Age allowance (married)	2895	400	3295
Additional personal allowance and widows bereavement allowance	770	110	880

(ii) Raising from £11,250 to £12,800 of taxable income the point at which tax starts to be paid at the higher rate, with proportionately similar increases in the higher thresholds. The new higher rate thresholds will be as follows :

/Rate...

Rate of tax	1981-82 taxable income	Proposed increase in starting point	1982-83 taxable income
%	£	£	£
40	11,251-13,250	1,550	12,801-15,100
45	13,251-16,750	1,850	15,101-19,100
50	16,751-22,250	2,350	19,101-25,300
55	22,251-27,750	3,050	25,301-31,500
60	over 27,750	3,750	over 31,500

(iii) An increase from £5,500 to £6,250 in the threshold for the investment income surcharge.

(iv) An increase from £5,900 to £6,700 in the age allowance income limit.

3. The proposed increases exceed the indexation provisions of the 1980 Finance Act by up to 2 percentage points. The cost of the main income tax proposals will be some £1.8 billion in 1982-83 and £2½ billion in a full year. The income tax changes (including refunds of tax overpaid since 6 April) should be reflected in pay packets on the first pay day after 26 April. The effects of the changes on individual taxpayers are illustrated in the tables described in a later paragraph.

The Indirect Tax Proposals

4. The Chancellor referred to the presumption which has grown up in recent years that the excise duties should be adjusted in line with the movement in prices from one year to the next. He proposes to apply this principle broadly to the main excise duties this year, with smaller increases in the case of tobacco and spirits. These exceptionstake account of the state of the industries concerned and the additional increase imposed on tobacco in July 1981.

5. The Chancellor's main indirect tax proposals are :

- Beer duty up about 2p a pint.
- Duty on table wine up 10p a bottle.
- Spirits duty up 30p a bottle.
- Tobacco duty up - e.g. 5p on a typical packet of 20 cigarettes.
- Petrol duty up 9p a gallon.
- Derv duty up about 7p a gallon.
- VED on cars up £10 a year.
- VED on most heavy lorries up by around 12 per cent.

/6...

6. These duty increases are inclusive of the consequential increase in VAT, where applicable. The impact effect of the duty increases on retail prices is estimated at about 0.8 per cent. The increases are expected to yield about £1.2 billion in both 1982-83 and a full year. The increases in the duties on hydrocarbon oil (petrol, derv) , take effect from 6pm today. The increases in the duties on alcoholic drinks, along with the increases in VED, take effect from midnight tonight. The increase in tobacco duty takes effect from midnight 11 March.

Income Tax : Illustrative Tables

7. The attached tables 1 to 5 show the effects of the changes in income tax proposed in the Budget on single and married taxpayers at different l evels of income. There are separate tables for elderly people benefitting from the increases in the age allowance and the age allowance income limit. Tables 4 and 5 give the information in the form of weekly instead of annual incomes at levels up to £300 a week.

Tables 6 and 7 show the weekly net income of single and married taxpayers, and families with two young children, after taking account of the increases in Child Benefit and National Insurance contributions.

Tables 8 and 9 illustrate the effect of the income tax changes after taking account of the effects of increases in earnings between 1981-82 and 1982-83: Table 8 incomes after tax for single people and married men on the illustrative assumption that earnings for 1982-83 rise by 7.5 per cent over earnings in 1981-82 (the assumption made by the Government Actuary in his report on the Social Security (Contributions) Bill). Table 9 gives figures on the same basis but taking account of changes in national insurance contributions as well as changes in income tax. Table 10 shows on the same assumptions the net weekly income of a married couple where both partners are earning.
The tables relate to earned income, but the figures are unchanged where investment income is less than £5,500 (the investment income surcharge threshold for 1981-82). Except for Table 10, the illustrative tables for married couples assume the wife has no earned income,

PRESS OFFICE
HM TREASURY
PARLIAMENT STREET
LONDON SW1P 3AP
01-233 3415

TABLE 1

SINGLE PERSONS - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1981/82		Proposed charge for 1982/83		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
1,500	37	2.5	0	0.0	37
2,000	187	9.4	130	6.5	57
2,500	337	13.5	280	11.2	57
3,000	487	16.2	430	14.3	57
4,000	787	19.7	730	18.3	57
5,000	1,087	21.7	1,030	20.6	57
6,000	1,387	23.1	1,330	22.2	57
7,000	1,687	24.1	1,630	23.3	57
8,000	1,987	24.8	1,930	24.1	57
9,000	2,287	25.4	2,230	24.8	57
10,000	2,587	25.9	2,530	25.3	57
12,000	3,187	26.6	3,130	26.1	57
14,000	3,925	28.0	3,730	26.6	195
16,000	4,794	30.0	4,494	28.1	300
18,000	5,694	31.6	5,361	29.8	333
20,000	6,688	33.4	6,261	31.3	427
25,000	9,256	37.0	8,727	34.9	529
30,000	12,050	40.2	11,384	37.9	666
40,000	18,050	45.1	17,231	43.1	819

TABLE 2

MARRIED COUPLES - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1981/82		Proposed charge for 1982/83		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
2,500	106	4.3	16	0.7	90
3,000	256	8.5	166	5.6	90
4,000	556	13.9	466	11.7	90
5,000	856	17.1	766	15.3	90
6,000	1,156	19.3	1,066	17.8	90
7,000	1,456	20.8	1,366	19.5	90
8,000	1,756	22.0	1,666	20.8	90
9,000	2,056	22.9	1,966	21.9	90
10,000	2,356	23.6	2,266	22.7	90
12,000	2,956	24.6	2,866	23.9	90
14,000	3,617	25.8	3,466	24.8	151
16,000	4,447	27.8	4,142	25.9	305
18,000	5,347	29.7	4,965	27.6	382
20,000	6,302	31.5	5,865	29.3	438
25,000	8,833	35.3	8,287	33.2	545
30,000	11,588	38.6	10,900	36.3	688
40,000	17,588	44.0	16,703	41.8	885

Calculations assume that only the husband has earned income.

ELDERLY SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1981/82		Proposed charge for 1982/83		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
	ELDERLY SINGLE PERSONS				
2,000	54	2.7	0	0.0	54
2,500	204	8.2	129	5.2	75
3,000	354	11.8	279	9.3	75
4,000	654	16.3	579	14.5	75
5,000	954	19.1	879	17.6	75
6,000	1,274	21.2	1,179	19.6	95
7,000	1,687	24.1	1,539	22.0	148
8,000	1,987	24.8	1,930	24.1	57
	ELDERLY MARRIED COUPLES (1)				
3,000	31	1.0	0	0.0	31
4,000	331	8.3	211	5.3	120
5,000	631	12.6	511	10 2	120
6,000	951	15.9	811	13.5	140
7,000	1,451	20.7	1,171	16.7	280
8,000	1,756	22.0	1,666	20.8	90

For incomes above these levels, the figures are the same as those in Tables 1 and 2.

(1) Calculations assume that only the husband has earned income.

TABLE 4

SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES

Income	Charge for 1981/82		Proposed charge for 1982/83		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£P.W.	£P.W.	per cent	£P.W.	per cent	£P.W.
	SINGLE PERSONS				
30.00	1.07	3.6	0.00	0.0	1.07
40.00	4.07	10.2	2.97	7.4	1.10
50.00	7.07	14.1	5.97	11.9	1.10
60.00	10.07	16.8	8.97	14.9	1.10
80.00	16.07	20.1	14.97	18.7	1.10
100.00	22.07	22.1	20.97	21.0	1.10
120.00	28.07	23.4	26.97	22.5	1.10
140.00	34.07	24.3	32.97	23.5	1.10
150.00	37.07	24.7	35.97	24.0	1.10
160.00	40.07	25.0	38.97	24.4	1.10
180.00	46.07	25.6	44.97	25.0	1.10
200.00	52.07	26.0	50.97	25.5	1.10
220.00	58.07	26.4	56.97	25.9	1.10
240.00	64.07	26.7	62.97	26.2	1.10
300.00	88.73	29.6	83.35	27.8	5.38
	MARRIED COUPLES (1)				
50.00	2.62	5.2	0.89	1.8	1.73
60.00	5.62	9.4	3.89	6.5	1.73
80.00	11.62	14.5	9.89	12.4	1.73
100.00	17.62	17.6	15.89	15.9	1.73
120.00	23.62	19.7	21.89	18.2	1.73
140.00	29.62	21.2	27.89	19.9	1.73
150.00	32.62	21.7	30.89	20.6	1.73
160.00	35.62	22.3	33.89	21.2	1.73
180.00	41.62	23.1	39.89	22.2	1.73
200.00	47.62	23.8	45.89	22.9	1.73
220.00	53.62	24.4	51.89	23.6	1.73
240.00	59.62	24.8	57.89	24.1	1.73
300.00	82.06	27.4	76.58	25.5	5.48

(1) Calculations assume that only the husband has earned income.

ELDERLY SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES

Income	Charge for 1981/82		Proposed charge for 1982/83		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£P.W.	£P.W.	per cent	£P.W.	per cent	£P.W.
	ELDERLY SINGLE PERSONS				
40.00	1.50	3.7	0.06	0.1	1.44
50.00	4.50	9.0	3.06	6.1	1.44
60.00	7.50	12.5	6.06	10.1	1.44
80.00	13.50	16.9	12.06	15.1	1.44
100.00	19.50	19.5	18.06	18.1	1.44
120.00	26.81	22.3	24.06	20.0	2.75
140.00	34.07	24.3	32.29	23.1	1.78
150.00	37.07	24.7	35.97	24.0	1.10
	ELDERLY MARRIED COUPLES (1)				
60.00	1.30	2.2	0.00	0.0	1.30
80.00	7.30	9.1	4.99	6.2	2.31
100.00	13.30	13.3	10.99	11.0	2.31
120.00	20.61	17.2	16.99	14.2	3.62
140.00	29.62	21.2	25.22	18.0	4.40
150.00	32.62	21.7	30.22	20.1	2.40
160.00	35.62	22.3	33.89	21.2	1.73

For incomes above these levels, the figures are the same as those in Table 4.

(1) Calculations assume that only the husband has earned income.

SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - WEEKLY FIGURES - INCOME TAX AND NATIONAL INSURANCE CONTRIBUTIONS

TABLE 6

Income	Charge for 1981/82			Proposed charge for 1982/83			Change in Income After tax and NIC
	Income tax	NIC	Net Income After Tax and NIC	Income tax	NIC	Net Income After Tax and NIC	
£P.W.	£P.W.	£P.W.	£P.W.	£P.W.	£P.W.	£P.W.	£P.W.
	SINGLE PERSONS						
30.00	1.07	2.32	26.61	0.00	2.62	27.38	0.77
40.00	4.07	3.10	32.83	2.97	3.50	33.53	0.70
50.00	7.07	3.87	39.06	5.97	4.37	39.66	0.60
60.00	10.07	4.65	45.28	8.97	5.25	45.78	0.50
80.00	16.07	6.20	57.73	14.97	7.00	58.03	0.30
100.00	22.07	7.75	70.18	20.97	8.75	70.28	0.10
120.00	28.07	9.30	82.63	26.97	10.50	82.53	-0.10
140.00	34.07	10.85	95.08	32.97	12.25	94.78	-0.30
150.00	37.07	11.62	101.31	35.97	13.12	100.91	-0.40
160.00	40.07	12.40	107.53	38.97	14.00	107.03	-0.50
180.00	46.07	13.95	119.90	44.97	15.75	119.28	-0.70
200.00	52.07	15.50	132.43	50.97	17.50	131.53	-0.90
220.00	58.07	15.50	146.43	56.97	19.25	143.78	-2.65
240.00	64.07	15.50	160.43	62.97	19.25	157.78	-2.65
300.00	88.73	15.50	195.77	83.35	19.25	197.40	1.63
	MARRIED COUPLES (1)						
50.00	2.62	3.87	43.51	0.89	4.37	44.74	1.23
60.00	5.62	4.65	49.73	3.89	5.25	50.86	1.13
80.00	11.62	6.20	62.18	9.89	7.00	63.11	0.93
100.00	17.62	7.75	74.63	15.89	8.75	75.36	0.73
120.00	23.62	9.30	87.08	21.89	10.50	87.61	0.53
140.00	29.62	10.85	99.53	27.89	12.25	99.86	0.33
150.00	32.62	11.62	105.76	30.89	13.12	105.99	0.23
160.00	35.62	12.40	111.98	33.89	14.00	112.11	0.13
180.00	41.62	13.95	124.43	39.89	15.75	124.36	-0.07
200.00	47.62	15.50	136.88	45.89	17.50	136.61	-0.27
220.00	53.62	15.50	150.88	51.89	19.25	148.86	-2.02
240.00	59.62	15.50	164.88	57.89	19.25	162.86	-2.02
300.00	82.06	15.50	202.44	76.58	19.25	204.17	1.73

Employees' National Insurance Contributions are at the Class 1 standard rate for employment not contracted out of the State additional (earnings related) pension scheme.

(1) Calculations assume that only the husband has earned income.

FAMILIES WITH CHILDREN
MARRIED COUPLE WITH 2 CHILDREN - NET WEEKLY INCOME

Weekly earnings	Weekly income in 1981/82 post November				Weekly income in 1982/83 up to November 1982					Weekly income in 1982/83 post November 1982		
	Child benefit	Income tax	NIC	Net income	Child benefit	Income tax	NIC	Net income	Change compared to 1981/82 post November, in income after child benefit, tax and NIC	Child benefit	Net income	Change compared to 1981/82 post November, in income after child benefit, tax and NIC
£	£	£	£	£	£	£	£	£	£	£	£	£
50.00	10.50	2.62	3.87	54.01	10.50	0.89	4.37	55.24	1.23	11.70	56.44	2.43
60.00	10.50	5.62	4.65	60.23	10.50	3.89	5.25	61.36	1.13	11.70	62.56	2.33
80.00	10.50	11.62	6.20	72.68	10.50	9.89	7.00	73.61	0.93	11.70	74.81	2.13
100.00	10.50	17.62	7.75	85.13	10.50	15.89	8.75	85.86	0.73	11.70	87.06	1.93
120.00	10.50	23.62	9.30	97.58	10.50	21.89	10.50	98.11	0.53	11.70	99.31	1.73
140.00	10.50	29.62	10.85	110.03	10.50	27.89	12.25	110.36	0.33	11.70	111.56	1.53
150.00	10.50	32.62	11.62	116.26	10.50	30.89	13.12	116.49	0.23	11.70	117.69	1.43
160.00	10.50	35.62	12.40	122.48	10.50	33.89	14.00	122.61	0.13	11.70	123.81	1.33
180.00	10.50	41.62	13.95	134.93	10.50	39.89	15.75	134.86	-0.07	11.70	136.06	1.13
200.00	10.50	47.62	15.50	147.38	10.50	45.89	17.50	147.11	-0.27	11.70	148.31	0.93
220.00	10.50	53.62	15.50	161.38	10.50	51.89	19.25	159.36	-2.02	11.70	160.56	-0.82
240.00	10.50	59.62	15.50	175.38	10.50	57.89	19.25	173.36	-2.02	11.70	174.56	-0.82
300.00	10.50	82.06	15.50	212.94	10.50	76.58	19.25	214.67	1.73	11.70	215.87	2.93

Notes

Net income is earnings, less tax and national insurance contributions, plus child benefit. It does not include any means tested benefit. It is assumed that only the husband is earning.

National insurance contributions are at the standard Class 1 rate for employment not contracted out of the state additional (earnings related) pension scheme.

Single parent families have the same net weekly income as married couples on the same weekly earnings except that a single parent family received £3.30 extra benefit per week from November 1981 and will receive £3.65 extra per week from November 1982.

Child Benefit The rate up to November 1982 is £10.50 per week (£5.25 per child) and will then be increased by £1.20 per week (60p per child).

SINGLE AND MARRIED COUPLES - INCOME ALL EARNED - COMPARISON WITH 1981/82
WHERE EARNINGS INCREASE BY 7½ PER CENT BETWEEN 1981/82 AND 1982/83

INCOME TAX

Income in 1981/82	Charge for 1981/82		Adjusted[1] Income in 1982/83	Proposed charge for 1982/83		Percentage change in income after tax
	Income Tax	Percentage of total income taken in tax		Income Tax	Percentage of total income taken in tax	
£	£	per cent	£	£	per cent	per cent
	SINGLE PERSONS					
3,000	487	16.2	3,225	498	15.4	8.5
4,000	787	19.7	4,300	820	19.1	8.3
6,000	1,387	23.1	6,450	1,465	22.7	8.1
8,000	1,987	24.8	8,600	2,110	24.5	7.9
10,000	2,587	25.9	10,750	2,755	25.6	7.9
15,000	4,344	29.0	16,125	4,544	28.2	8.7
20,000	6,688	33.4	21,500	6,977	32.5	9.1
25,000	9,256	37.0	26,875	9,665	36.0	9.3
40,000	18,050	45.1	43,000	19,031	44.3	9.2
	MARRIED COUPLES[2]					
3,000	256	8.5	3,225	234	7.3	9.0
4,000	556	13.9	4,300	556	12.9	8.7
6,000	1,156	19.3	6,450	1,201	18.6	8.4
8,000	1,756	22.0	8,600	1,846	21.5	8.2
10,000	2,356	23.6	10,750	2,491	23.2	8.0
15,000	4,017	26.8	16,125	4,192	26.0	8.6
20,000	6,302	31.5	21,500	6,540	30.4	9.2
25,000	8,833	35.3	26,875	9,225	34.3	9.2
40,000	17,588	44.0	43,000	18,503	43.0	9.3

(1) The adjusted incomes shown for 1982/83 are for illustration. They have been obtained by increasing the corresponding incomes in 1981/82 by 7½ per cent.

(2) Assuming that only the husband has earned income.

Cabinet / Cabinet Committee Document

The following document, which was enclosed on this file, has been removed and destroyed. Such documents are the responsibility of the Cabinet Office. When released they are available in the appropriate **CAB** (CABINET OFFICE) CLASSES.

Reference: CC(82) 9th Conclusions, Minute 2

Date: 9 March 1982

Signed CAWayland Date 14 August 2012

PREM Records Team

A1 BUDGET AND ITS EFFECTS

Main proposals:

(i) An effective 1 percentage point reduction in National Insurance surcharge for the whole year;

(ii) specific measures (part tax, part expenditure) for construction, enterprise, innovation and energy costs, etc. Suggested new employment measure;

(iii) uprating of income tax personal allowances and thresholds by 14 per cent (more than the statutory 12 per cent);

(iv) slightly less than full revalorisation of specific duties with substantially less on spirits;

(v) most social security benefits to be increased 11 per cent from next November.

(vi) changes in North Sea oil tax, capital taxes. Anti-avoidance measures.

Effect of measures shown in table below:

£ million

(see FSBR Part I for details)	Indexed Basis		Non-indexed Basis	
	1982-83	Full Year	1982-83	Full Year
	(- signifies increase in revenue)			
Cut in National Insurance Surcharge*	1,000	1,195	1,000	1,195
increase in personal tax allowances and thresholds	200	260	1,840	2,445
Excise duties	60	55	-1,150	-1,165
Relief on electricity prices to industry (expenditure)	100	n.a	100	n.a
Construction:- tax	140	170	140	170
Construction:- expenditure	100	n.a	100	n.a
Enterprise (mainly tax)	30	80	30	80
Increase in Contingency Reserve$^{\phi}$	150	n.a	150	n.a
Other measures (capital taxes, North Sea, gas prices, social)	125	760	125	760
Total	1,905	n.a	2,335	n.a
of which:				
TAX measures	1,555	2,520	1,985	3,485
TAX measures net of clawback**	1,195	2,090	1,625	3,055
EXPENDITURE measures	350	n.a	350	n.a
PSBR effect (allowing for second round effects)	£ 1.3 billion		about £1.7 billion (not quoted)	

*Shown gross of public sector payments as in FSBR. These will be clawed back.

**£360 million in 1982-83, £430 million in a full year.

$^{\phi}$Expenditure increases which will be charged to Contingency Reserve:-

cont.

BUDGET SECRET Copy No: 2 of 4 copies

14

10 DOWNING STREET

From the Private Secretary

8 March 1982

The Budget - The reduction in NIS and the public sector

The Prime Minister saw over the weekend the Chancellor's minute of 5 March on NIS clawback.

She is content for the Chancellor to proceed as he proposes.

I am sending a copy of this letter to David Wright (Cabinet Office).

M. C. SCHOLAR

Peter Jenkins, Esq.,
H.M. Treasury.

010 Econ Pol Budget

2

Prime Minister

I have told the Treasury what your view is.

MCS 8/3.

01 211 6402

BUDGET - CONFIDENTIAL

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON SW1

MT

8 March 1982

Dear Chancellor,

I have seen Norman Fowler's attached letter of 5 March and wish strongly to endorse his view that supplementary benefit heating additions should be fully uprated next November.

I entirely agree with him that to claw back this year's "overshoot" could seriously damage the credibility of the Government's policy of concentrating worthwhile help with fuel bills on those in greatest need. This is an essential complement to our pursuit of economic energy pricing and - on the domestic front - one of our main defences against attacks on that key element of our economic policy. It is very important that we should at least be able to continue to say that we are uprating assistance fully to take account of fuel price rises year on year. Your proposal would mean we could no longer do so.

Moreover, such a move could be presented as being in sharp contrast to our legitimate efforts on the industrial front to help the more intensive users of gas and electricity. We both attach particular importance to this element in your budget package to assist industry. Anything that might damage its impact should be avoided.

One such possibility is criticism from electricity consultative councils. Some are already pressing for the supply industry's financial target to be reduced to ease domestic price increases. A claw back might encourage them to pursue this via their statutory right to make representations to me. This could be embarrassing to our moves to help industry.

The claw back could also have an unfortunate impact on our efforts to persuade the gas and electricity industries to improve on their measures designed to help consumers having difficulty in paying their bills. We are hoping to reach agreement shortly on some worthwhile improvements. The industries' willingness to co-operate in this could well be affected.

I appreciate that the claw back is relatively small in terms of the overall expenditure on heating additions. But against the background of the recent severe weather and the continuing anxiety about gas and electricity price increases this will be interpreted as reducing the Government's commitment to protect the hardest hit. The political damage would in my view far outweight the financial benefit.

I well understand your need tó consider carefully every possible saving in public expenditure but I believe the balance of the arguments suggest you should forego this one.

I am copying this letter to the Prime Minister and Norman Fowler.

Yours sincerely

J.P. Clayton

NIGEL LAWSON

(Approved by the Secretary of State
and signed in his absence)

13

CH/EX. REF. NO. B(82)31

COPY NO. 1 OF 3 COPIES

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

Prime Minister

I have kept our second (Alan's) copy, and haven't yet read.

MLS 6/3

6 March 1982

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael,

BUDGET SPEECH : FINAL DRAFT

in attached folder

I attach a copy of the last draft of Tuesday's Budget speech. The Chancellor has some finishing touches to make, particularly to the first two sections, and the last one, before the text is finalised on Monday morning.

With one major exception, the structure of the speech remains the same as in the interim draft which you saw on Wednesday. The exception is the section on Fiscal Justice, which formerly came, with rather too much prominence, near the end. It is now more logically placed at the point where the Chancellor moves from discussing primarily spending proposals to fiscal proposals.

But the structure is, after further refinement of the text, now very much clearer. You will note the frequent sign-posts which now guide the audience from the initial strategic material on overall policy, jobs, money, and borrowing, through the expenditure items, and non-fiscal revenue proposals (NIS and the specific duties) to the fiscal sections, which now conclude with the welcome news on capital taxes and on income tax. (Some of the earlier fiscal sections are necessarily still fairly detailed, but the cumulative effect of the various changes should be considerable, and the speech ends on a satisfactory crescendo. I am told that it is now shorter than several recent Budget speeches.)

As you know, the Chancellor has incorporated a number of very helpful suggestions from Ian Gow. And the monetary and PSBR sections have of course been discussed with Alan Walters.

Yours ever,

John Kerr.

J.O. KERR

COPY 1 of 6

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
ALEXANDER FLEMING HOUSE
ELEPHANT AND CASTLE LONDON SE1 6BY
TELEPHONE 01-407 5522 EXT

BUDGET CONFIDENTIAL

Prime Minister

The Treasury are going to resist this. Do you wish to intervene?

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Great George Street
LONDON
SW1

Told J Rutter that the PM thinks it not worth £10m to have this row.

5 March 1982

MW 8/3

Dear Geoffrey.

SUPPLEMENTARY BENEFIT HEATING ADDITIONS

One item left unresolved in our meeting this afternoon was the uprating of heating additions in November. I promised to write to you after reflecting on the point.

The question is whether we reduce next November's uprating of heating additions in order to claw back the "overshoot" in the November 1981 uprating. This would save some £10 million in expenditure, since provision has been made for a full uprating. The overshoot, as you know, was mainly due to rebates given to electricity consumers in the autumn of 1981.

I entirely agree that it would be logical to recover the overshoot, but there are strong practical reasons for not doing so.

We should be accused of making a saving at the expense of the poorest householders. The additions go to those with special needs and include supplementary pensioners over 70 and families on supplementary allowance with a child under five. We made great play of these additions when we came under pressure earlier this year about high fuel bills because of the severe winter. We don't want to see this campaign reopened. And our ability to resist the pressures would be very much weakened if we appeared (however justifiably) to be cutting back on the additions.

We do rely very much on the help we give through supplementary benefits as a defence against those who attack our policy of economic pricing for fuel. If this defence were weakened, because we no longer appeared so ready to help hard pressed families, the cost to the Treasury could be much higher than £10m.

Altogether, having reflected on this, I still think that it would be much better, on this occasion, not to claw back the overshoot. Instead, we should take credit for deliberately making an exception to our normal policy of recovering overshoot in recognition of the impact of higher fuel bills on the families concerned.

I am copying this to the Prime Minister, in view of recent pressures on the supplementary benefit front, and to Nigel Lawson, as we agreed, because of the possible effect on energy pricing policy.

Yours.
Norman

NORMAN FOWLER

MAR 1982

BUDGET SECRET

Prime Minister

I thought we were going for maximum "clawback" anyway. But I can see that some of the colleagues may object. Agree that the Chancellor goes ahead as he proposes?

MS 5/3

Yes md

CH/EX. REF. NO. B(82)27

COPY NO. 1 OF 12 COPIES

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Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

THE BUDGET - THE REDUCTION IN NIS AND THE PUBLIC SECTOR

As you know we aim to clawback as much as possible of the uncovenanted addition to their spending which public sector employers will get from the reduction in the NIS.

2. The Chief Secretary has discussed this in relation to local authorities with the Secretaries of State for Environment, Scotland and Wales. It is clear that in order successfully to impose clawback on local authorities we must be seen by then to be equally firm with Departments, and with nationalised industries.

3. This means that our original plan - clawback through fewer, and reduced, increases in nationalised industry External Financing Limits, and Departmental pay votes - needs modification. Michael Heseltine is clear that we need to adopt a higher profile if we are to succeed with the local authorities. I accept this.

4. What I propose now is that all cash limits, Rate Support Grants and nationalised industries External Financing Limits for 1982-83 should be reduced by the amount of the reduction in the NIS they can expect to receive.

5. This should ensure a rather greater clawback.

6. It is however possible there may be problems with our colleagues when I mention it in Cabinet on Tuesday. Some may argue, not unfairly, that the essence of cash planning is that cash limits, once set, should take the rough with the smooth; and that when we increased VAT in the summer of

1979 cash limits were not increased. The point is particularly relevant to nationalised industry programmes, where we have consistently refused to accept higher tax, NIC etc as a reason for increasing EFLS, on the grounds that industries must cope, like all other businesses, with fluctuations in costs.

7. I think we can deal with these arguments. What I propose leaves programme managers where they would have been had the cash limits totals, and the NIS rate, remained unchanged. There is no loss to them; only the avoidance of an unintended gain. Moreover the reduction in the NIS rate is explicitly designed to help private business and industry and not the public sector; that is of its essence. You will recall, too, that at the Budget Cabinet on 28 January when we discussed NIS there were those who pointed out that steps should be taken to avoid public sector organisations enjoying part of the benefit for any NIS reduction.

8. The Secretaries of State for the Environment, Scotland and Wales, support this course. I shall speak before Cabinet to the Secretaries of State for Energy, Industry, and Transport.

9. A copy of this minute goes to Sir Robert Armstrong.

GH

(G.H.)

5 March 1982

Copy No 1 of 6

11

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

THE BUDGET

Virtually all the pieces in the Budget jig-saw are now in place. The main features remain as described in our discussions last week (Scholar's letter of 25 February) on the basis of my minutes of 18 and 23 February.

Monetary policy

2. As I envisaged, the "Red Book" up-dated version of the Medium Term Financial Strategy will show ranges for the monetary aggregates of 8-12 per cent for 1982-83, declining in subsequent years.

Fiscal stance

3. The Red Book will also show a forecast PSBR in 1982-83 of about £9½ billion. This compares with the figure of around £10½ billion which we forecast, and which we are on track to hit, for the current year; and £9 billion shown in last year's Red Book for 1982-83. For 1983-84 I am looking for a PSBR of around £8½ billion, as compared with the figure of £6½ billion envisaged for that year in last year's Red Book.

4. The PSBR of £9½ billion for 1982-83 enables me, after making allowance for uncertainties, to propose tax reductions having a PSBR effect in 1982-83 of around £1.3 billion. This figure will appear in the Red Book. The Red Book will also show the revenue costs involved, which are of course considerably higher.

5. For 1983-84 the measures I now propose will have a PSBR effect of around £1.5 billion (though this figure will not be volunteered); however the Red Book will show a positive fiscal adjustment for that year - ie a possible scope for tax reductions next year - of around £½ billion.

6. The figures reflect an assumption that the oil price of $31 a barrel will hold over the whole of 1982, and thereafter will increase only in line with inflation. My Speech, and the briefing, will emphasise that the fall in oil prices is tantamount to a substantial tax reduction for businesses and individuals, that it justifies a lower level of tax reductions than might otherwise be the case, and that further substantial falls might require compensating fiscal action. My judgement is that following your Speech to the EEF, and last week's Press reports, a PSBR of £9½ billion with reductions of £1.3 billion will not be seen as unduly tight.

Budget proposals

7. My detailed proposals on the fiscal front are shown in the attached Annexes. They are of course all familiar to you. We will be proposing something near full revalorisation (except for spirits),-the increases for petrol and Derv will be 9p and 7p per gallon respectively; on direct help to industry a 1 per cent cut in NIS made effective from the beginning of 1982-83; and on personal taxes an increase in income tax allowance and rate bands of about 2 percentage points over and above Rooker-Wise. There are also a number of additional measures which are shown in the Annexes.

8. The public expenditure planning total for 1982-83 is likely to emerge at a shade less than £115 billion, or very near to the figure in my 2 December announcement. The increases not charged to the contingency researve which I shall propose are more than

offset by the expenditure consequences of other Budget measures and estimating reductions. The increases charged to the Reserve include the costs of restoring the 2% shortfall on the 1981 uprating of Social Security benefits. The Reserve is set at £2.25 billion next year, with £4 billion and £6 billion for 1983-84 and 1984-85 respectively.

9. Of the PSBR costs of £1.3 billion for the Budget measures, over two-thirds can be presented as directly helping businesses. This is of course as it should be in a Budget designed to help industry and unemployment, and this will be the main theme of my Speech.

... 10. I attach a copy of the current draft of the Speech. Although it is still some way short of final form, you may like to see it as it stands. The proposed new employment scheme is set out in section 2. I shall have another session with Norman Tebbit on the language. The monetary and PSBR sections - 3 and 4 - have been discussed with Alan Walters; and the latter contains a fairly full treatment of the effect of oil price falls. Sections 15 and 16 on Capital Taxes and Fiscal Justice will I think evoke considerable interest: the measures proposed in the former should usefully stimulate the equity market, while those in the latter include a series which are designed to reduce the ways in which Banks, and others, reduce their liability for corporation tax.

GH

(G.H.)
3 March 1982

ANNEX A 3 MARCH 1982

	PSBR costs (after "second round" effects)		Tax effects in 1982-83		Tax effects Full year	
	1982-83	1983-84	Indexed base	non-indexed base	Indexed base	non-indexed base
Specific Duties (cost of less than full revalorisation - effects include petrol +9p and Derv +7p	65	45	65	(1145)	65	(1155)
NIS (1% effective cut from April 1982)	675	670	1000	1000	1195	1195
Personal taxes (about 2% over revalorisation on allowances and bands)	185	150	200	1840	260	2445
Other proposals (Annex B)	420	580	280	280	890	890
Total PSBR costs - tax and expenditure together	1345	1445				
Total revenue costs - tax only			1545	1975	2410	3375
Public expenditure not charged to the Reserve			200	200		

Note: "Tax effects in 1982-83" - "Tax effects in full year" columns will appear in the FSBR, not quite in the same form but with the same totals. "PSBR costs" columns will not, but the figure of "about £1.3 billion" for PSBR cost of measures in 1982-83 will be mentioned in the text.

BUDGET SECRET ANNEX B 3 MARCH 1982

		1982-83	1983-84	Full year
		(tax and expenditure together)		(tax only)
		£m		
1.	Enterprise (as Annex C)	28	75	78
2.	Innovation (as Annex C)	20	50	15
3.	Construction (as Annex D)	240	156	170
4.	Energy (as Annex E)	164	200	100
5.	Social (as Annex F)	93	244	16
6.	Other items (as Annex G)	14	(16)	(38)
7.	Unemployment (see note below)	?	?	?
8.	Capital Taxes (net cost of changes)	35	144	351
9.	North Sea (net cost of restructuring regime)	-	70	200
		594	923	892
	Less public expenditure items included above but to be charged to Contingency Reserve	111	263	
		483	660	
	Less PSBR offset for "second round" effects	60	80	
	PSBR costs in Annex A (say 420)	423	580	
	Tax costs in Annex A	280		890

Note: Unemployment measures cannot be costed at this stage. Expenditure will be charged to the Contingency Reserve.

BUDGET SECRET ANNEX C 3 MARCH 1982

ENTERPRISE PACKAGE

	£m Revenue costs 1982-83	1983-84	Full year (tax only)
1. Revalorisation of "small companies" corporation tax limits	6	10	11
2. Revalorisation of VAT registration and deregistration limits	5	10	10
3. VAT relief for services supplied before registration	Neg	Neg	Neg
4. Relief for purchase of own shares by companies	2	5	5
5. Tax relief for contributions to enterprise agencies	Neg	Neg	Neg
6. Liberalisation of interest relief to cover full time worker and job ownership companies	2	5	5
7. Increase in retirement annuity relief for old self-employed	12	27	25
8. Pre-trading expenditure concessions	Neg	Neg	Neg
9. BSS/ - carry forward unused 1981-82 allowances to 1982-83	Nil	8	20
- increase in limit £20,000	Nil	8	
10. Share schemes			
- revalorisation of limit on employee scheme	1	2	2
- rights issue technical amendments	Nil	Nil	Nil
- spreading of tax liability on exercise of options	Nil	Nil	Nil
	28	75	78

INNOVATION

		1982-83	1983-84	Full year
£130m 3 year package (including Information Technology promotion)	Public expenditure*	20	35	not tax
	Tax reliefs	-	15	15
		20	50	15

* charge to Contingency Reserve

/ Business Start-up Scheme

BUDGET SECRET

CONSTRUCTION PACKAGE

	£m revenue costs		
	1982-83	1983-84	Full year (tax only)
1. Extension of Small Workshop Scheme and industrial buildings allowance to cover warehouses (other than wholesale and retail	Neg	6	20
2. Capital allowances for new rented property under assured tenancy scheme	Neg	5	5
3. Stamp Duty on house purchase : increased thresholds	70	75	75
4. Additional public expenditure in form of grants to private sector house improvement	100	-	not tax
5. VAT: Maintenance of zero-rating of double-glazing insulation etc from 1 April 1982. (Mainly reversal of House of Lords ruling)	70	70	70
	240	156	170

£m revenue costs

ENERGY PACKAGE

		1982-83	1983-84	Full year (tax only)
1.	Electricity prices	97	[100]	not tax
2.	Continuation of Foundry Coke Scheme*	7	nil	not tax
3.	Industrial gas freeze to 31.12.82	60	[100]	100
		164	200	100

* charge to Contingency Reserve

Note: No decision has been taken about continuation of Electricity or Gas price schemes beyond 1982-83. For the purpose only of looking at the 1983-84 PSBR effects it is assumed that the Electricity scheme continues and the Gas freeze is not unwound.

£m revenue costs

SOCIAL PACKAGE

		1982-83	1983-84	Full year (tax only)
1.	Capital Transfer Tax - raise exemption on charitable gifts and bequests to £250,000	Nil	1	1
2.	Minor extensions of existing VAT reliefs for charities	Neg	Neg	Neg
3.	Development land tax - further relief for charities	Neg	Neg	Neg
4.	Exemption of Mobility Allowance from tax	8	10	10
5.	Stamp Duty relief for transfer to charities	4	5	5
6.	Restoration of 2% shortfall on 1981 uprating of social security benefit and public service pensions*	78	218	not tax
7.	Increase in capital disregard for supplementary benefit purposes*	3	10	not tax
		93	244	16

* charge to Contingency Reserve

£m revenue costs

OTHER ITEMS

	1982-83	1983-84	Full year
1. Minor PRT	5	(2)	(2)
2. Ring fence for CT	-	10	10
3. Company cars	-	(18)	(30)
4. Equity loans	-	(15)	(25)
5. Bus fuel grants	9	9	9
Totals	14	(16)	(38)

DSS

File

bc: Mr. Walters

10 DOWNING STREET

From the Private Secretary

2 March 1982

INTERNATIONAL TAX AVOIDANCE: SUNDAY EXPRESS ARTICLE, 21 FEBRUARY

You sent us, for Parliamentary Questions briefing purposes, a copy of the Inland Revenue note of 22 February on the Kenneth Fleet article in the Sunday Express the weekend before last. The Prime Minister mentioned this to the Chancellor at one of their Budget meetings last week; the Chancellor told the Prime Minister that there was no question of proceeding with these proposals in the Budget this year.

After studying the Revenue's note, the Prime Minister has asked me to record that she is very worried indeed about these proposals. The article seems to her to be substantially justified. The Prime Minister understands that the present package of proposals has generated a good deal of uncertainty and suspicion in the City, to such a degree that it seems to her that it might be best simply to withdraw the package in its entirety, not merely for this year but sine die. She has, in particular, been made aware of considerable concern in relation to the problem of UK resident management of portfolios. The Prime Minister accepts that it may be wise to proceed with some of the items, but thinks this would best be done by instituting fresh consultations.

M. C. SCHOLAR

John Kerr, Esq.,
H.M. Treasury.

A

BUDGET, SECRET

File copy Mr Scholar

10

blind cc Mr Walters

10 DOWNING STREET

From the Private Secretary

2 March, 1982

The Prime Minister and the Chancellor had a word this morning about the consequences of the reduction, by $4 per barrel, which BNOC are announcing this afternoon in the price of their oil.

The Chancellor said that this reduction was estimated to have a PSBR effect of some £300 million. On the basis of decisions already reached it would therefore be hard to avoid announcing a PSBR of £9¾ billion. In the light of the ~~past~~ recent and prospective fall in pump prices for petrol and derv he accordingly proposed a full re-valorisation here, adding 9p to the price of a gallon of petrol and 7p to the price of a gallon of derv.

After discussion the Prime Minister agreed that the Chancellor should proceed thus, on the basis of a PSBR unchanged at £9½ billion.

M. C. SCHOLAR

John Kerr, Esq
HM Treasury

BUDGET, SECRET

CONFIDENTIAL

SECRETARY OF STATE FOR THE ENVIRONMENT

Prime Minister (2)

MCS 2/3

cc

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:

Your ref:

2 March 1982

MS

Dear Leon

NATIONAL INSURANCE SURCHARGE AND RATE SUPPORT GRANT

with MCS 2

Thank you for your letter of 26 February (which did not arrive until today.)

I am glad that you recognise the general validity of the arguments in my letter of 25 February. (I would not wish to press the sole one with which you take issue).

The issue for decision is thus whether more weight is to be given to my arguments or to yours. My view remains as before: your proposal would create problems disproportionate to its benefits, and should not be proceeded with. I see that George Younger takes the same view.

I agree that we should meet urgently to resolve this disagreement. Could I look to you to call us together? I imagine that you will also wish to invite George Younger, Nicholas Edwards, and Jim Prior, to whom I am sending copies of this letter. I am also sending a copy to the Prime Minister.

Yours ever

Michael

MICHAEL HESELTINE

Rt Hon Leon Brittan QC MP

CONFIDENTIAL

Econ Pol

(2)

Prime Minister

MCS 7/3

SECRETARY OF STATE FOR THE ENVIRONMENT

2 MARSHAM STREET
LONDON SW1P 3EB

My ref: H/PSO/11387/82

Your ref:

1 March 1982

Dear Geoffrey

1982 BUDGET

The proposals in Patrick Jenkin's letter of 18 February seem desirable, if we are serious in our efforts to encourage small and new companies.

The response to the Loan Guarantee Scheme suggests it may be filling a gap in the sources of credit for small companies. Unless the ceiling is raised, we would be cutting off what now looks like a successful experiment before it could be fully evaluated, which would make no sense at all for what may well prove a valuable scheme. I am sure that the limit should be raised to £300m, as Patrick suggests, but I agree that we should keep the limit on loans at £75,000.

Patrick's remarks about the Business Start Up scheme confirm the anxieties that we have discussed about incentives in this field. It is now possibly too late but I have no doubt that if you really want results in this field you will have to move to a repayment of tax by way of grant system and you will have to so simplify the rules that effectively-within prescribed categories-repayment is certain and not open to bureaucratic scrutiny. In the meantime I support Patrick's suggestions to boost the existing scheme.

I am copying this letter to the Prime Minister, the Lord Chancellor the Secretaries of State for Scotland, Wales, Trade, Industry, Social Services, Energy and Employment and to Sir Robert Armstrong.

Yours ever

MICHAEL HESELTINE

Rt Hon Sir Geoffrey Howe QC MP

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Oddi wrth Ysgrifennydd Gwladol Cymru The Rt Hon Nicholas Edwards MP From The Secretary of State for Wales

cc AW

Prime Minister (2)

MCS 1/3

CONFIDENTIAL

1st March 1982

Dear Geoffrey

I have seen a copy of George Younger's letter of 12 February about the Budget strategy. I would like to add my support.

Generally industry in Wales despite recent encouragement remains in an extremely difficult position. Industrial firms continue to be worried about short term prospects and their capacity to respond when we move out of recession. I recently had talks with the CBI Wales who, while rehearsing the main points the CBI will have put to you nationally, were at pains to stress how many companies, despite positive attempts to operate at maximum efficiency, were able to survive only by Bank borrowing. Certainly, the CBI Wales see reductions in the NIS as the best and surest way to enable industry to improve their cash flow situation and to be in a position to benefit from the upturn in the economy. You will know that I would support this. Although I can see the attraction of seeking offsetting reductions in RSG, the practical objections described by Michael Heseltine in his letter of 25 February are very formidable and like him I hope you will not proceed with that idea.

Like George Younger I would be concerned if at the same time we did not maintain a level of regional aid which reflected the needs of the regions. Unemployment currently in Wales is 16.2% rising to over 25% in certain areas. Our main counter argument to those who are worried about unemployment and closures is that we are doing all we can to find replacement jobs in the regions. If we are to continue to attract inward investment and help sustain business confidence a commitment to at least the present levels of aid available in the Assisted Areas is essential. I welcome the decision of the Chief Secretary not to press the proposed cut in RDG rates.

/Representatives

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
LONDON

Representatives of local authorities in Gwynedd whom I met recently emphasised the value of incentives for house building and improvement and as you know, in our recent Cabinet discussions I supported those who favoured a package of time limited boosts to the building and construction industry.

As to the difficult judgement you have to make on the appropriate level of the PSBR and the scope for tax reductions, nothing that has happened since our discussion in Cabinet has caused me to shift my own opinion that a figure close to £9 billion would be lower than is desirable in present circumstances. I can find very few in the City who believe that to go for a PSBR of somewhere in the region of £10.5 billion would represent an abandonment of the Government's central strategy or would have an adverse impact on interest rates or the exchange rate. In my view recent events in the oil market strengthen rather than weaken the case I made. Having had this view put to me by a Director of the Bank of England and having seen it repeated in leading articles in the Economist and the Financial Times, as well as by a number of people in the City and industry whose views I respect, I don't think it can be regarded as particularly rash or irresponsible. As I also pointed out in an earlier discussion the politics and psychology of the decision are also very relevant. It is important that, while sticking very firmly to the central objective, we should seek both to inject an element of optimism that will encourage recovery and unite the Party in defence of our strategy. I believe that these factors add to the case for not sticking too rigidly to the lower end of the realistic range of options.

I am copying this letter to the Prime Minister, the Lord President, the Secretaries of State for the Environment, Industry, Scotland, Trade, Social Services, Energy and Employment and to Sir Robert Armstrong.

Yours

Nick

Econ Pol

File

BUDGET CONFIDENTIAL

bc Walters

10 DOWNING STREET

From the Private Secretary 1 March 1982

Share Incentives Schemes

Thank you for your letter of 19 February about the Chancellor's consideration of the George Copeman suggestions on share incentive schemes.

I have shown this to the Prime Minister, who has noted it without comment.

M. C. SCHOLAR

Peter Jenkins, Esq.,
HM Treasury.

BUDGET CONFIDENTIAL

File

ds

bc Walters

10 DOWNING STREET

From the Private Secretary

1 March 1982

Dear Jill,

North Sea Fiscal Regime

The Prime Minister was grateful for the Chancellor's minute of 26 February on the North Sea fiscal regime.

The Prime Minister is concerned lest in the present state of the oil market the proposed new fiscal regime will be too onerous for the oil companies, and will inhibit desirable exploration and development. The Prime Minister would have preferred a package which imposed a much lower rate of tax on marginal fields. She fears that, given the prevailing high level of taxation on the North Sea, companies may be encouraged to boost their offtake in order to maintain profits; whilst she endorses the decision not to impose production cuts for the time being, she would wish to do nothing positively to encourage companies to speed up their production.

Notwithstanding these reservations, the Prime Minister is ready to accept the package which the Chancellor has agreed with the Secretary of State for Energy.

I am sending a copy of this letter to Julian West (Department of Energy).

Yours sincerely,

Michael Scholar

Miss Jill Rutter,
HM Treasury.

Prime Minister ②
Mus 1/3

SECRETARY OF STATE FOR SOCIAL SERVICES

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
ALEXANDER FLEMING HOUSE
ELEPHANT AND CASTLE LONDON SE1 6BY
TELEPHONE 01-407 5522 EXT

cc. AD
AW

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Great George Street
London
SW1

February 27 1982.

Dear Geoffrey.

TAX RELIEF ON NI CONTRIBUTIONS PAID BY THE SELF-EMPLOYED

There is one other matter, quite separate from the 1982 uprating of social security benefits, to which I should draw your attention while you are considering your Budget proposals. This is the possibility of giving tax relief on that proportion of the national insurance contributions paid by self-employed people which corresponds to the employer's share of the Class 1 contribution about which Hugh Rossi wrote to you last autumn. In your reply to Hugh of 23 December you said that you were not convinced that introducing this measure of tax relief should be regarded as a high priority.

I should like to reinforce the case that Hugh put to you and to ask you to reconsider the matter. I think that there are powerful political arguments, as well as those which the organisations representing self-employed people have put to us, for making the change. You will obviously not want me to repeat everything that Hugh said when he wrote to you, but perhaps I might answer one of the chief points which you raised in your reply.

You rested your case mainly on the argument that, because self-employed people are, unlike employers, paying contributions to get benefits for themselves, those contributions are in the nature of a personal, rather than a business, expense. I think, however, that the existence of Class 4 contributions would make it hard to convince the self-employed lobby of this. I appreciate, of course, that Class 4 contributions go to finance benefits collectively; but the fact remains that a self-employed man at the upper profits limit will be paying £648 in 1982/3, compared with £195 for a man with Class 2 liability only, but will have nothing more in terms of benefit entitlement to show for it. This is in direct contrast with an employee, all of whose Class 1 contributions can be said to "work" for him by giving additional pension rights on earnings above the lower limit. This means that while primary Class 1 contributions are undoubtedly a personal expense, the analogy breaks down for self-employed people when we come to Class 4. So I think that it would be possible to defend tax relief on a proportion of the self-employed contributions without opening the door to a spate of rival claims.

I see two major political attractions in giving relief. The first, and more obvious, one is that our review of the self-employed and national insurance is coming to an end. At present there seems little prospect of our being able to offer any concession either in the way in which self-employed contributions are calculated or in the range of benefits open to self-employed people. As you will know, we conducted the review to honour a Manifesto pledge, and expectations were inevitably raised. A tax concession on the lines suggested by a number of organisations during the review would be seen as a positive response and meet widespread criticisms that the review was a mere formality.

The second argument concerns Clause 22 of the Social Security and Housing Benefits Bill, which makes statutory sick pay (SSP) earnings for the purposes of contribution liability. As you know, an amendment put down in Committee by our own backbenchers and carried with Opposition support relieves the employer of his liability to pay contributions on SSP: this would result in huge administrative problems and a loss of £65 million in revenue. The main reason for their amendment advanced by our supporters was to help small businesses. However, Hugh Rossi pointed out repeatedly that it would not achieve this: all employers would benefit, and large ones in proportion to the size of their payroll. We hope to restore the original Clause at Report Stage, but this may be difficult if we do not have adequate sweetners for our own side. While I take your point that tax relief on contributions for self-employed people would not necessarily create new businesses, it would undoubtedly provide a stimulus beamed more directly than the SSP concession at small businessmen, and distributed more evenly among them irrespective of the size of their work force. If you were able to announce this small measure of tax relief in your Budget statement, I believe that it could tip the scales in our favour at Report Stage, which will follow shortly afterwards.

I very much hope that you will feel able to reconsider the question of tax relief in the light of what I have said. I am copying this letter the Prime Minister, Patrick Jenkin and to Sir Robert Armstrong.

Yours Norman

NORMAN FOWLER

Copy to Mr Walters.

Prime Minister.

Are you content with the package which the Chancellor and Mr Lawson have devised?

[initials] 26.iii.82

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

In view of the present state of the oil market - the "take" is about as high - no!

NORTH SEA FISCAL REGIME

You will be interested to know where things now stand on my Budget proposals affecting the North Sea fiscal regime.

2. Last year we decided that there was scope for additional taxation on North Sea operations (mainly because of the major hike in oil prices in the late 1970s), and that the structure had to be made more responsive to oil price changes in future. In my Budget I therefore introduced the Supplementary Petroleum Duty (SPD) at 20 per cent of gross revenues (less an oil allowance of 1 million tonnes a year), and limited two of the main reliefs for Petroleum Revenue Tax (PRT) - "uplift" and "safeguard" - to the earlier years of an oil field's life. These changes were estimated to produce an additional £1,020 million for 1981-82 - mostly from the SPD.

3. The oil industry had made clear their strong opposition to the SPD when it was first announced not only because of the 'take' but also because the tax was levied on gross revenues not profit. In view of their representations, we decided that the SPD should be introduced for 18 months only (to end June this year), to give time for the industry and us to consider alternatives.

4. Since then, I have received representations from the main industry representative bodies (the UK Offshore Operators Association - UKOOA, and the Association of British Independent Oil Exploration Companies - BRINDEX), some individual companies and some independents (including the Institute of Fiscal Studies). The main common element in the industry's representations has been the plea for a substantial reduction in Exchequer take and

the abolition of SDP (with arrangements on at least a temporary basis for accelerating PRT take instead). These proposals and the existing regime have been reviewed by the Treasury, Inland Revenue, and the Department of Energy. Following that review Nigel Lawson and I have agreed on a package of measures which will be announced in the Budget.

5. We are not convinced by the case for a substantial reduction in yield. Despite the current weak state of the oil market, analysis suggests that the existing North Sea fields currently in production or under development remain reasonably profitable on a wide range of assumptions about the future movement in the oil price, and that potential future fields are also likely to remain attractive. But neither do we think there is scope for any increase in the overall yield. The industry has shown considerable concern, some of it genuine, about the level of taxation, and may need something of a psychological boost. With the present state of the oil market, I think this points to a modest reduction in take, though going less far than the oil industry would wish.

6. We have decided to make the following changes to the strucutre of the fiscal regime, which do, I think, improve the structure without sacrificing our objectives on yield. These are:-

(a) to abolish the SPD with effect from end 1982 (i.e. extending it to run for a further 6 months only);

(b) to introduce from 1 January 1983 an "advance PRT", computed as SPD is as present, but differing from SPD (which as a separate tax in its own right is only deducted in computing PRT liabilities) by being set off in full against PRT liabilities as soon as these arise, or - failing set off - by being eventually repaid;

(c) to increase the rate of PRT from 1 January 1983 to 75 per cent instead of 70 per cent;

(d) to introduce "smoothing" arrangements for paying most of PRT liabilities by monthly instalments from 1 July 1983 (instead of in two large lump sum payments in a year).

7. We believe that the advantages these structural changes offer are:

(a) they - in particular the abolition of SPD - are a significant move towards the industry's own proposals, but the advance PRT will continue to ensure a substantial Exchequer yield from fields in their early years of production before they become liable to ordinary PRT.

(b) Post-tax rates of return on additional investment in existing fields will be much closer to pre-tax returns, so reducing the risk that incremental investment at the margin to recover oil that otherwise might be lost might be made uneconomic solely because of the tax system.

(c) The marginal rate comes down from 90.3 per cent to 89.6 per cent.

(d) The position on creditability against foreign tax, a matter of particular concern to the US companies, should be somewhat improved (though this does of course ultimately depend on the attitude of the US authorities).

(e) "Smoothing", which secures a more even public sector cash flow will be a considerable benefit to monetary management.

8. The estimated cost of the package is:-

	£m (gross)	Interest gain from "smoothing"	Overall Effect
1982-83	0	0	0
1983-84	-100	+20	- 80
1984-85	-160	+40	-120
1985-86	-140	+50	- 90
1986-87	-280	+70	-210
	-680	+180	-500

That is consistent with our conclusion on the taxable capacity of the oil companies. From 1982-83 to 1984-85, the reduction represents less than 1 per cent of North Sea yield as compared with the reduction of 5 per cent which industry wanted.

9. Apart from the main structural proposals, I propose to legislate for a few minor changes to improve the regime - in part in response to the industry's representations. There are also a number of particular problems affecting PRT expenditure reliefs in certain circumstances and the taxation of pipeline tariffs and other non-oil receipts. We need to deal with these but I have agreed with Nigel Lawson that we should defer legislation until 1983 and issue a consultative paper with our proposals shortly after the Budget.

10. I believe that this package - in combination with the decision not to impose production cuts for the time being which Nigel Lawson will be announcing shortly before the Budget - should go a long way towards reassuring the industry that North Sea development can now go ahead on the basis of a more stable structure which has taken account of some of their main objections to the existing regime. The industry will inevitably still claim that overall tax is too high. But I do not think we could ever expect to agree with them on that! While we shall obviously need to keep matters under review in the event of changes in the economics of the

oil industry, I believe that our judgement of taxable capacity is broadly right in existing circumstances and should prove reasonably robust against quite a wide range of the more likely possible future developments. It is vital to strike the right balance between the need on the one hand to give adequate incentives to the industry to ensure the further development we need and the need to ensure the maximum Exchequer yield. I believe this package does that.

11. I am copying this minute to Nigel Lawson.

(G.H.)
26 February 1982

MC

Econ Pol
Budget

26 February 1982

PERSONAL AND CONFIDENTIAL

At their discussion yesterday morning the Prime Minister mentioned to the Chancellor a note which Bernard Ingham had put to her on presentation of the budget statement. The Prime Minister undertook to send a copy to the Chancellor.

I attach a copy. This is, of course, intended only for the Chancellor, and I have made no copies of this letter and enclosure.

M. C. SCHOLAR

John Kerr, Esq.,
H.M. Treasury.

pa ✓ c AW

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

26 February 1982

D. Lumley, Esq.,
Private Secretary,
Department of Energy

Dear David,

PRESS NOTICES RELATING TO THE BUDGET

I wrote to you on 22 February setting out the arrangements required for dealing with press releases relating to the Budget. I am afraid that the numbers required have now changed in thelight of increased demands made by the Vote Office.

I would be grateful if Departments issuing Budget press notices would send 1600 copies of them to Committee Section at the Treasury (c/o Mr. A.W. Batchelor) in two separate bundles, one of 1150 copies (destined for the Vote Office) and one of 450 copies (mainly for distrubution to the press). Copies should, as before, have a hole punched through the top left-hand corner. Copies of press notices should reach Treasury Committee Section by 4.00 p.m. on Friday, 5 March.

Other arrangements remain as set out in my original letter of 22 February.

Copies of this letter go to Private Secretaries of other Members of the Cabinet.

Yours,

Jill

JILL RUTTER

CONFIDENTIAL

PRIME MINISTER

BUDGET PRESENTATION

I promised you a note on the above subject:

- The first point is for the Chancellor to get off to a good start and to avoid words which offer the waiting Opposition a horselaugh. Those behind him will be willing him to do well - they are now beginning to feel the need for him to do so - and it is very important that the first 2-3 pages are scrutinised for traps.

- Second, the Chancellor needs the sort of opening which perks up his supporters and rocks back the Opposition. Norman Tebbit did this very effectively by quoting Benn extensively in opening the Second Reading of the Employment Bill. In short the Chancellor needs, if he can, to stamp his dominance on the occasion at the outset or very early on.

- Third, _he_ needs to control the presentation of _his_ Budget. How does the Government want the overall Budget to be seen? How can that overview best be conveyed in simple, pithy terms? Thus what we need is a catchword. (In devising one we should try to avoid words like "recovery" which now almost invites ridicule).

- Fourth, some goodies should be thrown in first - and early. The reason for doing this is not simply to condition radio or tv commentators and the listening audience; or for that matter to get the most positive evening news headlines; it is also necessary to help Backbenchers who need to be fed the ammunition with which to dominate the other side. Nothing, apart from downright opposition is more damaging to wider media presentation than for the Chancellor to be received in silence and sullenly by his own side.

- Fifth, it is highly desirable that the facts and arguments should be presented simply and in plain English without jargon. This is important not merely because of the radio audience, but because it minimises opportunities for Opposition ridicule.

- Sixth, some light and shade would greatly help. This is merely another way of saying that this is a most important Budget both for the Chancellor and the Government, and the better the performance and presentation, the better the product will be regarded.

- Seventh and finally, peroration requires close attention for it is in these last paragraphs that the Chancellor needs to bring people back to:

  - theme;
  - catchword;
  - overall objective;
  - hope and reward for perseverence;
  - Government determination to see it through, confident that in spite of all the siren voices it is right to be steadfast.

Such a presentational plan does, of course, dictate the structure of the speech and it would help to know the plan before drafting begins.

B. INGHAM
26 February 1982

9

MR. SCHOLAR

KENNETH FLEET ARTICLE 21 FEBRUARY 1982, SUNDAY EXPRESS

In addition to the two points you mention in your covering note, I think it is worthwhile making four others.

1. The package entitled "International Tax Avoidance" has generated such uncertainty and suspicion in the City and eslewhere that it might be best simply to withdraw it in its entirety, not merely for this year, but sine die.

2. It would be wise to proceed with some of the items in the package by instituting fresh consultations. For example, there is a genuine case of tax avoidance in the up-stream loans. Since this is primarily a matter for Corporation Tax, it might be considered along with the changes in Corporation Tax law. Discussions are going on about the changes in Corporation Tax arrangements now.

3. The problem of UK resident management of portfolios has caused an enormous amount of concern. (I believe that the Prime Minister received a copy of Sir Eric Faulkner's representation to the Chancellor.) This is related to the issue of "deeming" which is, I believe, going to be changed in the current Budget. But clearly, even the most modest risk of CTT incidence would discourage any non-resident from holding funds and having those funds managed in the United Kingdom.

4. I think the general message is that we should proceed very cautiously. Other financial centres are becoming increasingly attractive as fund managers. For example, Hong Kong has recently abolished its withholding tax and should be well placed for a considerable expansion in her Asian, Dollar and Euro business. The City is becoming vulnerable.

AW

26 February 1982

ALAN WALTERS

Told Chf Ex's office MES 1/3

CONFIDENTIAL !

Chancellor - Please look at classification of these documents urgently

MS.

Prime Minister

MES 26/2

ECON POL Budget

Treasury Chambers, Parliament Street, SW1P 3AG

Rt Hon Michael Heseltine MP
Secretary of State
Department of the Environment
2 Marsham Street
London SW1P 3EB

26 February 1982

Dear Michael,

THE NATIONAL INSURANCE SURCHARGE AND THE RATE SUPPORT GRANT

Thank you for your letter of 25 February. - attached.

I understand your concern that any reduction in the national insurance surcharge would be indiscriminate. I am concerned that it should not be more indiscriminate than necessary. I therefore hold to my view that any benefit to the local authorities should be offset by a reduction in the rate support grant.

I take many of the other points in your letter. Certainly, I should be the last to pretend that reducing the rate support grant would be easy. Nonetheless, I believe the considerations to which you draw attention are outweighed by three main points:-

(i) the purpose of reducing the NIS would be to help to moderate industrial costs, not to direct assistance to local authorities or their ratepayers:

(ii) so long as overspending by local authorities on current account is such a huge problem, we simply cannot afford to increase the scope for it by giving local authorities a windfall gain;

(iii) if the Chancellor finds he has any room for manoeuvre on local authorities at all, you and I are agreed that capital spending must have priority over current.

The only argument of yours with which I would take issue is the suggestion that allowing local authorities to retain the benefit of an NIS reduction might actually reduce their overspending. So far as I can see, this could only happen if we left their targets

CONFIDENTIAL

unchanged despite the cut in NIS. My strong view is that we should reduce the targets against which overspending is measured - just as we should reduce the rate support grant - by the amount of any saving on national insurance surcharge.

If you would like a discussion, I should be happy to have one. I am sending copies of this letter to George Younger, Nicholas Edwards and Jim Prior. I am also sending a copy of the correspondence to the Prime Minister.

Leon

LEON BRITTAN

MR. WALTERS

Copy No. 2 of 3 Copies

8

10 DOWNING STREET

From the Private Secretary

25 February 1982

I am writing to record the outcome of a number of discussions which the Prime Minister has had with the Chancellor on the matters raised in the Chancellor's minutes to the Prime Minister dated 18 February, 23 February and 24 February.

Monetary Policy

The Prime Minister has noted that the Red Book will again contain an updated version of the medium-term financial strategy; that the medium-term monetary objectives will be expressed not only, as hitherto, in terms of Sterling M3 but also of the wider aggregates generally, as well as M1 and the narrow aggregates; and that it will be said that the exchange rate will be taken into account in assessing monetary conditions. The Prime Minister has also noted that the precise ranges to be shown for the aggregates will probably be fixed at 8-12 per cent for 1982/83, with declining ranges for subsequent years.

Fiscal Stance

The Prime Minister agrees with the Chancellor's aim to go for a PSBR for 1982/83 of about £9½ billion. She thinks it very possible that the oil price will go down some way below 30 dollars a barrel, and on this basis believes that tax reductions with a PSBR effect in 1982/83 of around £1.5 billion are at the top end of what can be afforded within the £9½ billion figure.

Detailed Proposals

On the specific duties, the Prime Minister is content with the proposals set out in Annex A to the Chancellor's minute of 18 February. In two contexts, the Chancellor and the Prime Minister discussed the possibility of raising the proposed 5p increase on petrol and derv: in connection with the Cabinet's decision not to proceed with the proposal to recover motor accident NHS costs from insurers; and also in the context of recent falls in the oil price. Their conclusion was to stick to the proposed 5p increases.

On the national insurance surcharge, the Prime Minister was doubtful about the economic merits of the proposed 1½ per cent cut to take effect from August. She was concerned about the effect on pay, and doubtful about the wisdom of a tax reduction

/which

which reduced banks' and insurance companies' costs as much as it did those of manufacturing industry. She acknowledged, however, the political case for some move here; and also the need to help industry. She has agreed, therefore, to a 1 per cent reduction over the year as a whole; she recognises that, to secure this effect, it will be necessary to reduce the surcharge by 1½ per cent from August when the cut will take effect. The Prime Minister is most concerned that the cut should not be described as a 1½ per cent cut in the surcharge; and that there should be no implication that there will be an automatic continuation of the 1½ per cent in 1983/84.

On personal taxes, the Prime Minister accepts the Chancellor's proposal for an increase in tax allowances and thresholds of 15 per cent, i.e. three percentage points above the minimum required by the "Rooker-Wise" legislation. The Prime Minister accepts that it may be necessary to trim this figure downwards, in the interests of containing the tax reductions to around £1.5 billion.

On the "Additional Measures", summarised at Annex B of the Chancellor's minute of 23 February, the Prime Minister accepts that there should be no element in respect of domestic gas prices (her immediate inclination was to reverse the planned October increase, and to include an element in Annex B on that account). She has agreed, however, to the proposal made by the Secretary of State for Energy, and accepted by the Chancellor, that industrial gas prices should be frozen after the March 1982 increase up to the end of calendar 1982.

On the mortgage interest relief ceiling, the Prime Minister has agreed not to press her proposal that the ceiling should be increased to £35,000. She has indicated, however, that she will certainly wish to increase this ceiling in next year's Budget. To meet her concern that the Budget was not doing enough for home ownership, the Chancellor proposed that the bands on which stamp duty is charged should all be raised by £5,000. This would cost somewhere in the region of £70-100 million, and would benefit labour mobility as well as home ownership. The Prime Minister accepted this proposal.

M. C. SCHOLAR

John Kerr, Esq.,
HM Treasury.

Econ Pol Budget

2 MARSHAM STREET
LONDON SW1P 3EB

My ref:
Your ref:

25 February 1982

Mr Culpin
PPS FST EST
MST(C) MST(L)
Sir D Wass
Sir A Rawlinson
Mr Ryrie
Mr Middleton
Mr Bassatt
Mr Wilding
Mr Battishill
Mr Kemp
Mr Kitcatt
Mr Mountfield
Mr Kelly
Mrs Case
Mr Griffiths

Dear Leon

NATIONAL INSURANCE SURCHARGE

I was concerned to see from your letter of 16 February that you and Geoffrey Howe are still considering a reduction in the National Insurance Surcharge. As you know, I am strongly opposed to what I believe would be an indiscriminate tax reduction. I will not repeat the arguments, with which you are familiar.

However, I have gone fully into the implications for local authorities. First, the examination illustrates the way in which the incidence of the surcharge is widely spread over a large number of employers, with a relatively small effect on any one of them. I assume that you are proposing an offsetting adjustment not only in the cash provision for local government but also in that for similar public sector non-trading bodies such as the National Health Service.

I do not know, of course, the scale of the reduction which you have in mind. It would technically be possible to amend the rate support grant settlement as you propose, but for the following reasons I would be most reluctant to do so. The total cost of the surcharge for local authorities in England is about £450 million. I imagine that you envisage a reduction of only some part of this. In the context of the £20 billion of relevant expenditure allowed for in the settlement, the prospective reduction may be quite small. We would have to change relevant expenditure, aggregate Exchequer Grant, specific grants, individual GRE's, and individual block grant entitlements, and lay a Supplementary Report before Parliament. Moreover I think it is impossible to achieve your proper proposal that no authority should be better or worse off as a result of this change. While this should be possible as a whole, there is no way in which we can ensure it for individual authorities. To make even a small adjustment would lay us open to the challenge that we have once again changed the rules after the game has started.

I share your concern for the PSBR. It would however be wrong to assume that authorities would necessarily spend all of the extra cash accruing to them from a reduction in the surcharge if it were not clawed back through a reduction in grant. In so far as the cash is not spent, external borrowing by local authorities would be reduced, thus dampening the upward effect on PSBR of the reduction in the surcharge.

In normal circumstances, we now expect local authorities to take the rough with the smooth in terms of RSG and cash limit assumptions. With cash limit factors over the years underestimating actual inflation, they have taken much of the rough. This is an occasion when they could justifiably argue that they should benefit from one of the rare changes in their favour. Even so, the benefit from a small reduction in the surcharge is unlikely to compensate for the amount by which inflation exceeds the pay and price assumptions on which the settlement was based. If by allowing local authorities to retain the benefit of any reduction on the surcharge we can reduce the aggregate overspend it will have proved a worthwhile concession.

Nor am I convinced that your proposal is consistent with the principles of cash planning. We have determined a cash provision for local authorities in aggregate and individually. We have said that if pay and prices diverge from our assumptions, local authorities must bear the consequences. The surcharge is a cost of manpower, and to validate a change in it would implay that the cash provision was made up of 2 components, volume and price. This might have been an acceptable procedure last year - but not in a cash planning regime.

My conclusion, therefore, has to be that your proposal would create very significant problems and should not be proceeded with.

I am sending copies of this letter to George Younger, Nicholas Edwards and Jim Prior.

yours ever

MH

MICHAEL HESELTINE

Rt Hon Leon Brittan QC MP

26 FEB 1982

(2)

Prime Minister

You may wish to be aware of this.

MCS 26/2

MR. SCHOLAR

SHARE INCENVITE SCHEMES

From my examination of Copeman's schemes, I found there was some justification for his view that the Stock Exchange imposes undue restrictions on the introduction of share schemes. I believe the Chancellor is right to seek some relaxation of the Stock Exchange rules.

Like the Chancellor, I can see no convincing argument for removing the £1,000 per annum limit on appropriations of tax relieved shares. The Treasury paper identifies a number of real dangers, especially by using the superannuation umbrella for much wider purposes than it was intended.

Finally, I do not see that the Copeman proposal for vesting is needed. The Treasury points out that the 1980 legislation will largely cover this.

25 February 1982

ALAN WALTERS

(1) MICHAEL, Scholar.
(2) Alan Walters.

I hope this explanation is helpful!

DW.

01-623 8000

20, FENCHURCH STREET

LONDON, EC3P 3DB.

24th February 1982

BY HAND. - URGENT

D. Wolfson, Esq.,
10 Downing Street,
London SW1.

Dear David,

As requested, I enclose a few comments on some of the points behind the Sunday Express article about the Inland Revenue's draft legislation, entitled "International Tax Avoidance", which was published in November 1981 with the Government's authority.

What really prompted the draft has not yet been admitted publicly, but it looks as if upstream loans may be a proper anti-avoidance target in certain circumstances; exchange control was perhaps considered a bulwark against avoidance and evasion, but I suspect implementation of the draft, with all its new uncertainties, may do more harm to genuine businesses, and cost more — not to mention the need for additional staff — than it would gain. It has also been suggested that the Inland Revenue wishes to make more non-UK controlled companies UK resident so that requiring dividends from tax haven companies will produce additional advance corporation tax.

The draft may have drawn enough adverse comments for the Inland Revenue to regard them as an orchestrated campaign, but this does not surprise me as the draft is considered more extreme than the consultative document which preceded it and itself drew adverse comments from many quarters. There is, of course, a degree of overlap in the composition of many sub-committees in the City which comment on Government proposals and other matters, but many of the various bodies represented — and their constituent members — are apt to be affected in a similar way and to see the need to make representations.

There is also a suspicion that the question of upstream loans could have been covered explicitly in the consultative document and not brought forward — clause numbers included — only a few months before the Budget and with a 6th April 1982 effective date. This subject should therefore be deferred as being more suitable for consideration with the general review of corporation tax contained in the current Green Paper.

I gather several detailed submissions on the draft are emerging, the final date for receipt being the end of this week, and you might like me to get you a copy of one or two of the best ones.

Naturally, please also let me know if I can help in any other way.

Yours,

George

GRP/mc

DRAFT LEGISLATION PUBLISHED BY THE INLAND REVENUE IN NOVEMBER 1981 ON "INTERNATIONAL TAX AVOIDANCE"

Fundamental objections on general principles are that a general bludgeon is being created for use against tax avoidance without specifying targets, that fundamental changes in the UK tax system are being introduced under the guise of being anti-avoidance legislation, that the Inland Revenue is taking wide discretionary powers (without any provision for clearances to be obtained) to decide whether the grey areas are to be treated as black or white and whether or not to require (subject to appeal to the Special Commissioners as to the circumstances of the requirement) the production of documents of, for example, any foreign subsidiary and its clients and that there is a general bias against the financial sector.

Many UK resident companies have overseas subsidiaries. Some are operating subsidiaries, some are holding or finance subsidiaries. Some are intended to protect the parents from risks overseas, to satisfy overseas requirements or to provide the more efficient planning of global tax liabilities; some are needed because their customers will not deal directly with UK residents, because the Inland Revenue will no longer (following a change in its practice after the removal of exchange control regulations in 1979) consent to eurobond issues by UK resident companies or because fiscal burdens are eased and, as a result, keener competition is possible with overseas rivals who would otherwise be subject to less onerous conditions.

Most international groups have an element of co-ordination and reporting requirements that make the determination of residence by the proposed new concept of "independent control and management "of overseas subsidiaries more difficult in practice than might have been supposed. The existing concept of"central management and control" has been judicially determined, and compliance with the new concept would seem likely to require much higher overseas employment costs, resulting in reduced UK profits assuming the business remains competitive.

The concept of employing an adequate number of employees seems over-subjective as a standard for judging the genuineness of a business since it depends on selecting working practices, as well as general efficiency, for comparison.

It is also the case that some UK companies would become non-resident under the proposed concept, which could have unexpected — and sometimes unfair — results.

As regards privileged tax regimes, the UK is regarded as such by foreigners in many respects, and it is not clear why a high nominal rate of tax offset by large allowances should be more acceptable than a low nominal rate of tax or a tax holiday.

Non-UK resident clients need to have confidence that they will not unexpectedly be burdened by UK taxation, and Sir Eric Faulkner's recent correspondence with the Chancellor and Mr. Ridley seems to have been unsuccessful in obtaining reassurances that non-UK residents can have their portfolios managed by UK residents without being deemed to have agencies in the UK and that their foreign currency cash, for example, deposited with UK banks (but necessarily held by overseas banks in the country of the currency) should not on death be liable to capital transfer tax. It is therefore even more important for UK controlled overseas subsidiaries in the Channel Islands and elsewhere to continue to be able, for example, to take non-resident deposits to place in the UK and, with the assistance of periodic advice from the UK, to manage portfolios for non-UK residents. Not all Channel Islands subsidiaries are controlled from the UK, and these and other non-UK resident companies compete actively for business. It is, of course, to be expected that evaders of UK taxes reduce the risk of detection by using non-UK groups, not that harming UK groups will reduce evasion.

The question of upstream loans was only alluded to in the consultative paper, but these would be accepted as proper targets for anti-avoidance legislation if, for instance, they were made by certain cash box companies overseas. However, the draft contains penal proposals without tax refunds on repayment of the loans or proper recognition of allowances and underlying taxes, and it does not acknowledge that dividends are not always appropriate. There may be compulsory retentions overseas, and expanding businesses need retentions of profits, whether calculated on UK or overseas criteria. Furthermore, the draft gives the Inland Revenue too much scope for attacking groups of companies with genuine businesses in the financial sector.

N.B.

Implementation of the draft would give rise to years of uncertainty and confusion and, abetted by overseas competitors, frighten away existing and new clients, particularly in the field of invisible earnings. Even if this had been thought worthwhile, the Inland Revenue may not have dealt with all the practical difficulties which ought to be solved, including that it should have the staff capacity to cope at short notice with large numbers of applications for clearances.

GRP/mc
23rd February 1982.

BUDGET CONFIDENTIAL

Prime Minister

For this afternoon's Budget meeting.

MES 24/2.

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

PRIME MINISTER

MORTGAGE INTEREST RELIEF CEILING

I know you feel very strongly that we should include in the Budget a provision to increase the ceiling on mortgage interest relief. It seems to me that the minimum we could sensibly do would be to increase the ceiling to £30,000. The Revenue estimate that the 1982/83 cost would be £50m. The longer term cost would of course be significantly higher as people increase their mortgages toward the new ceiling.

2. I must say that I am less worried about the revenue costs of this move than about its political impact. It would give an immediate windfall gain to people who already had mortgages in excess of £25,000 who will be among the better-off in this country. The average income of all building society borrowers in 1981 was about £8,800. But the average income of those taking out loans greater than £25,000 was £16,400. I think this would be damaging in a year when I can do little more than bare indexation on the income tax thresholds.

3. Moreover I am concerned that this move, taken together with the measures I propose on Capital Gains Tax and Capital Transfer Tax, would tilt the balance of my budget towards relief for the better-off. That would attract criticism not only from the Opposition but possibly also from our own supporters.

4. There are also, I think, compelling regional reasons for not increasing the mortgage interest relief ceiling. Only in the South-East has the ceiling begun to bite. In 1980, the average

/new mortgage in London

new mortgage in London was £17,000. In the rest of the country it was just over £13,000. In the South-East 32 per cent of new loans in 1981 were in excess of £20,000, (in the GLC area the proportion was 42 per cent) compared to a UK average of 20 per cent. So the benefit of the increase in the ceiling would be concentrated largely on the South-East: in much of the rest of the country the move would be seen as irrelevant. I think again that it would be damaging to make a move whose benefit was concentrated on the most affluent area of the country.

5. Political attention tends to focus on the plight of the first-time buyer. People who already own their houses benefit from their capital gain when they trade-up. But if we were minded to help the first-time buyer a rise in the mortgage interest relief ceiling is not the way to do it. 85 per cent of first-time buyers have mortgages of under £20,000. Mortgages of over £25,000 tend to be concentrated on those with higher incomes.

6. To my mind possibly the most telling objection is the political capital our opponents could make out of an increase in tax relief to owner occupiers when we are at the same time reducing subsidies to council house tenants by putting up council house rents. Owner occupiers are already favourably treated by the tax system. To improve that treatment further when we are, rightly I believe, reducing subsidies in the public sector would be very difficult. Since we took office the central government subsidy to council house tenants has been reduced by 30 per cent in cash terms. Over that same period relief to owner-occupiers has increased from £1.45 billion to £2 billion: an increase of 40 per cent.

7. My last more general worry is that by raising the £25,000 limit we would be open to criticism for giving further encouragement to bank lending for house purchase, with the inevitable attendant risks to the money supply or interest rates, and to the obvious disadvantage of industrial borrowers.

8. Taken together I think these factors point to not doing

/anything on the

anything on the mortgage interest relief ceiling this year.

G H

(G.H.)

24 February 1982

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+ one copy made by me for AW

MCS 24/2

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

MS.

PRIME MINISTER

THE FORTHCOMING BUDGET - FISCAL PROPOSALS

I am now very close to decisions about the fiscal proposals in the forthcoming Budget, on which I minuted to you on 18 February.

Fiscal stance

2. After further reflection, I am reinforced in my view that we should look for a PSBR of £9½ billion for 1982-83. Taken with tax reductions having a PSBR effect in 1982-83 of around £1.5 billion, this should provide a small measure of security against the effects of a possible fall in oil prices. For 1983-84, where the uncertainties are of course very great indeed, I still intend to propose in the MTFS a PSBR of £8½ billion, which should enable us to show a small positive fiscal adjustment for that year.

Detailed proposals

3. These are summarised at Annexes A and B. On the specific duties, the die is already cast. On the tax changes, decisions are needed by Thursday.

4. So far as direct help to industry goes, the main element must be a reduction in National Insurance Surcharge (NIS). Between the two options described in paragraph 8 of my earlier minute I now believe that we should propose a 1½ per cent cut to take effect from August. After making allowance for some offset to public expenditure (by way of clawback from NIS paid by public bodies) the full year PSBR cost of this is estimated at £675 million in 1982-83 and £1000 million in 83-84. The economic and industrial arguments - as between 1½ per cent and 1 per cent - are as you know very finely balanced. But politically, in terms of what our backbenchers, the CBI etc are expecting, 1% would not cut much ice. Some move has already been discounted, and I judge that 1½ per cent is needed for consistency with what will be the declared aim of the Budget; help for business, and for jobs.

5. On personal taxes (paragraph 4 of my earlier minute) I now favour an increase in rates and thresholds of 15 per cent - that is, 3 percentage points above the minimum required by the "Rooker-Wise" legislation and more than enough to compensate, in cash terms, for the NIC increase which we announced in December. The additional costs over Rooker-Wise are some £350 million in 1982-83 and £300 million in 1983-84.

6. The miscellany of additional measures, largely for industry, is summarised at Annex B. You will see that the cost of the package has shrunk. There are two reasons. First, it no longer includes an element in respect of gas prices, whether industrial or domestic; on reflection, my judgement is that it would be a retrograde step to do anything on this front, and preferable to use the money either by way of direct help to industry or personal thresholds, as I propose. Secondly, I now think it should be feasible to fund from the Contingency Reserve the proposed £100 million concession on electricity prices for industry. The "construction" element contains £70 million as yet unallocated: This could be used for action on the mortgage interest relief ceiling or on stamp duty (about which I shall minute separately tomorrow). But I myself would see attraction in using all or part of it for additional special measures directly helping the construction industry and inner cities, on which Treasury officials are in touch with DOE.

7. The costs are shown at Annex A. Also set out there is an alternative package, at similar cost. It would entail a 1 per cent rather than 1½ per cent reduction in NIS, a 2 per cent reduction in the general level of corporation tax, with or without a corresponding reduction in the rate for small companies, and a 4 per cent rather than 3 per cent improvement on "Rooker-Wise" on personal allowances. I am now clear that this alternative is less attractive. As explained in paragraph 4 above, I see a strong political case for a 1½ cut in NIS; a reduction in corporation tax, while presentationally and possibly psychologically attractive, has little economic priority at this stage; and next year, rather than this year, would in my view be the right time for further progress on raising the personal thresholds. This year we benefit people most by helping industry most; and to do so will be seen as consistent with our strategy. It is also, of course, in line with what colleagues wanted, judging by the Cabinet discussion on 28 January.

8. I should emphasise that although the costs are now displayed in terms of the PSBR, (including second round effects, - and some of the figures are still under review) I shall on Budget day refer to the unindexed cash amounts, on a full year basis. Our proposals will be seen as tax reductions of some £4½ billion, offset by increases in specific duties of about £1 billion, leaving a net reduction of some £3½ billion in cash terms.

9. Perhaps we could discuss this tomorrow?

(G.H.)

23 February 1982

ANNEX A

SUMMARY OF BUDGET PROPOSALS AT 23 FEBRUARY 1982

	PSBR cost (including second round effects)			
	MAIN		ALTERNATIVE	
	1982-83	1983-84	1982-83	1983-84
A. **Specific duties**	290	200		
Cost of less than full revalorisation			290	200
B. **Direct relief to industry**				
NIS: 1 % cut from August			450	670
1½ % " " "	675	1000		
Corporation tax 2% cut			90	190
C. **Personal Thresholds**				
3% real increase	350	300		
4% real increase			480	400
D. **Other proposals**				
As Annex B	260	320	260	320
	1575	1820	1570	1780

ANNEX B

	Subject		Revenue cost ranges (£m) 1982-83	1983-84
1.	Enterprise package		43	74
2.	Industrial innovation		20	40
3.	Construction package		170	72
4.	Energy		113	114
5.	Measures on social front		10	16
6.	Capital taxes	CTT	35	85
		CGT	nil	nil *
7.	North Sea regime		nil	70
			391	471
	Of which scored against existing Contingency Reserve (Item 2 and Item 4)		133	154
			258	317
	Say		260	320

Note. Any further construction/inner cities assumed charged to the Contingency Reserve.

* formerly £100 million

23 February 1982
ALAN WALTERS

6

PRIME MINISTER

Prime Minister
MCS 23/2

PRICE OF OIL AND THE BUDGET

1. Since a reduction in the price of oil is exactly analagous to a reduction in an excise tax, we ought to consider prospective oil price decreases as part and parcel of the process of fixing tax rates for next year. The Chancellor will be telling you that the BNOC believe that the average price of North Sea Oil in 1982/83 will be $32 per barrel, about $3.50 less than the price in the first quarter of 1982. This will give rise to a reduction of about £650m in North Sea revenues in 1982/83 and £1½bn in 1983/84. The PSBR effect would be somewhat less than this, depending upon the devaluation of sterling against the dollar. But if you accept the oil price forecast, it would in my view be unwise to plan for less than a £½bn shortfall of revenue in 1982/83.

2. I think I ought to make my own view known, however. I believe that the fall in prices will be even greater than the BNOC's commercial judgement suggests. You will recall that in the predictions of the Department of Energy, such as those which appeared in the Electrification Report, the Department always showed a price of oil which was increasing at unbelievably high rates. These forecasts seem to me to deny the inexorable laws of demand as firms invested more and more in processes which were energy-saving.

3. I believe we ought to consider seriously the possibility of a fall well below $30 in 1982/83. We have been caught before by rises in oil prices far above anyone's expectation. I suspect that we are about to witness a fall in prices which again will be sharper than anyone expected.

4. I was confirmed in this view when I discussed the issue with Walter Salomon. He said he also thought there would be a sharp fall in the price of oil which would not be reversed. I believe that the judgement of such a shrewd man as Walter Salomon should command respect; it certainly commands mine.

5. In its essence, this means that we should think in terms of at least £½bn and perhaps £1bn tax relief in 1982/83 being afforded

/by this

by this shortfall in the price of oil. This strongly suggests that we should incline towards other tax reductions nearer to £1bn rather than £1½bn.

AW

23 February 1982 ALAN WALTERS

Prime Minister

(2)

CONFIDENTIAL

PRIME MINISTER

Please copy to the Chancellor
MS

MLS 24/2

BUDGET PRESENTATION

I promised you a note on the above subject.

- The first point, bearing in mind previous occasions, is for the Chancellor to get off to a good start and to avoid words which offer the Opposition a horselaugh. Those behind him will be willing him to do well - they are now beginning to feel the need for him to do so - and it is very important we scrutinise very closely the first 2-3 pages for traps.

- Second, and as an extension of this, he needs the sort of opening which perks up his supporters and rocks back the Opposition. Norman Tebbit did this very effectively by quoting Benn extensively in the Second Reading of the Employment Bill. In short, the Chancellor needs, if he can, to stamp his dominance on the occasion at the outset or very early on.

- Third, he needs to control the presentation of his Budget. How does the Government want the overall Budget to be seen? And how can that overview best be conveyed in simple, pithy terms? Thus what we need is a catchword. NB: In devising one, we must try to avoid words like "recovery" which now almost invites ridicule.

- Fourth- and this is the point you mentioned - some goodies should be thrown in first and early. But the reason for doing this is not simply to condition radio or tv commentators and the listening audience; or for that matter to get the most positive evening newspaper headlines; it is also necessary to help the Backbenchers who need to be fed the ammunition with which to dominate the other side. Nothing, apart from downright opposition, is more damaging to wider media presentation than for the Chancellor to be received in silence or sullenly by his own side.

- Fifth, it is highly desirable that the facts and arguments should be presented simply and in plain English without jargon. This is important not merely because of the radio audience but because it minimises opportunities for Opposition ridicule.

- Sixth, some light and shade ~~is~~ are much needed. But this is merely another way of saying that this is a most important Budget for both the Chancellor and the Government, and the better the performance and presentation the better the product will be regarded.

- Seventh - and finally - the peroration requires the closest attention for it is in these last few paragraphs the Chancellor needs to bring people back to:

  - theme; catchword;
  - overall objective;
  - hope and reward for perseverence;
  - Government determination to see it through, confident that in spite of all the siren voices it is right to be steadfast

Such a presentational plan does, of course, dictate the structure of the speech. It therefore should be agreed before drafting begins.

It might also be helpful, taking account of the need for tight security, if a limited number of us could, at the appropriate time, have an opportunity to contribute to its presentation. If the broad approach set out above is agreed and followed the needs of security and presentation could perhaps be met by a session on the Sunday or Monday before the Budget. The fateful time for leaks will be the end of the preceding week when the Sunday newspapers will be pulling out all the stops.

B. INGHAM

23 February 1982

CONFIDENTIAL

CAW Prime Minister (2)

MCS 23/2

BOARD OF INLAND REVENUE

THE BOARD ROOM
INLAND REVENUE
SOMERSET HOUSE

C D Wass

Chancellor. I am very worried indeed about these proposals – and that they seem to have got so far without any reference to you. The whole seems insubstantially justified – MT

22 February 1982

Private Secretary to the Chancellor

INTERNATIONAL TAX AVOIDANCE: SUNDAY EXPRESS ARTICLE
21 FEBRUARY 1982

... 1. This article (copy attached) gives a one-sided and somewhat hysterical account of proposals which arose out of a general review of the increased scope for international tax avoidance since the abolition of exchange control. It deliberately ignores the underlying objectives of these proposals (although these have been clearly stated and accepted - at least in principle - by many representative bodies and other interested parties).

2. However, it is fair to say that there is widespread concern about the detailed implications of the proposed legislation. For this reason, it was agreed at a recent meeting with the Financial Secretary and the Economic Secretary that the legislation should not be introduced in this year's Finance Bill but should be deferred for a year, to allow further public examination of the proposals. A recommendation to this effect will be made to the Chancellor.

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cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (L)
Economic Secretary
Sir Douglas Wass
Mr Douglas French
Mr Battishill
Mr Lavelle
Mr Gordon
Mr Robson
Mr Reed
Mr Perfect
Sir Lawrence Airey
Mr Dalton
Mr Rogers
Mr Taylor Thompson
Mr Pollard
Mr Keith
Mr D A Jones
Mr Hunter
Mr Fairley
Mr Munro
Mr Dunbar

CONFIDENTIAL

Background to the proposals

3. There is much past history on these proposals, but briefly the background is as follows. Although the proposals are presented as a complete package, each is largely self-contained and to some extent raises different issues. If enacted in their present form they would:-

i. Abolish Section 482 of the Taxes Act (which imposes criminal penalties on the emigration of companies, and certain other transactions, without Treasury consent). It is widely accepted that such a provision is inappropriate in a climate of free exchanges.

ii. Introduce new criteria, more in keeping with present-day commercial reality, for determining whether or not a company is resident here for tax purposes. The emphasis would be placed on where a company's business as a whole is managed rather than where a company's affairs are controlled. We have been concerned for some time that the present rules are unsatisfactory. Without the protection of Section 482, UK companies could artificially contrive non-residence in order to secure a tax advantage. Moreover, there are other ways in which the rules can be exploited against which Section 482 provides no defence.

iii. Impose a new charge on UK companies which accumulate surplus overseas profits and income in tax haven 'money box' companies in order to avoid UK tax. In recent years UK groups have made increasing use of such companies and the abolition of exchange control clearly increases the scope for arrangements of this sort.

iv. Remove the present tax advantages available where UK-owned overseas companies remit profits in the form of an 'upstream loan' instead of a dividend.

4. In attacking the proposals, the writer of the article rests his case on three main contentions. In the first place, a satisfactory case has not been made out for the proposals. In

particular, no estimates have been published of the amount of tax at stake. Secondly, in preparing the draft legislation, the Revenue has totally ignored the representations made during the earlier period of consultation. Finally, the proposals would, if enacted in their present form, have disastrous consequences not only for businesses but for the economy as a whole. In particular, they would reimpose exchange controls by the back door and jeopardise the UK's position as a major international financial centre.

Justification for the proposals

5. The proposals to abolish Section 482 (about which there is little argument) and to redefine company residence need to be considered separately. Despite the claims made in the article, many representative bodies now acknowledge that the present company residence law is unsatisfactory and could be exploited if Section 482 were to be repealed. The main reason for the continuing opposition to this proposal is the inevitable uncertainty inherent in any change in the law. The revenue lost through current exploitation is probably relatively insignificant.

6. On the other hand the tax havens and upstream loans proposals are directed at specific avoidance arrangements which UK companies are increasingly utilising. Section 482 and other anti-avoidance provisions in the Taxes Acts are no defence against such avoidance. By its very nature, such avoidance is difficult to quantify, but isolated cases we have seen indicate that substantial amounts of tax are at stake.

Previous representations

7. The article implies that previous representations were unanimous in their opposition to these proposals, but that the objections made were rejected out of hand. This is quite untrue, particularly as regards the proposals on tax haven companies. A full report on the outcome of the first round of consultations was made to Ministers and, in the light of these comments, a number of important changes were made to the proposals.

Likely consequences of the proposals

8. The predictions of the disastrous consequences of the proposals are at best exaggerated and at worst nonsensical. Thus, it is claimed that to tax unremitted overseas income would be contrary to the policies underlying the abolition of exchange control. But the aim of abolishing exchange control was to give UK residents the freedom to choose where to invest, and how to finance such investment thereby allowing companies to earn the best possible return on their capital and so to make the best possible contribution to the national income. The accumulation of income in tax haven 'money box' companies makes no contribution to the national income, but instead leads to a substantial loss of revenue.

9. Similarly, the proposals would not automatically deny to UK companies the benefit of overseas tax incentives, but would only apply where such companies then banked their increased profits in tax havens instead of repatriating them.

10. The claim that our invisible earnings would be damaged because foreign companies based in this country would be frightened away is presumably directed at the possibility that such companies might, under the proposed definition of company residence, be regarded as resident here. In general, we believe that the vast majority of companies, whether resident here now or trading here as non-residents, would not be affected. It is by no means clear that the proposals would have the effect claimed and, even if they did, that this would drive such companies away.

11. Finally, the assertion that the proposed legislation would confer on the Revenue unprecedented powers to obtain information from companies is plainly wrong. Such powers already exist for Section 485 of the Taxes Act (transfer pricing) and in general have attracted relatively little criticism.

Robin Dyall

pp. M A Keith
Assistant Secretary

(p. 25)

THE SUNDAY EXPRESS February 21 1982

City notebook by KENNETH FLEET

THE TAX BOMB IN THE BUDGET IN-TRAY

A DANGEROUS bomb is ticking away in the Chancellor of the Exchequer's office.

Encased in a yellow cover, it is timed to explode on Budget Day, March 9. If it does go off the damage from fall-out in the City of London and the international reaches of British industry, will be extensive and irreparable.

There are signs that those who planted it, the Board of Inland Revenue, are now themselves shocked at what they have done. They may agree to defuse it.

They had better. For should it go off, their master, Sir Geoffrey Howe, probably deceived by the device's innocent appearance, will be left with more than egg on his face.

If I tell you that the Inland Revenue's misguided plot is code-named "International Tax Avoidance I Company Residence II Tax Havens and the Corporate Sector III Upstream Loans" you may show a flicker of interest in tax havens and then turn off the light and go back to sleep.

If I tell you that the Revenue is effectively seeking

● To reimpose through the tax system exchange controls the same Sir Geoffrey Howe bravely abolished in October 1979;

● To remove from British companies operating abroad tax incentives given them by the countries where they trade;

● To reduce and inhibit the overseas business of British banks;

● To strike terror into the pocket of every expatriate and foreigner with a bank deposit;

● To encourage foreign-owned companies to abandon both the City (still the world's leading international financial centre) and the United Kingdom as the effective centre of their operations;

Sir Lawrence Airey: Inland Revenue Chairman

● To cut at a stroke this country's important "invisible" earnings;

● To plunge the tax system into years of confusion and uncertainty;

● And to take onto itself breathtaking powers of investigation into every British company's every book → the sort of powers the U.S. Congress specifically refused the U.S. Internal Revenue Service: then perhaps you will have another cup of tea and bear with me for a few bars.

The Inland Revenue, of course, has a case when it comes to tax havens. It is not an open-and-shut case but no tax inspector worth his professional salt can possibly resist the challenge of those who seek to avoid or evade paying what the inspector believes are their dues.

The Revenue knows it can rely on the moral support, much of it bogus, of those who resent others "getting away" with anything, even though it may be legal. And the Revenue is currently in a very strong position vis-à-vis the majority party in the Commons.

Some of the Tory MPs who actually comprehend taxation—Peter Rees (now at the Department of Trade) and Tom Benyon, for instance—have been liberally tarred with the brush of Rossminster, past masters of tax avoidance schemes. They might find it awkward even to open their mouths.

Nonetheless, the Revenue is pushing its luck in wanting to overturn all the rules which determine a company's residence and therefore where it is liable to pay tax—rules, I might add, painfully arrived at over the years.

I said at the beginning that if the Revenue has its way, it will have brought back a large measure of exchange control through the back door of Somerset House. I suspect that its first thought was to change the residence rules to make it easy to police tax havens.

The price is unacceptable whether expressed as the damage the Revenue's proposals will do to British companies and our invisible earnings, or looked at through the extra taxes the Revenue believes it can rake in. The former is huge, though incalculable, the latter unknown because the Revenue has given no estimates.

In January last year the Revenue issued two consultative documents, one on company residence, the other on tax havens. It invited comments—and it got them, in volumes.

Last November the Revenue responded to the blast in two ways. It showed it had ignored virtually all the counter arguments of industry and the accountancy profession. And it put out its yellow document, containing draft legislation.

Warming to its task, the Revenue also threw in a pernicious set of rules designed to kill the use by British companies of loans made to them by their overseas subsidiaries. And it promised that if the new laws were given the official nod, they would be in the 1982 Finance Bill.

One thing the Revenue may not have reckoned on was such an early Budget (March 9, when Sir Geoffrey would have to make his intentions known). Even without that, the time allowed would have been much too short.

The Revenue is pushing hard for this year because it realises its chances in the 1983 Budget would be slim and thereafter it would have to wait for Tony Benn.

The tax collectors' legitimate professional ambitions and their reading of the political odds are not, in my view, sufficient excuses to disregard the serious objections to these proposals. Nor do they relieve the Revenue of the necessity of properly arguing its case.

The gaps in its evidence are astonishing. It scarcely begins to justify such sweeping changes. It appears to have given no consideration to the broader economic consequences of tax changes of this magnitude. It offers no estimates of future tax yield or the administrative costs of the new régime.

The Revenue, as always, is plausible in its general approach and clever in its detailed draftsmanship. It has a neat way, for example, of not falling foul of all Double Tax Agreements with other countries.

But boil it all down and you are left with a campaign that, if successful, can only make the international business of British companies more costly and less competitive.

In Sir Geoffrey Howe's book, ignorance of the real world should not be a sufficient cause for letting the Revenue run riot.

Stubbs stuck to his ambition

BUDGET CONFIDENTIAL

c AW

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

19 February 1982

Michael Scholar Esq.
Private Secretary
10 Downing Street
LONDON
SW1

Dear Michael

SHARE INCENTIVES SCHEMES

Last summer George Copeman, of Copeman Paterson, wrote to the Prime Minister enclosing a paper on share incentive schemes. The Prime Minister expressed interest in his ideas and, following an exchange of correspondence between Tim Lankaster and Peter Cropper, it was agreed that officials would meet Dr Copeman.

As you know this meeting was held in September. It was attended by officials from the Treasury, Inland Revenue and Department of Employment. Professor Walters also attended. A record of the meeting is attached together with an assessment of Dr Copeman's main proposals.

In the run up to the budget the Chancellor has been examining various proposals in this area. He has considered Dr Copeman's ideas but does not find them attractive. There is no great pressure for them. He does, however, hope to be able to include in the budget some improvement and extension of the arrangements for employee share schemes. Following the measures introduced in the 1980 Finance Bill there has been an encouraging flow of new employee share schemes, with now over 380 schemes set up since the Government took office. The Chancellor feels it right to build on this success rather than introduce fundamental changes of the sort proposed by Dr Copeman.

The Chancellor is writing to the Chairman of the Stock Exchange about the possibility of some relaxation of their rules regarding these schemes. This picks up one of Dr Copeman's points.

Yours ever

Peter

P.S. JENKINS
Private Secretary

GEORGE COPEMAN : PROFIT SHARING

On September 16 Dr George Copeman and Professor Peter Moore gave a presentation on share incentive schemes. The audience included Professor Alan Walters from the Prime Minister's Office, a representative from the Department of Employment, three from the Inland Revenue and seven from the Treasury.

2. Dr Copeman argued that there was greater scope than was generally appreciated for profit sharing schemes ~~which~~ improved employees motivation. Such schemes benefitted employers and shareholders.

3. He saw a need for employees to identify more closely with their company - what he termed 'team enterprise'. He pointed out that only 3.8% of people in the UK directly owned shares. In these circumstances, it is not surprising if employers have little sense of community of interests with companies.

4. He went on to argue that, while wider share ownership was highly desirable, employees had to earn their share by increasing output and productivity. He had devised a scheme to achieve this.

5. On the basis of US evidence, he considered there was a roughly constant split between profits and wages in any industry. If employees could be pursuaded not to take out in wages their "normal" share of any increase in productivity, this would leave more cash for investment in the company. This investment would lead to further increases in productivity and so a virtuous cycle is set up.

6. Dr Copeman's scheme seeks to achieve this by rewarding employees in a mixture of cash and shares for increases in productivity. The element taken in shares represents the wage foregone to enable investment to be increased.

7. He noted that there was no guarantee that a bonus scheme of cash and shares would necessarily increase productivity. If there was no increase in productivity, no bonus was paid. The employees had to deliver before getting the bonus.

8. Dr Copeman gave evidence from the US to demonstrate a link between incentive schemes of this sort and improved company performance. He had introduced his scheme into a number of UK companies but it was too soon to draw firm conclusions about their effect.

9. Dr Copeman made a number of suggestions for Government action against certain obstructions to the widespread introduction of profit sharing schemes. These were :-

i) to end the need for shareholder approval of employee share schemes;

ii) to remove the £1,000 per annum limit on appropriation of tax-relieved shares;

iii) to bring back "vesting". Vesting makes the employees' ability to take up shares dependent on remaining with the firm for a specified number of years.

iv) to review corporation tax in the light of the role it can play in promoting individual employee capital accumulation and related objectives.

10. There have been considered by Treasury and Inland Revenue officials. Detailed comments are in the Annexes to this note. The main conclusions are :-

i) it does appear that the Stock Exchange rules are more restrictive than the Companies Act as regards employee share scheme (See Annex A). It is far from clear that this is actually inhibiting the introduction of schemes. It would be possible to prove the Stock Exchange on this matter if Ministers felt that would be desirable.

ii) this proposal is explored in Annex B. Ministers have been very wary of proposals of this sort which can be characterised as re-introducing substantial share benefits for top executives. The proposal would have significant staff requirements in Revenue to counter possible abuse.

iii) vesting is considered in Annex C. The key point is that "vesting" is already applicable under existing legislation. It is hard to see Dr Copeman's problem here.

iv) the proposals on corporation tax - see Annex D - are not being pressed hard by Dr Copeman. In general they amount to a subsidy for employee share schemes. The cost in terms of corporation tax foregone could be substantial.

11. On proposals (ii), (iii), (iv) above, Copeman ~~is~~ proposing a major structural change to the present framework of profit sharing shcemes. Profit-sharing is at the moment (perhaps surprisingly) bouyant. Inland Revenue are continuing to get a steady and encouraging stream of applications for approval of new schemes from companies. Given that the initial push occurred as long ago as 1978, the market is really holding up remarkably well, and this is something that the Government can rightly take plenty of credit for (the 1980 amendments to the profit sharing legislation look now to have been well judged). However, the system of tax relief for profit sharing is essentially a long-term exercise (invovling, as with share options, periods of up to seven years). Its continued success is likely to depend on companies' perception that it is continuing to keep a reasonably bi-partisan framework. The history of tax relief for employee share schemes in the 1970's has been a pretty scarred one, and companies who operate in this general are are going to look carefully at any changes to the legislation to see whether they are likely to make its general structure more or less long-lasting. Looking in the round at the radical change Copeman is proposing, above, firms may take the view that we are heading back into the "on-off" game that characterised the history of these schemes in the early 1970s and the flood tide of applications for approval of schemes may simply halt.

12. On the same sort of point, but at a slightly different level, Ministers are pressed from time to time to make approved profit sharing schemes more widely available (e.g. in the nationalised industries), but they are under no pressure at present from anywhere else to make the sort of structural change Copeman is proposing (no even to raise the £1000 limit). To implement Copeman's change would require considerable time and expense on the part of both the companies who run schemes and the Revenue. It should be borne in mind that we are still involved in negotiations with companies who are required to change the terms of their schemes by virture of the amendements to the Finance Act 1978 legislation introduced by Finance Act 1980. There is a lot to be said for a period of consolidation.

ANNEX A

<u>Shareholder approval for employee share schemes</u>

As a condition of listing on the Stock Exchange, companies are required to undertake that they will have any employee share scheme, and any material improvement in an existing scheme, approved by shareholders in general meeting.

2. Dr Copeman considered this inhibits the introduction of share schemes as companies may not wish to call general meetings of shareholders, particularly companies who felt under threat of possible takeover.

3. This inhibition is far from self evident. A holder of 10% of the voting shares in a company can call an extra-ordinary general meeting at any time. A company must in any case hold an annual general meeting and this could be used to approve employees share schemes.

4. Having said that, it does appear that the Stock Exchange requirements in this matter are more demanding than the Companies Act. The 1980 Companies Act requires shareholder approval for issues of shares but there is no need for the company to specify the reason for the issue. As a result companies tend to seek authority from shareholders for an issue well ahead of expected need. When the issue is made, the Act requires it to be offered to existing shareholders. This rule does <u>not</u> apply to, inter alia, employee share schemes. This means that, under law, specific shareholder approval of an employee share scheme is not required. This can be taken as an indication of the value of Government places on such schemes.

5. It would be possible to probe the Stock Exchange on their more restrictive requirement. Ministers may consider this worth doing even if the effects of any change are unlikely to be substantial.

Removal of £1000 per annum limit on appropriations of tax-relieved shares

Dr Copeman's proposal is that the current statutory maximum of one thousand pounds' worth of shares in any year of assessment be replaced by a new maximum which would cover tax relief on both shares appropriated under an approved profit sharing scheme and other forms of capital accumulation, including payments to secure a pension. Share acquisitions under an approved scheme which exceeded a certain figure in a particular year would be reported to our Superannuation Funds Office. That Office would review individual cases on ensure that excessive tax relief for "~~capital~~ accumulation" was not being obtained. After a certain time limit the employee could switch his share investment into index-linked savings certificates.

2. Dr Copeman sees this as encouraging job mobility. Employees lose pension rights by changing jobs. Employee share schemes offer such people an alternative way of building up capital for retirement.

3. The first - and probably the most important - point to be made about this is that in all likelihood it would be characterised in some quarters as a means of re-introducing substantial share benefits for top executives; it would very considerably widen the margin between the lowest and highest amounts of share appropriated to different employees within a single firm. This is a point on which Ministers have been up until now very wary.

4. Perhaps the second point to make is that these proposals seem to be a long way from the purpose which tax relief for superannuation is intended to serve. The principle of such relief was considered by the recent Treasury Working Group on Taxation and Savings. Their findings in effect endorsed the view taken at least since the Royal Commission on the Taxation of Profits and Income (1955). The Royal Commission identified superannuation relief as a form of spreading income which was not and could not feasibly be a form of relief generally available. Its justification lay in the fact that the man whose income is derived from retirement and the care of his dependants as a charge upon those earnings. So long as the spreading which is allowed by way of tax relief is controlled so as to serve this purpose only, they felt that superannuation relief was entitled to its place in the system.

5. The principal aim of Copeman's scheme, however it is dressed up, would be to encourage the employee to invest in his firm. In recent years an increasing amount of SFO's effort has been used in supervising the degree to which self-administered pension schemes invest in the company which has set them up, our concern being to ensure that contributions which have been given superannuaton relief should be invested for the purpose of producing pensions. It is not necessarily the case that self-investment is the best way of guranteeing that the administered pension schemes are allowed to invest up to 50% of the scheme monies in the employer's firm. If Copeman's suggestions were accepted it would be very difficult to insist on any limitation on self-investment by pension schemes.

6. Elaborate provisions would be necessary to ensure that tax relief intended for superannuation provision was not used for the member's earlier advantage. This could happen for example through the manipulation of share prices. Alternatively the employee might seek to use his share as a security for a loan. It is also worth noting that the pension benefits Copeman's proposals might ultimately produce would depend on the performance of the shares or the yield of the savings certificates. These could be considerably less than a pension linked to $\frac{2}{3}$ final salary.

7. Copeman's proposals are not explained in enough detail to assess the additional workload which would be involved for SFO, but on almost any reckoning it could be a great deal. He may be under the impression that SFO keep an eye on individuals' tax relieved entitlements under approved pension schemes. They do not. Under the code, limits are imposed on the emerging benefits from approved schemes. Where the scheme is insured, SFO simply satisfy themselves at the outset that the funding is unlikely to produce excessive benefits. Self-administered schemes are required to send SFO periodic acturial reports which are examined for signs of over-funding. In contributory schemes the employee contribution is usually fixed and will be limited by the rules to 15% of remuneration. The employer pays whatever balance is required. The ongoing level of employee contributions during working life does not therefore involve any workload for SFO. In Copeman's soheme however the control would be on the input for every year in respect of which an employee received profit sharing bonus shares in excess of £500. Apparently SFO would be required to ascertain the employee's prospective maximum approvable pension on each occasion, and, after taking account of the emplo er's contributions, notify the employee of the tax relief available to him for htat year. The Inspector would have to be notified about what proportion of the profit sharing appropriation, if any, would be liable to tax.

Very likely the sponsors would insist that the scheme, to be fully effective in securing its purpose, should allow carry forward of unused tax relief, thus necessitating the keeping of running records.

8. All this would be entirely new work, for which the scheme offers no corresponding staff savings. Those who would be most attracted by it would be those for whom further provision for retirement as such has a low priority but who would see in this type of scheme an opportunity of obtaining tax relief for personal investment. Even with limitations written into the legislation to prevent abuse, there would be no gurantee that these would be effective without considerable administrative effort. In terms of the staffing effect, this speaks for itself. Under the present system, policing of the profit-sharing share appropriation limit is a matter for companies and the turstees of share schemes. It is a simple enough operation to involve virtually no staffing resources.

ANNEX C

Bringing back "vesting"

1. Copeman proposes that the concept of "vesting" be introduced into the approved scheme legislation; the form suggested being that of share forfeiture if employment terminates before a certain period of service (5 years?) has been completed. His aim is to reassure companies that an employee will not leave and take his shares after only a short period of service.

2. The main point to make about this is that the general concept of "vesting" is already freely applicable under the legislation introduced in 1980 by this Government giving tax relief for savings-related share option schemes. Copeman's proposals focus on the profit-sharing legislation (the framework for which was set up in 1978), but it is perfectly possible for a firm to run both a profit-sharing and a share otpion scheme. If the firm wants to start giving a new employee a stake right from the start, without the risk of him absconding with his shares in a short period of time, this is possible under the share option legislation. The share option legislation is proving attractive to companies.

3. Even under profit sharing schemes, there is no bar to admitting employees new to the firm. (As a minimum, a scheme has to encompass all employees in the firm with more than five years' service, but that is only a minimum.) The reasons for a vesting provision advanced by Copeman seem to be relevant really only for small private companies. Such companies are laready able to achieve under profit-sharing schemes what Copeman is seeking by having a provision in their Articles requiring employees to serve a transfer notice on termination of employment.

4. Finally, Copeman implies that the introduction of vesting would be a simple matter - a new clause, with the basic rules remaining the same. This is not so. The current legislation is drawn in terms of the participant, subject to the terms of a contract between him and the company, being absolutely entitled to the shares held by the trustees from the time of appropriation. Vesting would alter that relationship to render the employee's interest contingent and this contingency would presumably extend to the cash and new shares, etc, resulting from capital reorganisations. Because of the trustees' increased interest in the shares the administration of the schemes would be more difficult rather than less.

Review corporation tax for the role it can play

Dr Copeman's specific proposals are :

(i) there should be a maximum percentage of taxable profits available for capital allowances and stock reliefs in any year; the balance should be taxed;

(ii) the tax scale should be graduated from 40% up to ay 64% according to the size of consolidated profits of the ultimate controlling company;

(iii) the specific, chargeable company should have relief of a few percentage points on the tax scale for each and any of the following :

(a) having a share quotation, thereby creating a market measure of share value and general access to the company's shares;

(b) having approved share scheme facilities, operated on a significant minimum scale (e.g. an average issue or purchase of no less than one-half of 1% of share capital per annum;

(c) acquiring at least half the employees' shares by purchase rather than new issue - as a guard against takeover bids;

(d) reducing the size of disclosure unit until it coincides with the pay determining unit.

2. It was clear from Dr Copeman's comments at the seminar that he regards these proposals as the icing on the cake.

3. His first proposal for a "maximum percentage" seems to be borne of expediency (it ensure that all companies have sufficient taxable capacity to make sue of the new tax reliefs which he goes on to propose). It does not have any obvious basis in principle. On what grounds of accountancy practice, equity or economic welfare would we base the rule that (say) a company that has invested £10m in machinery should get the same depreciation allowances as the company that (with the same equity capital) has invested £5m?

4. The proposal for a graduated rate of corporation tax has been considered already - and rejected ~~- by Ministers~~. However, it is being looked at again in the forthcoming Green Paper.

5. Third, Copeman's four specific tax reliefs - for companies getting a market quotation etc etc - meet the familiar objections to any special tax privilege for matters which are unconnected with the company's own taxable capacity. They are, in effect, a deliberate Government subsidy, designed to induce companies to offer particular kinds of share incentive schemes. As such, they should in principle be tested for cost-effectiveness in the same rigorous way as proposals for additional public expenditure. On the fact of it, it seems possible to us that the corporation tax cost of the proposals - up to 12 points on the rate of tax - could in certain cases be equivalent to a very large proportion - if not the whole amount - of the cost of the share incentive scheme to the company.

SECRET and PERSONAL

Prime Minister
For Monday's meeting at 1115.
MCS 19/2

5

Prime Minister

MT.

Budget Arithmetic!

£m. PSBR Cost (incl second round effects)

	1982/3 Low	1982/3 High alt	1983/4 Low	1983/4 High alt
Duties (already agreed)	290		200	
1% NIS from August	450*		670+	
OR 1½		675**		1,000++
Corp tax (52% to 50%)	90		190	
RookerWise +1%	100		90	450
—— +5%		500		
OR				
Other [Elec 100, Gas 100, Constn 170, CTT 40]	460		630	
Low	1390	2015	1780	2450
Low with RW+5%.	1790		2140	
Low with 1½% NIS	1615		2110	

* Gross cost £625 m
\+ ——— £1,250

** Gross cost £935 m
++ ——— £1,875 m

JFF70/71 CONFIDENTIAL Econ Pol

Prime Minister (2)

MLS 19/2

See paras 10 & 11.

PA MLS 24/2

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
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Secretary of State for Industry

18 February 1982

The Rt Hon Sir Geoffrey Howe QC, MP
Chancellor of the Exchequer
Parliament Street
LONDON
SW1P 3HE

Dear Chancellor

1982 BUDGET

Forgive me for raising two further Budget issues with you further to my letters of 11 December and 26 January, but I think they are important.

2. First the Loan Guarantee Scheme. John MacGregor has only just begun his first, inevitably very interim, review with the banks. In the course of this we have considered the suggestion put forward by the Parliamentary Industry Committee's Study Group on bank lending and raised again at the Prime Minister's meeting last week with Michael Grylls and others of the Industry Committee that the present ceiling of £75,000 on individual loans should be raised substantially, say to £250,000 or £500,000 as they advocate. I do not think that the case for this is made out. The average size of loan guaranteed under the Scheme is only £34,000. Less than 20 percent of loans have been at the £75,000 limit and many of these form part of a larger package comprising commercial loans, equity and overdrafts.

3. The £75,000 ceiling was aimed to cover the small end of the market where we saw a specific need for Government support. Most of the private sector organisations such as the Venture and Development Capital Companies are only interested in larger investments where their administration costs are proportionately less. We would therefore be changing the whole nature of the Scheme and opening it up to many larger businesses, possibly to the detriment of the smaller ones that have benefitted hitherto. Moreover there is already very considerable demand for the Scheme as it stands, so enlarging the scope could mean a very considerable increase of its size or, if we were not prepared to contemplate such a pro rata increase, a possible need for rationing. There are also some aspects of the present Scheme which may in the light of further experience be shown to need

alteration. It would be better to await a more considered review before simply extending the Scheme in its present form by such an increase in ceiling.

4. However I do feel that we will have to take decisions soon about the present ceiling of £150m, which was originally announced for a 3 year pilot scheme. By the end of January, 2,325 guarantees had been issued in respect of £80.1m of bank lending, 80 percent covered by guarantee. In October last year you agreed that the ceiling for the first year of the Scheme should be raised to £100m. At the present rate this will be exhausted before the end of March. If the remaining £50m were to be made available then, it also would have run out by the end of July on present trends. I do not believe that we should wind up this Scheme after only 14 months. I think that now is the time to consider the financial provision necessary for the second year of the Scheme, ie to the end of May 1983.

5. I believe that we have sufficient evidence on the Scheme for you to announce in your Budget Statement that guarantees will be issued at the current rate for another year. The rate of lending has been increasing and I consider that an additional £150m of bank lending (£120m of which would be guaranteed) should be the figure you announce. Unless the economy picks up rapidly, this should be sufficient to cover the greater part of the second year.

6. We must, of course, satisfy ourselves that the objectives of the Scheme are being met and that it is not being mis-used. As I said in my letter to you of 30 September 1981, some important aspects of the Scheme (eg the loss rate) are not susceptible to early review, and will in any case be influenced over time by movements in the economy and in interest rates. John MacGregor has put in hand arrangements for monitoring the Scheme, in conjunction with the London and Scottish Clearing Banks and ICFC. My officials have discussed these with yours. The monitoring exercise is to include a continuing analysis of the statistics and of cohort samples of individual loans, involving contact with the borrower and his bank. John MacGregor has held a meeting with the banks to secure their cooperation. I hope to have the result of the initial survey by early June. At that stage I shall want to consider with you and other colleagues how the Scheme has been shown to have been operating and what changes in its terms and conditions might be desirable.

7. John MacGregor has also had a preliminary discussion with the banks about their views on the Scheme. There was general agreement that the Scheme was on the whole working well and the

banks declared themselves satisfied that the vast majority of loans under the Scheme were genuinely additional to that they might have done in any case. Clearly we will need to test this as part of the monitoring exercise.

8. I suggest that any announcement should therefore be confined to the increase in the ceiling ~~of~~ to £300m and should state at the same time that we are keeping open the possibility that, as the result of the current review, we might see the need to change some features of the Scheme when the first tranche is used up. Our current agreements with the banks relate to a pilot Scheme of £150m, and I think that if we wish, we could change some of the terms before issuing any further guarantees, although it has to be recognised that this would require fresh negotiations with the Clearing Banks. The question of raising the £75,000 ceiling could be considered again then.

9. An increase of this size in the ceiling for the Scheme would mean that we should need to seek an increase in the overall limit for assistance under Section 8 of the Industry Act 1972. This would require further legislation, but an announcement in the Budget about the Loan Guarantee Scheme would provide a good opportunity for stating our intention to raise the Section 8 limit. We hope to put a paper to E(EA) shortly on this point.

10. The second issue is the Business Start-Up Scheme. I have already suggested to you that the individual investment limit should be raised perhaps to £20,000. I also suggested that further consideration be given to reducing the restrictions which surround the Scheme.

11. Since then there have been two further developments; first, the Parliamentary Industry Committee at the same meeting with the Prime Minister argued strongly that the Scheme needed revision if there was to be substantial take-up, and the Prime Minister responded positively to them; second, we are now beginning to get firmer feedback from major accountancy firms, financial institutions and so on about the extent of the take-up of the Scheme so far, and this tends to confirm the view that it will be very limited indeed this year. In view of the substantial political capital which you and many of us have invested in the Scheme, this is disturbing and I now believe that more needs to be done in the Budget to redress this position.

12. I have the following suggestions to make:-

a. I believe that consideration should be given to raising the limit to £25,000 or even possibly £50,000. This may be necessary to attract sufficient individual investors investing directly; without an incentive on this scale they may not be willing to contemplate the considerable administrative and legal work in setting up a scheme, as well as the risk; and I have had it argued to me that once a major individual investor comes in others would be prepared to top-up on his assessment. A higher level might also attract in more intermediaries to act as "brokers"; at present there seems to be insufficient scope for them within the Scheme to cover the administrative and other costs of setting up individual arrangements.

b. There have been some criticisms that the Inland Revenue are reluctant to advise on "hypothetical" marginal situations and that this may again deter potential investors. I am sure that inspectors have been instructed to cooperate fully in answering queries and I appreciate, and understand, the reluctance of officials to give categorical advice in advance of an established set of facts. However I do feel that a complex new relief of this nature deserves a rather special approach and I would urge that inspectors be asked to refer any difficult questions to the appropriate technical division and that the clearest possible advice should be given speedily to potential applicants for the relief.

c. Quite apart from the complications and uncertainties, there are particular difficulties in relation to getting schemes off the ground in this current financial year. Effectively the Scheme only came into operation almost half way through the year, and with the inevitable time it takes to locate suitable start-ups and arrange matters, many potential investors are likely to find that they will be unable to claim relief in 1981/2. This is also a particular difficulty for the approved funds, and on present evidence it is likely that only a small porportion of their funds already invested will be eligible for tax relief by the end of the year. This could produce unfavourable publicity at that time, and thus create a further disincentive to potential investors. In order to overcome this, I would like to suggest a facility to carry forward unused relief. This could either be for one year or alternatively it seems to me entirely within the spirit of our intentions that an investor who has not previously had relief should be able to claim the combined relief for all three years of the Scheme in the third year. Should we later decide to extend the Scheme beyond three years, you might wish to consider applying some form of cut-off to the carry-forward facility. But in the meantime I believe it would significantly improve both the effectiveness and reputation of the Scheme.

13. I have set out some rather specific proposals here, but I would also like to reiterate the general point which I made in my letter of 26 January - that British companies are in a weak position to face a difficult future. The latest index of production statistics, which show declining output in the last two months of 1981 indicate how fragile any recovery is. It is, in my view, of the greatest importance that the Budget should as far as possible concentrate on measures which help and strengthen industry, most of all by cutting their costs.

14. I am copying this letter to the Prime Minister, the Lord President, the Secretaries of State for the Environment, Scotland, Wales, Trade, Social Services, Energy and Employment and to Sir Robert Armstrong.

Yours sincerely,

Jonathan Spencer

pp PATRICK JENKIN
(Approved by the Secretary of State and signed in his absence)

19 FEB 1982

PRIME MINISTER

As you know, I have been pressing the Chancellor's office for a written piece on the Budget. This is attached.

I don't suppose that you will wish to go through it all this evening. Most of it can wait for the weekend. But it would be helpful if you could have a look tonight at the section on the specific duties (paragraph 7 and Annex A). There are, so far as I can see, no surprises here.

On the other issues Alan Walters, I know, wants to have a word with you. Perhaps we can arrange a time tomorrow afternoon; or, failing that, giving you the weekend to look at it all, some time early next week.

Agree Annex A – but ask if Chancellor wishes to reconsider any item in view of decisions at yesterday's Cabinet.

MS

MICHAEL SCHOLAR
18 February 1982

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1 extra copy made by MCS on 19/2, for Alan Walters.

PRIME MINISTER

THE FORTHCOMING BUDGET

We have spoken about progress on the Budget. This minute sets out in more detail how matters now stand.

General

2. The general thrust of the Budget will be to maintain progress on reducing inflation and improving the health of the economy. At this point in time I think it right to place the main emphasis on the need to help businesses, and to tackle unemployment; these being twin and not opposed objectives.

Monetary policy

3. The Red book will again contain an updated version of the Medium Term Financial Strategy. The medium term monetary objectives will be expressed not only, as hitherto, in terms of £M3 but also of the wider aggregates generally, as well as M1, and the narrow aggregates. It will explain how, as has been the case over the past year, we shall take the exchange rate into account in assessing monetary conditions. The precise ranges to be shown for the aggregates are not yet settled, but they will probably be fixed as 8 - 12 per cent for 1982-83, with declining ranges for subsequent years. I shall explain the reasons why £M3 has grown rather faster than we expected and why, as a result, the ranges, though higher than in the last MTFS, do not imply a loosening of monetary conditions.

Fiscal stance

4. As you know, I have it in mind to look for a PSBR for 1982-83 of about £9½ billion. This compares with a figure of £10½ billion for the current year, and one of £9 billion for 1982-83 which I gave in last year's MTFS. For 1983-84 I shall tentatively be looking for a PSBR of around £8½ billion, as compared with the

figure of £6½ billion envisaged for that year in the last MTFS. These figures, though, like the monetary figures, higher than in the old MTFS, still imply a fiscal tightening over the period covered.

5. A PSBR of £9½ billion for 1982-83 will enable me, after making allowance for uncertainties, notably on oil, to announce tax reductions having a PSBR effect in 1982-83 of around £1.5 billion, or perhaps a little higher, and in 1983-84 of around £2 billion. The figures I shall present on 9 March, and emphasise in my speech, will of course be the full year ~~revenue~~ costs, which will be considerably higher.

Detailed proposals

6. The following are the principal elements in the package.

7. On the specific duties I have, as you know, analysed the RPI effects, and envisage something a little less than full revalorisation in line with 12 per cent (past) inflation. Annex A sets out my proposals, and how they compare with full revalorisation. The largest shortfall is on petrol, which seems to me right on industrial and regional grounds. The PSBR cost of the total package - compared to full revalorisation - in 1982-83 is £290 million, and in 1983-84 £200 million.

8. The largest element of direct help to industry will be a cut in the national insurance surcharge of either 1 per cent - costing £450 million in 1982-83 and £670 million in 1983-84 - or 1½ per cent - costing £675 million in 1982-83 and £1,000 million in 1983-84. If we go for the former, it might be coupled with a 2 per cent cut in corporation tax, costing £90 million in 1982-83 and £190 million in 1983-84. I am clear, as you know, that an NIS cut is right, and will be widely welcomed. But decision on its precise scale cannot be taken in isolation from decisions on personal taxes.

9. On personal taxes, we must certainly increase all the income

tax allowances - and higher rate thresholds - by 12 per cent, in accordance with the "Rooker-Wise" legislation. We can in fact go rather further, but I am at present undecided whether to stop at 13 per cent, 15 per cent, or 17 per cent. The additional costs, over Rooker-Wise, are some £100 million a point. I have noted your views on mortgage interest relief ceiling, and will minute separately to you about that, and about stamp duty.

10. I also envisage a miscellany of additional measures, largely for industry. Work on them is still proceeding, but the present picture is shown at Annex B. They are individually small, but they do I think add up to an impressive list which should help with the presentation of the Budget as one aimed to help business.

11. I propose also to put forward fresh ideas on unemployment. We have spoken about the concept of a "community work scheme" under which jobs would be provided at Government expense by public authorities and others, paying only the social security benefit rate plus a small premium. The trade unions might not like this, but I think they would find it hard to block it; and it would be consistent with the need to break up the rigidity of the labour market and get people to accept jobs at realistic rates of pay. I propose also to refer, more neutrally, to the possibility of a scheme whereby employers would be paid a premium to take on additional people in the lower-paid range - in its way an extension of the young persons' scheme which you announced to the House last summer.

Summary

12. My present judgement is that we cannot prudently afford to go to the top of the range of possibilities mentioned in paragraphs 8 and 9 above, i.e. 1½ per cent off NIS, 2 per cent off corporation tax, and 17 per cent on personal allowances. The costs of my proposals on the specific duties and the additional measures (paragraphs 7 and 10) amount to some £750 million: for the remaining £750 million (or perhaps a little more) we need to consider the balance to be struck between direct help for business, and raising the personal tax thresholds.

13. My present inclination is to concentrate these marginal reliefs on business. The latest output figures; the need to be seen to act on unemployment; and the political case for aiming to help individuals in the 1983 Budget, all point this way. The last factor is of course relevant to the overall size of the package: if we try to do too much this year, we would face the prospect of publishing in the MTFS the prospect of a negative "fiscal adjustment" for 1983-84.

14. You may wish to discuss this with me. For administrative reasons I need to go firm this weekend on the specific duties, and it would therefore be very helpful if during the course of tomorrow you could confirm that you are content with the proposals in paragraph 7, and Annex A, even though you may wish to leave the other matters till later.

G.H.

18 February 1982

ANNEX A

APPROXIMATE PRICE EFFECTS (INCLUDING VAT) OF PROPOSED CHARGES

	Proposal	(Full re-valorisation)
Beer	2p/pint	(2p)
Spirits	30p/bottle	(50p)
Wine	10p/bottle	(10p)
Tobacco	5p/pkt 20	(7p)
Petrol	5p/gall	(9p)
Derv	5p/gall	(9p)
VED	£10	(£10)

ANNEX B

Subject		Revenue cost ranges (£m) 1982-83	1983-84
1. Enterprise package		40	75
2. Industrial innovation		20	40
3. Construction package		170	72
4. Energy		213	214
5. Measures on social front		10	16
6. Capital taxes	CTT	30-45	85-125
	CGT	Nil	100
7. North Sea regime		Nil	70
		483-498	672-712
Of which scored against existing Contingency Reserve (Item 2 and part of Item 4)		33	54
		450-465	618-658
Say		460	630

MR. SCHOLAR

I am going to a meeting at the Treasury at 2.45 this afternoon which will discuss the issue raised in the enclosed note. I do not know which way the decision will go, but I am very keen on lifting the thresholds and would like the Prime Minister to see the enclosed note before she meets the Chancellor this evening.

AW

18 February 1982

ALAN WALTERS

MS

5. It may be argued, per contra, that the best way of tackling the "Why Work?" problem is to reduce the benefit levels. Or at least avoid indexing those levels to the rate of inflation. But granted that politically one cannot do that, then one must take the benefit levels as given and adjust the tax system so it does not produce these considerable disincentives. Rooker-Wise plus 5% would bring the main thresholds in real terms back to where they were in 1978/79.

POLITICAL CONSIDERATIONS

6. One of the arguments for not increasing the thresholds above the Rooker-Wise plus 1% is that there has been no pressure for it, compared with the enormous CBI etc pressure which has been exerted on behalf of the nationalised and private industries. I think this is true. But the perception of the increase in tax thresholds will be very much more widespread than the change in the NIS. Furthermore, you will be able to present this Budget as a measure which has a very strong "caring" element. It will take many people at the lower end of the income scale out of the tax net and give them incentive to work again.

7. Both measures have a positive effect in increasing employment. The thresholds measure will have more effect at the lower end, whereas the NIS measure will be fairly wide-ranging - including nationalised industries, etc. As far as I can judge, from Minford's work and other publications, the actual number of jobs created in both cases would be about the same per million pounds PSBR cost.

CONCLUSION

8. I believe that now we have a little more leeway, the case for going to Rooker-Wise plus 5% is very strong. We can at the same time afford a 1% reduction from August in the NIS. While I agree that a 1½% increase in NIS, at the cost of reduced thresholds, would go a way towards satisfying the industry lobby, I believe that the cost, social, economic and political, of not taking this opportunity to raise the thresholds would be much larger than the benefit to industry of the ½%.

AW

18 February 1982

ALAN WALTERS

18 February 1982

ALAN WALTERS

PRIME MINISTER

MT

BUDGET

PSBR AND TAX REDUCTIONS 1982/83

1. The present estimates suggest that if we aim for a £9bn PSBR in 1982/83 we shall have about £1½bn net tax reductions available this year. This gives a little more leeway than I reported in my memorandum of 10 February.

NIS VERSUS INCOME TAX THRESHOLDS

2. Nevertheless the issue remains the same as I mentioned in my memo of 10 February. The contrast now is between having a 1½% reduction in NIS together with Rooker-Wise plus 1%, or a 1% reduction in NIS and Rooker-Wise plus 5%.

3. The pressure for the 1½% NIS and only 1% more than Rooker-Wise is considerable. Terry Burns has argued the case strongly on the grounds of redressing the balance between the personal and corporate sector and of course, reducing labour costs. (I am doubtful about the corporate/personal sector balance argument. A fall in the oil price, the rapid reduction in real wages, the increase in productivity and the probable fall in material prices and interest rates should transform the relative balance of the sectors.) There was, as you recall, considerable pressure from colleagues for as big a reduction in NIS as we could afford.

4. I would, however, much prefer that we put as first priority the increase of the income tax thresholds of 5% above Rooker-Wise (ideally I would prefer two Rooker-Wise, which was strongly urged as an absolute priority by Nigel Lawson in the pre-Budget Cabinet meeting). Rooker-Wise plus 5% would bring the basic threshold to the level of the national insurance pension, this is also the subsistence level determined for supplementary benefit purposes. It seems wrong that the state, having increased incomes to this "subsistence level" should then reduce them below that level by imposing tax. The marginal effective rates of tax-cum-benefits at that rate of income are very high indeed.

/5. It may

CONFIDENTIAL

Prime Minister (2) c/c AD

this 18/2

DEPARTMENT OF HEALTH AND SOCIAL SECURITY
ALEXANDER FLEMING HOUSE
ELEPHANT AND CASTLE LONDON SE1 6BY

TELEPHONE 01-407 5522 EXT

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
Treasury Chambers
Great George Street
LONDON SW1

16 February 1982

Dear Geoffrey.

1982 BUDGET

We have discussed the 1982 uprating of social security benefits, and I am writing to you separately about that. The purpose of this letter is to mention a number of other matters relevant to the Budget which have implications in my field.

National Insurance Surcharge

As you know, you would have my strong support if you felt able to offer employers at large a reduction in the national insurance surcharge. A change in rate during a tax year would pose problems for my Department, but I regard these as a small price to pay for the relief to industry that such a reduction would bring. (As you know, the problems arise mainly because of the increased errors which result from having two sets of contribution tables operative in the same year and also from adverse effects on our checking system; the adverse effects are less the further the change is from the middle of the tax year.)

I should be opposed to any move to apply relief from the surcharge selectively, for example by size or type of employer. This would not only seriously complicate the national insurance contribution arrangements, but would also give rise to problems of policing, classification and adjudication, necessitating, at a broad estimate, some 500 extra staff in my Department.

You have, I think, already rejected the idea of preparing alternative sets of tables for employers for issue in the Spring after a decision on surcharge rates. This indeed is a non-runner. Employers - particularly ones with computerised payrolls - insist that they must have the tables eight weeks before the start of the tax year. This means sending the tables out to over a million employers no later than the beginning of February, the alternative being a real risk of serious disruption in pay and deduction arrangements in the first weeks of the tax year.

Tobacco and Alcohol

I hope that in considering duties on alcohol and tobacco you will again take into account the implications for health of smoking and excessive consumption of alcohol.

On tobacco, the increases in duty in March and July last year were welcome to Health Ministers and we are pleased to note that they seem to have led to a fall in cigarette consumption, though I understand that this may not be as great as the industry claim. But cigarettes are still cheaper in real terms than they were when the effects of smoking on health were first fully appreciated in the mid-sixties. I hope, that you will feel able to increase the duty on cigarettes to the extent necessary to ensure that their price at least keeps pace with the movement of prices generally since the last Budget.

These comments apply equally to the duty on hand-rolling tobacco. However, I would not be unduly concerned should you decide not to increase the duty on pipe tobacco and cigars.

As to alcohol, there are many arguments on health and social grounds, put forward by bodies concerned about preventing alcohol misuse, for not allowing the value of duty overall on alcoholic drinks to fall in real terms. These are set out in Chapter IV and VII of 'Drinking Sensibly', the discussion document on alcohol misuse which I published in December last year. Health Ministers could find it difficult to defend the position if the real value of duties on alcoholic drinks were allowed to fall in the coming Budget.

Private Hospital Development

You will remember that, when Patrick Jenkin wrote to you at the beginning of last year about our Manifesto commitment to restore tax relief to employee - employer medical schemes, he noted that our officials had prepared jointly a paper on a request from BUPA for capital allowances to promote hospital building, and that the paper had concluded that there was quite a strong case for making this change. You concluded that it was then more important to make progress directly related to the Manifesto commitment. Now that the commitment has been fulfilled, however, I should like to ask you to consider seriously a further relief of this kind in your forthcoming Budget.

The case for such a concession is, I think a strong one. Although there has been some private building of hospitals and nursing homes in the past year, the prospects are that we still run the risk of a shortfall in supply in future years unless development can be encouraged. Moreover, we want to encourage health authorities to use private facilities. The supply of private facilities needs to be increased to complement expansion of private insurance, and to accommodate NHS use of them.

A tax concession would help to support our general policy of encouraging private care alongside the NHS. We need to look increasingly to commercial rather than charitable bodies for private hospital development; and they are likely to prefer more profitable investments unless the rate of return on hospital development can be improved. A capital allowance would also benefit the construction industry.

E.R.

Patrick was understandably concerned about political difficulties from such a concession. In my view, however, the risk of such difficulties would be much reduced if, as I would like to suggest, we went for the 20 per cent rate of allowance available for hotel building rather than the much higher rate for industrial building. Private hospitals and nursing homes offer many hotel-style amenities, so this would be logical. Its revenue cost should not be too high; the 1980 report estimated that it would rise to around £10 million after a number of years when buildings provided for 1,500 hospital and nursing home beds were being completed each year.

Help for the most vulnerable

A valuable and politically effective part of your earlier budgets was the package of measures which showed concern for disabled people and other vulnerable groups. I hope you will be able to give a further boost to the voluntary bodies helping these people. There is, as you will have seen, a lot of publicity for charities' claim for VAT relief. If there really is no way of overcoming the obstacles in the way of relieving their VAT burden, I hope you will look sympathetically at the idea of some additional financial support for voluntary bodies working in the broad social services field.

The Raison Group is already examining this issue, but I suspect that it would be sensible to relax somewhat the criterion which Treasury colleagues wish to apply, that any growth of voluntary activity that is supported must be in substitution for public services. It should, I believe, be sufficient for them to supplement public services in a valuable way.

I am copying this letter to the Prime Minister, Patrick Jenkin, Jim Prior, George Younger, Nicholas Edwards and Sir Robert Armstrong.

Yours ever,
Norman

NORMAN FOWLER

Econ Pol

CONFIDENTIAL

Prime Minister (2)

AD

SECRETARY OF STATE FOR SCOTLAND

SCOTTISH OFFICE
WHITEHALL, LONDON SW1A 2AU

I am arranging a talk for you with George Younger and Geoffrey Howe this week.

The Rt Hon Sir Geoffrey Howe
Chancellor of the Exchequer
HM Treasury
Whitehall

MCS 15/2

12 February 1982

I would like to follow up ~~on~~ our discussion of general Budget strategy on 28 January by commenting on the points made in Patrick Jenkin's letter to you of 26 January. I am broadly in agreement with the points which Patrick has made: in particular I am persuaded of the priority which cuts in the National Insurance Surcharge should receive in our macroeconomic strategy, and of the need for increased assistance to innovation. But I should like to qualify and supplement them in some respects. My main concern is to add to the points made by Patrick, the need for recognition of the special problems of the Assisted Areas: I think this omission could have serious economic and political consequences.

As you will know from your recent visit here, the situation in West Central Scotland and the Highlands is particularly bleak. Already unemployment rates in Strathclyde are running at just under 18 per cent with male unemployment well over 20 per cent; and the problems are even more acute in North Ayrshire and North Lanarkshire. Although Scottish industry had fared quite well in relative terms during 1980/81, the signs are that this position has not been maintained and a number of serious threats are looming up in the immediate future.

While I very much favoured the principle of concentrating regional aid in the areas most in need, any further steps to reduce the amount of assistance available in these areas at this time would be very damaging. They threaten the process of investment and renewal which is vital to longer-term recovery, and they risk losing important new projects of the type that are urgently required. We need now to do what we can to boost industrial confidence and it would be particularly helpful in this respect if we could abolish the present 4 month period of deferment in the payment of RDGs. The delay contributes to firms' cash flow difficulties and presentationally, is a thoroughly bad adjunct to a system designed to help industry in the regions.

Our experience in Scotland with the various Department of Industry schemes concerned with advanced technology confirms that there is substantial potential which proposals for enhanced assistance could unlock. If we are to regenerate some of our most difficult industrial areas, it is essential that they participate fully in the newer technologies. It seems anomalous, therefore, that in many of the Schemes listed in Patrick Jenkin's letter, promoting developments which are likely to have the most profound long-term effects, there is no preference given to Assisted Areas. And yet the problems of the older industrial areas in developing new products and applying new technologies have emerged as one of the main issues for those of us directly concerned with their development. I suggest that the maximum assistance under MAP, PPDS, and other Science and Technology Schemes, should now be set significantly higher in the Assisted Areas. I believe that an increased emphasis on new technology, on the lines which in Scotland we have already been striving to achieve with the Scottish Development Agency, would help to bring the new growth we need and be seen as an effective response to our regional problem.

I recognise of course that you will have many competing claims for funds even within the field of industrial policy. For my part I fully recognise the importance of the measures taken already to help enterprise and small firms. These are beginning to pay off. But I should not like to see the emphasis on general support for the small firms sector crowd out a response to the need of the assisted areas for further help.

I am copying this letter to those to whom Patrick Jenkin copied his.

Approved by the Secretary of State
and Signed in his Absence

Prime Minister (2)

~~10~~ February 1982

ALAN WALTERS

Tell Alan

MLS 10/2 2

PRIME MINISTER

BUDGET

Oil Price Revisions

1. You will have heard of the revisions for forecast PSBR brought about by revised expectations of lower oil prices. This has reduced our room for manoeuvre by at least £½bn in 1982/83. This suggests that the maximum tax remission we should be aiming for is about £1bn.

2. This sharpens the contrast between the various options which are being considered. In the event that we attempt to hold the PSBR at £9bn, and I think we should, it is likely that there will be direct competition between a 1% national income surcharge reduction and a straight 5% increase in income tax allowances.

Rooker-Wise + 5%

3. I believe there is a much more powerful case for raising the threshold (which would cost £535m in 1982/83) rather than the reduction of NIS 1% from October (which in 1982/83 would cost £425m gross and £1.25bn in 1983/84).

4. I confess that I would ideally prefer two Rooker-Wise to bring us back to the pre-March 1981 condition. But at least the increase of 5% would restore the basic threshold to 1978/79 values and to the level of the national insurance pension which is also the subsistence level determined for supplementary benefits. More important, as Patrick Minford has pointed our so cogently, tax rates at these low levels of income do greatly inflate unemployment. We have dealt with high confiscatory marginal rates of tax at the upper end. We should at least get back to our policy of dealing with them at the low end of the income scale.

NIS

5. The national income surcharge reduction, although of course desirable in itself, should have a much lower priority. Much of it accrues to nationalised industries, public sector bodies, and service industries such as the banks. Some will be clawed back from nationalised industries etc. The Treasury believe they will claw

/back some

back some £75m of the £425m gross revenue cost in 1982/83 and some £450m of the £1,250m cost in 1983/84. Perhaps so, but I doubt it. Money has a habit of disappearing without trace down the public sector drain.

6. Rather than reduce NIS, it would be much better if we reduced interest rates below the level they would otherwise attain. This would benefit industry to the tune of about three-quarters of a billion pounds for each 1%, and at the same time the banks would pay a significant part of this cost, rather than benefit it as they do under the NIS reduction.

Political Considerations

7. There is considerable pressure coming from the CBI and large industrialists (but not IOD) for this reduction in NIS. Indeed there is a widespread expectation that at least some relief is going to be provided. It would be disappointing to industry and to many colleagues who expressed their strong support for a reduction in NIS. It would reduce labour costs by 1% and so increase employment eventually by some 100,000. It can be represented as an element of an "employment budget".

8. On the other hand, a budget which raised the thresholds 5% above Rooker-Wise could be represented very much as a "caring Budget". Not only does this measure assist the poor, but more important it gives the right kind of help. It gives an incentive for those at the bottom of the income ladder to work hard and climb it. It is an incentive not a hand-out. Furthermore, it can be represented as a measure to encourage employment and so part of an employment budget. True it does not reduce directly the cost of labour, but it does restore incentives to work - still a good basis for Tory policy.

9. I suspect that during 1982/83 the recovery will be greater than the Treasury are forecasting. This is likely to mean that the PSBR realised realised over 1982/83 will be considerably less than the one we forecast in March 1982. However, I do not regard this as a good argument for aiming substantially over £9bn. Keeping our sights

/at £9bn

at £9bn will allow us to have stable monetary conditions, lowish interest rates and very considerable room for manoeuvre in the 1983 Budget.

10. Barring disasters, it should then be possible to deliver both a reduction in standard rate, increased thresholds and reductions in excise taxes (ie only partial valorization) which would in turn enable an apparent reduction in inflation to appear in mid-1983. And all this would be no risk to our long term strategy.

AW

10 February 1982 ALAN WALTERS

SECRET

Econ Pol Budget

SECRETARY OF STATE FOR THE ENVIRONMENT

CC AW ~~AD~~ JV

144 (1) 1

2 MARSHAM STREET
LONDON SW1P 3EB

Prime Minister (2)

MLS 5/2

My ref:

Your ref:

5 February 1982

Dear Chancellor of the Exchequer

I have been considering what measures, if taken now, could be expected to provide a decisive boost to the construction industry, particularly to private sector house-building. I shall be setting out in my paper to E Committee the reasons why I believe priority should be given to these sectors, and I was pleased to note the widespread view of colleagues at last Thursday's Cabinet discussion that some early direct stimulation was needed in this area.

The purpose of this letter is to urge you, as strongly as I am able, to see that any resources that are available in the context of the forthcoming budget are used wherever possible directly to stimulate construction. I would like to see special impetus given to industrial development, to housebuilding and to home improvements, including insulation measures. The latter activities in particular are highly labour intensive and attract a good measure of private finance. If we could find a fixed additional sum for private sector improvement and insulation grants I have ascertained that I could allocate the sums in such a way that they would be used specifically and exclusively by local authorities for these programmes under the aegis of a scheme of national importance. I accept, of course, that this would be an additional public expenditure bid for 1982/3 but one that I think is well worth promoting.

The second initiative I would press for is the proposal which Tom King wrote to you about on 29 December, namely encouragement to the intensive efforts that I and other colleagues have been making over the last few years to get enterprise agencies off the ground. There are now over 50 enterprise agencies operating throughout the country, and another 50 in the process of being set up. They are one of the few examples of genuine partnership between the various sides of industry, local authorities, and central government. I believe that we could significantly develop this creative activity if you were able to allow contributions by larger companies to the enterprise agencies to be tax-deductable. This would greatly reinforce the enterprise agencies' drive to start up new firms and expand existing companies.

The third area where early progress could be made is with the introduction of more generous capital allowances for industrial buildings. I believe that such a scheme should operate on a time-limited basis so as to being investment forward. Given the timelag in the building process a 2-year concession would seem appropriate. Last year you increased the allowance for industrial building from 50% to 75%. I should now like to see a full 100% allowance. The cost of so doing would be negligible in the first year and would rise to about £60m in year two. It also seems inequitable to give no allowance for warehousing, servicing and repair and commercial activity which are equally important in generating employment. I imagine that to extend the 100% industrial building allowance to warehousing and so on would cost very little in year one and perhaps £200m in year two. Similarly a 20% allowance for all commercial building would cost around the same amount (£200m). I am also of the view that we should do all we can to encourage industry to modernise its building and I strongly support the case which the construction industry itself has been making for industrial building allowances to be extended to cover refurbishment.

Fourth, and I suspect that this does not require specific action but rather a whole-hearted commendation in the budget speech, I would like to see far moreemphasis given to the benefits of high-gearing public sector programmes for the private sector. I have already launched a new initiative with the 1982/3 derelict land programme and intend to do so shortly with the urban programme; it would be most helpful if you could announce a firm Government commitment to give priority to the promotion of such schemes throughout the public sector. We could invite local authorities and other public bodies to bid for capital allocations on this basis, and give early notice that schemes bid for in this way would begin in 1983/4, which would allow for the further preparation which would be necessary. We could, for example, without in itself prejudicing our public expenditure ceiling, find room to offer (subject to the outcome of our experience in 1982/3) up to £20m of derelict land grant and perhaps £50m of urban programme resources on this basis, which should bring forward significant enhancement from the private sector which up until now has added little to either programme. I shall hope to return to this point in the paper being prepared for E Committee.

Fifth, through not specifically related to housing or construction, I would advocate again the introduction of a tax refund scheme for people setting up their own small businesses. This would operate by way of cash grant which would effectively repay personal tax previously paid by those people who showed they were investing in small business.

Sixth, I also commend for your consideration the attached paper by Michael Grylls' Sub-Group advocating the establishment of a system whereby interest payments of loans for defined industrial projects should be payable net of the corporation tax ultimately deductible in the hands of the borrower.

Seventh, I believe that the scheme recently announced by Chancellor Schmidt, to stimulate capital investment in industry by means of a 110% tax allowance to companies which maintain, or increase by a given percentage, their past level of capital investment, could and should be introduced here. It is very much on the lines that I have discussed with you in the past. Again, a time limit would ensure that investment was brought forward rather than deferred.

Next I turn to housebuilding where I have a number of specific proposals.

Stamp Duty

I have no doubt that you will be looking at the various representations made to you about stamp duty. There is a very considerable body of opinion in the private housebuilding industry which would prefer a significant reduction. If you were considering a wider and significant package for housing and construction, stamp duty changes could play a part. But I do not consider that this should be the major priority, as I believe the more incentive-directed proposals I have made would have more effect in stimulating the capital investment which we all want to see.

If you are thinking of taking action on this measure, my preference would be to concentrate any reduction in the incidence of duty at the lower end of the housing market. It might be sensible to adopt an arrangement whereby successive rates of duty are payable only on that proportion of the purchase price which exceeds the relevant threshold - a "slice" rather than "slab" system.

DLT

I was interested to see the proposals in the Joint Taxation Committee's submission of 26 January for further changes in the incidence and administration of DLT. My officials are consulting the Revenue on the particular points made. I do, however, have particular sympathy with the argument that deemed disposal assessments at the start of new housing projects lead to considerable administrative work both for housebuilders and for the Government, while producing very little revenue.

New housebuilding for rent

There is also an urgent need to stimulate new building for rent. I am persuaded by the very helpful study which your officials and mine have recently made of the private rented sector that we should now take prompt action to provide private landlords, especially the major property and development companies, with an incentive to take advantage of the assured tenancy provisions. The study examined the case for both grants and capital allowances, but I hope we can agree that the latter will be simpler and more effective. It is also the approach which the British Property Federation advocated (in their letter to you of 17 July 1981) as being the most effective means of stimulating building for rent. The BPF sought a 100% first-year allowance, but on the basis of the study I consider a 75% first-year allowance sufficient , with the remaining 25% being spread over the following 5 years. The allowances would need to apply to all income - not just rental income - and also to both corporation taxpayers and income taxpayers. The volume of new building for rent is at present negligible, so an estimate of costs has to rely on assumptions about the likely impact of the incentive. In the first full year it seems probable that no more than 1,000 new homes would be built, rising gradually thereafter - with say, 2,000 in the second year. On this basis, the first year cost would be about £7½ million, and the second year about £15 million.

Home improvement and repair

It is also crucial that we should provide a new impetus to the labour-intensive activities of house improvement and repair. Apart from my proposal about private sector grants for improvement and insulation set out in paragraph 2 above, I do not believe we can, or should, do more at present to assist owner-occupiers. But the private rented sector, which still contains much of our most run-down housing, would greatly benefit from extra investment by landlords in the upkeep of their property.

I therefore further propose that the 75% capital allowance for new build, set against both income and corporation tax, should apply also to conversions and improvements to dwellings that are or will be let. It would not, of course, apply to any grant-aided element of expenditure. The cost would depend on the extent of improvement and conversions done, and on the tax position of the landlords concerned, which will vary greatly. On the basis that half of such work is anyway met by grant, our best estimate of the cost of a 75% capital allowance would be £75-100 million per annum, relating to about £750 million work done.

In addition, I would again propose that costs of repairs and maintenance by landlords should be offset against all income and not only rental income as at present: this would particularly help landlords faced with major repairs and could be achieved at very little extra cost.

You will appreciate that in the time available I have not been able to assess the public expenditure cost of all the schemes I have put forward, or the tax losses which would result. In any event, I believe that the judgements of these orders of magnitude must be for you. But all these proposals could be controlled in a manner that would ensure that progress was made within a given allocation. It must be for you to decide the limit we can afford.

None of the proposals made in this letter need await the longer-term proposals I shall be making in the E paper, a first draft of which should be with you within the next few days.

I am copying this to the Prime Minister, the Secretary of State for Industry, and to the Chief Secretary.

Yours sincerely

[signature]

for MICHAEL HESELTINE

(Letter dictated by the Secretary of State and signed in his absence).

Rt Hon Sir Geoffrey Howe QC MP

4F

MEMORANDUM - 25 JANUARY 1982

From: The Study Group established by Michael Grylls MP (Chairman of the Conservative Parliamentary Backbench Industry Committee).

Terms of Reference: "To examine the terms and conditions of bank lending in Britain and its relationship to industry in general".

Chairman - Sir John King
The Study Group - WG Poeton, BA Baldwin, GT Edwards

It is clear from the Study Group's latest consultations with a number of British industrial managers that, throughout the country, a major improvement in attitudes is being achieved by Government. This improvement relates both to productivity generally and, in particular, to the criteria of internationally competitive products. However, it is also clear that it is essential for a fundamental improvement to be made in the terms and conditions on which funds for industrial investment are made available by banks and other lending institutions. This would provide the necessary encouragement to industrialists, establish a new confidence in the financial system and a stimulus to create an investment led rather than a demand/import led recovery.

Certain papers have been produced by lending institutions, following the publication of the Study Group's initial report. These papers have not been able to disprove the fact, which is at the heart of our fundamental problem, that the real return required on loan funded projects in Britain is so high as to exclude many private sector investment projects which, if pursued, might add considerably to new output and jobs. In its contribution to the Study Group's researches, the Committee of London Clearing Banks indicated that the average period of outstanding term bank loans in Britain is somewhat under two years - this implies an original liability of four years on average. A four year loan at 16% requires an annual cash cost of 36% to fund repayment and interest.

After wider discussions of the initial report with Treasury and Department of Industry officials, the Study Group has refined its principal proposal which is now as follows:

- Medium to long term loan interest payable on funds for defined industrial projects should be paid net of corporation tax by the industrial borrower and the interest so paid would not rank for relief for corporation tax purposes.

  The lending institutions, and not the Treasury, would carry the cost of the corporation tax deduction by borrowers until such time as each institution settles its own corporation tax liability for the accounting period concerned.

Addressing last Tuesday's meeting of the Backbench Industry Committee the Chairman of National Westminster Bank stated that this amended proposal was a reasonable burden for the banks to carry.

The effect on industrial funding considerations could well be dramatic by halving to single figures the immediate interest cost on loans for five years and upwards, thus creating a significant boost to cash flow projections. This would enable, for example, an industrial investment with an estimated 25% return to be financed effectively over a seven year period.

It is important to appreciate that the proposal, as now amended, does not result in any cost to the Exchequer in the forthcoming fiscal year. For example, payments of interest net of corporation tax by industrial borrowers in 1982 would not result in offsetting tax credits being claimed by the lending institutions until they settle their 1982 corporation tax liabilities, probably about January 1984. At the same time those investing companies, utilising the proposed loan finance and having taxable profits, would be paying additional corporation tax as a result of not obtaining corporation tax relief on the interest payable when calculating their taxable profit.

However, as far as "tax exhausted" investing companies are concerned, although currently they are able to obtain the benefit of "unusable tax allowances" on individual items of new plant by leasing such plant, they do not obtain any tax relief at the present time on borrowings for funding project development, design expenditure and the working capital to support the utilisation of the leased plant. The proposal would give these industrial borrowers full corporation tax relief on the cost of such funds for new projects. This relief would be received some eighteen months ahead of the time at which it would be necessary for the Exchequer to meet the cost of the tax credits due to the lending institutions (as set out above) on these particular borrowings without any matching, additional corporation tax being paid by the "tax exhausted" borrowers.

The measure of this limited cost to the Exchequer would be directly related to the degree of success of the proposal. Furthermore, the period of time, which must elapse before any cost has to be met, will allow the invested funds to create new output and jobs which in turn should generate an increase of revenue. Potentially, the full implementation of the proposal offers a profitable return to the Exchequer.

CONFIDENTIAL

Econ Pol
Budget

Econ Pol

Lee AH

10 DOWNING STREET

From the Principal Private Secretary

SIR ROBERT ARMSTRONG

I have shown the Prime Minister your minute A07304 of 1 February 1982 about the article in The Economist of 30 January about last Thursday's Cabinet discussion of economic policy, and she agrees that there is no point in having a leak inquiry.

FERW.

2 February 1982

CONFIDENTIAL

AH

NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY AT 3 P.M. ON TUESDAY, 2ND FEBRUARY, 1982

Present:-

Chancellor of the Exchequer	Sir Raymond Pennock)
Financial Secretary	Sir Terence Beckett)
Mr. Ryrie	Sir Donald MacDougall)
Mr. Burns	Mr. D.R. Glynn) C.B.I.
Mr. Quinlan	Mr. R. Utiger)
Mr. Battishill	Mr. A. Willingdale)
Mr. Cassell	Mr. J. Pope)
	Mr. D. McWilliams)
Mr. Isaac) Inland	
Mr. Ware) Revenue	

C.B.I. BUDGET REPRESENTATIONS

Referring to the CBI document "A Winning Budget" due for publication on Wednesday, 10 February, Sir Raymond Pennock said that the CBI's basic message to the Chancellor did not claim to be original and he had heard it before. Above all what was needed was a Budget which cut business costs to reduce the disproportionate burden on the business sector. The aim should be to improve competitiveness and redress the imbalance of pressure in the economy which had borne less heavily on Government and consumption and much more heavily on production and investment. Since the last Budget the situation had changed significantly in a way which added validity to the CBI's basic case. This time last year the recession was still getting deeper; it was now clear with hindsight that it had reached bottom at the end of the second quarter of 1981, but the recovery had been so slow it had been difficult to discern. The second point was that the Government was a year nearer an Election which could be as little as 18 months away. British industry had done a great deal to make itself more competitive; and the CBI and Government were completely agreed that this was the key to recovery. The only way out of the recession would be by sustaining the improvement in productivity and reducing costs, particularly pay. Pay was a success story - the level of settlements had been halved last year, and in the present year they were running at 4 to 6 per cent in the private sector which represented a further halving of last year's level. On productivity, the CBI's figures showed that even with reduced output productivity in terms of output per man was up 10 per cent. The potential for improved productivity was even greater; in the case of his own company, BIC, if it were possible to return to the 1979 volume (i.e. 10 per cent up on present level) profitability would increase very substantially because the workforce was down by 25 per cent.

2. In the battle for competitiveness industry had therefore done what was required of it. But this contrasted markedly with what had happened in the public sector. When industry examined those costs over which it did not had control - and he had in mind particularly the NIS, rates, energy costs and other nationalised industry charges - it found they had all increased substantially. This had to be seen in the context of present levels of profitability which were around 2 per cent return on capital. A cut in NIS would be a sure and certain way of improving competitiveness or productivity or both. If the Government thought there was a danger than a NIS reduction would be passed on in higher wage settlements, then it was out of touch with reality. With 3 million unemployed and pre-tax profits at the present historically low level this simply would not happen. The CBI had demonstrated that at least 60 per cent of the benefit would go to manufacturing and distributive industry.

3. Sir Terence Beckett said that the CBI's quarterly trends survey was published that day. Its findings were consistent with the latest projections of 1 per cent growth in GDP and 3 per cent growth in manufacturing. The slight decline in confidence evident in the October survey had been reversed, but there was no significant improvement in demand or output. 93 per cent of respondents had said their output was constrained by lack of orders or sales. The position on competitiveness, and under-use of capacity were much the same, and it was clear that more job losses were in the pipe-line. There was also more de-stocking to be done on raw materials, work in

progress and finished goods. Trend profitability was improving; there was evidence that costs were under control and margins were hardening in both home and overseas markets. Investment intentions were rising for the 5th survey in a row, but it had to be remembered that there was a lag between intention and action of around 12 months, so that the spend would not occur until the second half of the year. On this evidence the case for help from Government to keep things moving in the right direction was compelling. But he had himself said quite clearly on radio and television that morning that reflation must be modest and restrained, since in the present state of the economy the risk of overheating and bottlenecks, and the renewed surge of inflation was very real.

4. Mr. Utiger commented in answer to a question from the Chancellor that although the CBI's representations only touched briefly on the question of excise duties, there was no doubt that last year's measures which did more than revalorise the duties had had a severe impact on the industries and there was therefore a strong case for restraint here. On income tax the CBI supported indexation of the thresholds on the Rooker-Wise formula. But they were convinced that an NIS cut should be preferred to a cut in income tax. It would be far more effective to act directly on business costs, than to try to help industry by increasing consumer purchasing which would tend to suck in imports.

5. The Chancellor commented that the Treasury's own analysis showed that the difference in the end between a cut in income tax, indirect taxes or the NIS on the level of activity were very slight. The Institute of Directors had argued in favour of an income tax cut mainly because of the helpful effect this would have on pay negotiation But he had noted the force of the CBI's argument on this point.

6. In answer to a question from the Financial Secretary about the case for cutting corporation tax, Sir Terence Beckett commented that he saw little point in this as few companies were making substantial profits. What was needed was a reduction in business costs generally not a reduction in the tax burden on profits.

7. Mr. Utiger said that the CBI attached considerable importance to its proposals for local authority finance. In particular it considered that the present depressed state of the economy and the huge rise in business rates over the last two years fully justified the reintroduction of 15 per cent business de-rating - the recommendatio was for 15 per cent. The abolition of rates on empty property, described in the document as "moth-balling" relief was also important.

8. In further discussion the CBI made the following main points:-

(i) The effect of its proposals on the level of the PSBR would be broadly in line with the level targetted for in the current year. In putting forward its package therefore it saw some scope for a reduction in interest rates. It did not feel that interest rate policy should be used to prop up the exchange rate.

(ii) It believed there was a strong need for additional investment in capital projects providing certain criteria were met, and it would like to see public sector projects financed by private capital.

(iii) On energy costs, a number of specific proposals had been put forward costing approximately £70 million in a full year. It was a little cynical about the likely outcome of the review of the CEGB's bulk supply tariff, and it hoped the Government would take early and positive action. The needs of the large users were too real and important to be put on one side too long, and the sums were comparatively modest. It realised the difficulties on fuel oil duty and had not made too much of this question in the document - but obviously any movement here would be very helpful.

(iv) On capital taxes, on which a very detailed submission had been made in October 1979, a number of changes had been made, but a great deal was still to be done. On CGT, where the most objectionable feature was the fact that it often proved to be a tax on inflationary rather than real gains, the CBI favoured the introduction of a 7 year cut-off in preference to the indexation of the threshold. On CTT it argued strongly for the extension of business relief, so that assets currently qualifying at 30 per cent should be merged with those currently relieved at 50 per cent, and the relief increased to 75 per cent for all of them (with assets now receiving 20 per cent relief being increased to 30 per cent). The CBI also attached importance to the review and overhaul of retirement relief rules for capital gains tax - this would be particularly helpful to small businesses.

(v) Development Land Tax, which only brought in some £25 million per year, should be scrapped.

9. The CBI would like to see further measures to help positively small firms, which suffered particular handicaps, and could not insulate themselves from prevailing economic conditions. It believed that the Business Start-Up reliefs should be made available to established companies, and particularly so in the case of management buy-outs. Individuals should be allowed the same tax relief as is now given for investing directly in eligible companies when they invested through the mechanism of a small firms investment company.

10. Summing up for the CBI, Sir Raymond Pennock said that the basic message was that the Budget should cut business costs significantly to improve competitiveness, even at the expense of the consumer. The direct effect on business costs of their recommendations were shown on page 5 - this showed a total reduction of £2590 million in 1982/83 and £3,000 million in 1983/84. The net addition to the PSBR on the CBI's calculations were shown on page 7 - £1840 million in 1982/83 and £1700 million in 1983/84. This meant a PSBR in money terms for 1982/83 of about £11 to £12 billion, which would represent about the

same percentage of GDP as the target for 1981/82 announced in the 1981 Budget. The CBI believed that the City had already discounted the effect of an increase in the PSBR of £1½ billion over the target of £9 billion. On page 6 of the document, the CBI had made some suggestions about how the proposals should be financed, and he wished to emphasise the importance of the second suggestion, reductions in Government current spending. This could be achieved by implementing the recommendations of the CBI working party on Government expenditure, from additional asset sales and lower interest payments. His general message would be for the Government not to believe anyone in the public sector who said they had already achieved as much as they could in this direction.

11. Finally, he would like to make a point on wages. He had already stressed that the CBI did not believe an NIS cut would feed through into higher wage settlements. This was partly because there had been a change in attitudes, away from a deterministic view of wages and the idea that there was an entitlement to wage levels above the level of inflation. There was now a much better appreciation of how overall costs could directly affect job security; and a realisation that profits were needed for investment.

12. The Chancellor thanked the CBI for their clear and full representation.

PJ

P.S. JENKINS
3rd February 1982

Circulation:

Ministers & officials present
Chief Secretary
Economic Secretary
Minister of State (L)
Minister of State (C)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Kenneth Couzens
Mr. Lavelle
Mr. Kitcatt
Mr. Evans

Mr. Barratt
Mr. Middleton
Mr. Kemp
Mr. Griffiths
Mr. Robson
Mr. Norgrove
Mr. Mountfield
Mr. R.I.G. Allen
Mr. Christie
Mr Monck

Mr. Dixon
Mr. Gordon
Mr. Buckley
Mr. Ridley
Mr. Harris
Mr. Burgner
Mr. Lovell
Mrs. Gilmore

PS/Inland Revenue
PS/Customs & Excise

CONFIDENTIAL

Prime Minister (2)

MS 2/2

Econ Pol

Treasury Chambers, Parliament Street, SW1P 3AG
01-233 3000

1 February 1982

M C Scholar Esq.
10 Downing Street
LONDON
SW1

Dear Michael,

BUDGET PAPERS

Thank you for your letter of 9 December about Budget security.

The Chancellor shares the Prime Minister's concern to avoid any leak of the 1982 Budget proposals. The investigators' report into the 1981 Budget leak gave the Treasury's Budget security arrangements a clean bill of health, but the Chancellor has nevertheless approved a number of measures designed to reinforce them. They are as follows:-

i. There will be a new system of spot-checks on Budget papers within the Treasury designed to ensure that the required security procedures are properly observed.

ii. The Chancellor has instructed that knowledge of Budgetary matters should be restricted to the maximum extent possible. The "need to know" principle is to be applied rigorously. Access to Budget papers will be confined to those who have an unambiguous need to know about particular proposals, either for direct operational reasons or because of their interaction with other parts of the Budget. Staff concerned with Budget matters have been reminded of the need to apply the rules strictly; and to pay particular attention to the circulation of all Budget papers.

iii. Sir Douglas Wass has issued a notice to all Treasury staff reminding them of the correct procedures for handling Budget papers and of their personal responsibility for the safekeeping of Budget information. Sir Lawrence Airey and Sir Douglas Lovelock have issued similar reminders to the staff in Inland Revenue and Customs & Excise. I have written to the Private Secretary to the Governor of the Bank.

/iv.

iv. The Chancellor has given instructions on the handling of contacts with the press in the coming weeks. Discussion of matters bearing on the Budget must not take place unless specifically authorised by him; and any such discussion must be recorded and reported. This rule will apply to Ministers, advisers and officials at all levels. The normal day to day work of the Treasury Press Office in meeting requests for unclassified background information will, of course, continue, but the recording arrangements will apply to the Chancellor's Press Secretary and her Deputy.

It is of course important that necessary occasional contacts with other Departments on some Budgetary matters should be treated with equal discretion. This is not an area where general rules can easily apply, but we shall ensure that such contacts are kept to an absolute minimum, and that those concerned are reminded of the need to treat information relating to the Budget with the utmost care.

I have noted how Budget papers will be handled within No. 10. We shall ensure that copies are sent only to you.

Yours ever,

J.O. KERR
Principal Private Secretary

1

Prime Minister.

Agree no leak inquiry?

AJW 1 ii 82

Yes MT

Ref: A07304

CONFIDENTIAL

MR. WHITMORE

attached. — I expect that you will have seen the article on page 37 in The Economist of 30th January entitled "The Chancellor opens his Treasury books". It looks very like a leak of the Chancellor of the Exchequer's Cabinet paper on Economic Strategy.

2. I doubt whether the blame lies within the Treasury; drafts of the paper have been around for some time and one could have expected earlier leaks if they were going to come from the Treasury.

3. Internal evidence suggests the Department of Industry as a possible source: the last sentence of the 5th paragraph talks about the Department of Industry being "generally miserable about the way the Treasury has treated industry in its budget papers", and talks of Department of Industry officials planning to produce their own paper for Cabinet discussion. This would be consistent with a leak from the Department of Industry at or shortly before the time the Secretary of State for Industry sent round his letter indicating the help he thought the budget should give to industry.

4. But this speculation would be a flimsy basis for a conviction of guilt of the leak, and there are obviously other possibilities.

5. I have discussed with Sir Douglas Wass whether we should have a leak inquiry. We are against doing so. It is unlikely that it would disclose the culprit; Sir Douglas Wass does not feel that the article has done very much damage; and the very fact of instituting a leak inquiry would tend to confirm the accuracy of the article.

RTA

Robert Armstrong

1st February 1982

The chancellor opens his treasury books

Cabinet ministers trooped into Downing Street at 10am on Thursday for a novel experiment in British politics: the prime minister and the chancellor of the exchequer had decided to consult the cabinet about the budget (this year to be unveiled on March 9th). In the usual British way of budgets, most cabinet ministers have no idea what the chancellor has in store for them until a few hours before his budget speech. But Mrs Thatcher and her chancellor, Sir Geoffrey Howe, have been urged by backbench and cabinet critics to open the treasury books a bit this year and to consult them on budget options. The critics want to head off another hardline budget which would make life even more difficult for Tory members of parliament at the next election.

The treasury's somewhat flimsy background brief for cabinet discussion suggests that the gulf between the chancellor's intentions and the demands of the wets need not be too wide. It confirms that the chancellor has more elbow room for tax cuts or extra public spending than even he thought likely a few months ago.

The public sector borrowing requirement looks like being close to its £10.5 billion target for 1981-82. In the 1982-83 fiscal year, the treasury reckons Sir Geoffrey will be able to index income tax in line with inflation (along Rooker-Wise lines) and still meet his £9 billion PSBR target. That assumes excise duties are also increased in line with inflation and that the government sticks to its public spending plans as outlined in its recent white paper. Since these projections included a 4% "assumption" about public-sector pay which has already been broken by several major groups, spending totals could be higher than forecast next year.

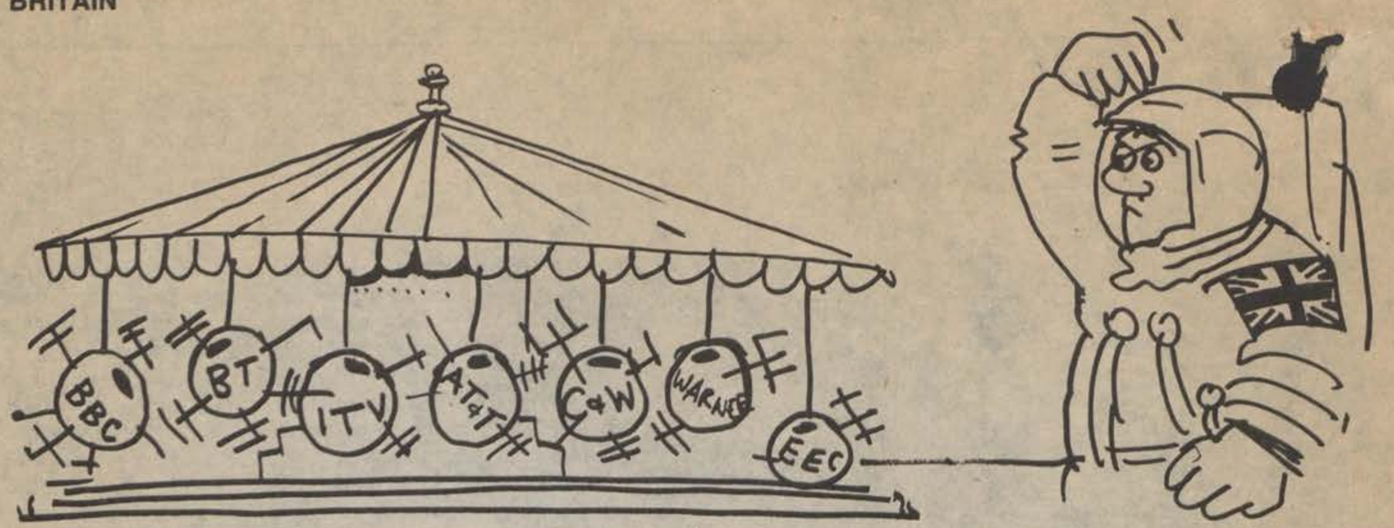
Sir Geoffrey even suggests that a 1982-83 PSBR of £7 billion-8 billion (which would mean junking Rooker-Wise for the second year) would do most to impress the financial markets and help bring down interest rates. But that is just his opening bid in the budget talks. It makes his £9 billion offer look more reasonable and £10 billion positively generous.

The cabinet was presented with three options for taking the PSBR into double digits: income tax cuts in addition to indexing, which would keep Tory election promises; cuts in Vat and excise duties which would help cut prices; and specific help for industry, such as a cut in the national insurance surcharge, which might best reduce the jobless, now the main worry among even Tory voters. The industry department was happy to see the surcharge billed for a possible cut, but it is generally miserable about the way the treasury has treated industry in its budget papers. So department officials are planning to produce their own paper for cabinet discussion.

The chancellor holds out the hope of reasonable growth in 1983, inflation down to around 8% and unemployment falling. But he warns that this modestly rosy future could be destroyed by inflationary wage claims or continued high interest rates (fuelled from America or by a giveaway budget in March). He reckons that high interest rates on Wall Street (where they are likely to stay high after this week's state of the union message) are an extra reason for keeping a tight grip on Britain's PSBR, otherwise there would be little prospect of bringing Britain's rates down, and every chance of them going higher. Sir Geoffrey is also telling his cabinet colleagues these days that the exchange rate for sterling is just as important as the monetary aggregates.

The cabinet wets went into Thursday's meeting without a co-ordinated plan of attack. Many leading critics have piped down in recent months. Mr Jim Prior is busying himself with Northern Ireland. Others, such as Lord Carrington, rarely speak up on economic affairs. Not all of them speak openly to each other about budget matters anyway. On Thursday morning cabinet critics were uncertain about how genuine the consultation was meant to be. Budget discussion was fitted into a normal cabinet agenda, which meant that, after remarks by the chancellor and the prime minister, there would only be time for a quick run round the table, giving each minister perhaps three or four minutes to express his view.

The fact that Sir Geoffrey may now be gearing up for a 1982-83 PSBR of between £10 billion and £11 billion means that he will have room to do some of the things they have been clamouring for anyway: indexing income tax cuts and cutting the national insurance surcharge have been at the top of most of their lists.



Who dares hop aboard Britsat?

Any British government which drags the country into the new era of electronic information will do for Britain's industry in the 1980s what the railways did for it early last century. The Thatcher government, with its liking for the free-market and its need to get unemployment down from 3m, has better credentials and greater cause than most to try it. It started, but already seems to be losing its nerve.

Breaking the grip of the old Post Office monopoly last year was the easy part. Information societies flourish best when a thousand flowers are allowed to bloom. In corporate Britain that is not so easy to arrange.

This week the government's minister for information technology, Mr Kenneth Baker, had to intercede to persuade British Telecom (the new name for the telecommunications side of the old Post Office) to be kinder to Cable and Wireless. Cable and Wireless was the recently privatised company which the industry department picked last year to compete with BT's trunk telephone network. It wanted BT to guarantee international connections at decent rates. The company froze its Project Mercury (an optical-fibre communications link) in the face of tough bargaining by BT.

The government leaned on BT after Cable and Wireless complained. No doubt BT was trying too hard to protect its monopoly of connections to the rest of the world. Equally Cable and Wireless has for generations been in the highly political business of imperial and foreign communications. Its first instinct is not to drive hard bargains in the marketplace, but to squeal for ministerial help. After three years of Tory rule, the future of Britain's information technology is still substantially in the hands of companies which have been state-owned for so long that they have not yet unlearned the ways of state ownership.

Cable and Wireless is now set to receive its operating licence from the government to compete with BT on trunk routes. It is a slow start to establishing a new fast-track private communications network to satisfy business complaints about BT's services—especially from the City, which fears being left behind by other financial markets in the world of increasingly high-speed money.

The industry department's faces would have been even redder, however, had Cable and Wireless pulled out of Project Mercury altogether. In a free-enterprise world that would have given the government an excuse to let in American Telephone & Telegraph, the deregulated American monopoly now about to burst into world markets. Britain could benefit from its vigour and technology. But British Telecom would have been vulnerable. The Thatcher government believes in competition, but not that much.

Another tough decision in the government's in-tray is the all-British direct broadcast satellite. The home office is about to announce that it wants Britain to move quickly into this area: large, powerful satellites that can broadcast television programmes straight into people's homes. It will invite applications for a television satellite, to be launched by 1986, to provide two national television channels plus plenty of spare capacity for telecommunications circuits.

The cost of hopping on Britsat will be around £150m. The government says there will be no help from the public purse. But France, West Germany and Luxembourg are keen to go with direct-broadcast satellites of their own. The usual British indecision would leave the country overshadowed by their beams and give the Europeans a head start in satellite manufacture. The opportunity lost could be very large: the position in the earth's orbit allocated to Britain under international rules for broadcast satellites (way out over the Atlantic) has commercial advantages which most continental allocations, more to the east, lack—the entire eastern half of the United States, from New Orleans to Chicago, would fall within Britain's beam.

Plenty of British firms are sniffing around Britsat, but each is waiting for the other to make a firm offer. As the official regulating agency, the home office is having to play marriage broker. The most ardent suitor is British Aerospace. It is anxious to manufacture the Britsat system (two in orbit and a spare on the ground) as its showcase to other countries buying broadcast satellites over the next two decades.

It would adapt a version of the European Communications Satellite (ECS), that it is already making for Eutelsat, the European consortium of public telecommunications authorities. Work on Britsat could begin as soon as it has the home office licence. GEC-Marconi is ready to collaborate by providing the business systems payload; N. M. Rothschild is ready with the money.

Who would use Britsat? British Telecom for one. It would use the telecommunications circuits, amounting to perhaps a third of the satellite's capacity, and shoulder a third of the costs. Then, dead stop. BAe and BT will not go ahead unless they get firm guarantees from Britain's two broadcasting organisations. Back to the home office: the BBC an the Independent Broadcasting Authorit (IBA) cannot make a move until th home office decides how it wants the tw

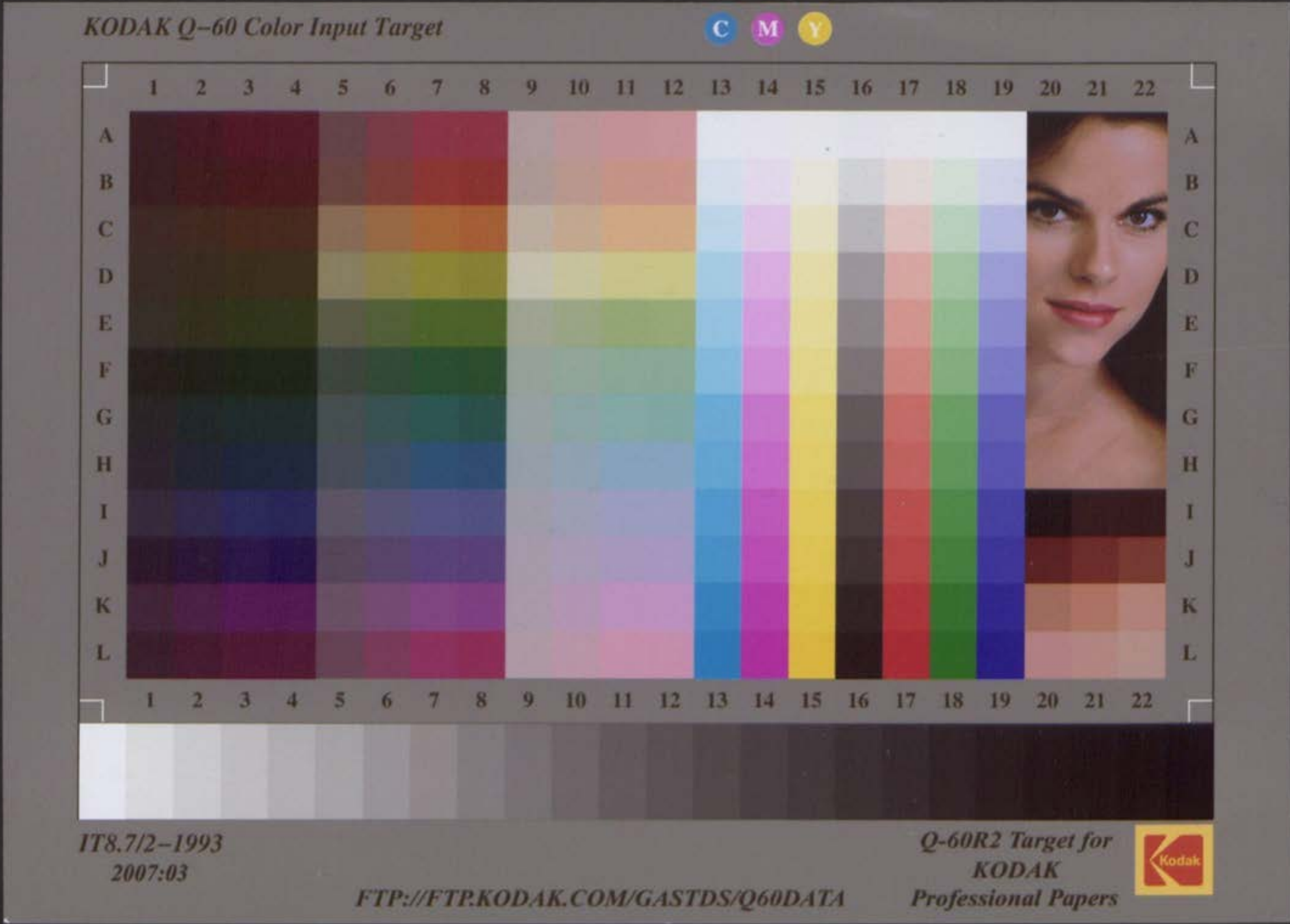
PART 6 ends:-

28.1.82

~~MCS to Sir Ray Pennock of 27/1/82~~

PART 7 begins:-

RTA to CAW (A07304) of 1/2/82.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