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PREM 19/997

Part 10

Confidential Filing

The 1983 Budget

ECONOMIC POLICY

Part 1: May 1979

Part 10: February 1983

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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15.3.83							
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PART 10 ends:-

DHSS Press Release 15/3/83

PART 11 begins:-

Ch/Ex to PM 17/3/83

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC (83) 6th Conclusions, Minute 3	10.2.83
CC (83) 9th Conclusions,	15.3.83

The documents listed above, which were enclosed on this file, have 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

Signed AWayland Date 21 March 2013

PREM Records Team

Department of Health
and Social Security

Alexander Fleming House
Elephant and Castle
London SE1 6BY

Telephone 01-407 5522

PRESS RELEASE

83/58 15 March 1983

Norman Fowler, Secretary of State for Social Services, today gave details of the social security changes outlined in the Chancellor's Budget Statement. He said:

"I shall be introducing a Bill immediately to restore the historic basis of uprating social security benefits. What this means in practice is that this year's uprating, and future upratings, will be based on the actual increase in prices over a past period, not on the forecast increase. The forecast system - introduced to save money by the last Government - has not worked. The forecast has been wrong in five years out of seven. I believe the certainty and stability that this change will bring will be widely welcomed.

"In addition the benefit improvements announced in the Budget are probably the most significant made during the lifetime of this Government. They will give considerable extra help to many different groups in our community - the unemployed, the sick and disabled, the elderly and families with children. I am particularly glad that we are increasing the real value of child benefit and one-parent benefit to their highest ever level; abolishing the "invalidity trap" which our predecessors were not able to do; and restoring the 5 per cent abatement of unemployment benefit.

"A Bill to return to the historic method of uprating will be introduced tomorrow. The Government has also decided to make the following improvements:

uprate child benefit and one-parent benefit by 11 per cent next November. This means a real increase in value, and both benefits will stand at their highest value since their introduction. Child benefit will be £6.50 and one-parent benefit will be £4.05.

remove what is known as the "invalidity trap" so that people on invalidity benefit can qualify for the long-term rate of supplementary benefit;

restore the 5 per cent abatement of unemployment benefit;

improve the two main capital disregards in the supplementary benefit scheme and introduce a new disregard for the surrender value of life assurance policies;

allow all men over 60 on supplementary benefit to qualify immediately for the higher long-term rate;

award national insurance credits automatically to men over 60 thus relieving them of the need to register as unemployed whilst preserving their future benefit position;

increase the amount which sick and disabled people are allowed to earn without affecting their incapacity benefit;

introduce a new mobility allowance for war pensioners in place of the war pensioners' vehicle scheme.

Commenting on the changes Mr Fowler said:

UPRATING METHOD

"The present forecast method of uprating has given rise to general dissatisfaction. Since its introduction in 1976 the upratings have been based on forecasts but these forecasts have only been correct in two years. In most cases, therefore, the forecast method has meant having to adjust the benefit increases due a year later. Whether the adjustment was upwards or downwards it invariably led to strong public criticism and to confusion.

"The historic - or actual - method avoids the possibility of forecasting error and therefore the need for later adjustment of uprating increases. It replaces doubt with certainty based on fact. The Labour Government last used this method in 1975. They then decided to change the method because they did not wish to include in the reckoning for the 1976 uprating a period of high inflation which pensioners had recently suffered. They left an 8 months' gap in their calculations from which they saved £500 million - equivalent to £1 billion at today's prices.

BENEFIT IMPROVEMENTS

Mr Fowler said that there were eleven major benefit improvements announced in the Budget:

Families

"First, child benefit is to be uprated in November by 11.1 per cent. This will take the rate to £6.50 a week, an increase of 65p, which is substantially more than necessary to protect the November 1982 level of the benefit. Indeed the increase will more than restore the April 1979 value which the Government inherited and the new rate will represent the highest value since child benefit was introduced.

"Second, one-parent benefit will be similarly increased - by 11 per cent - to £4.05 taking it to its highest ever value in real terms.

"These decisions demonstrate in a practical way the importance we attach to support for families generally and to giving extra help towards the special needs of one-parent families. The increases will cost £122 million in 1983/84 and £340 million in 1984/85.

The Elderly

"Third, the main capital limit in the supplementary benefits scheme is to be raised from £2,500 to £3,000. This is the second increase of £500 in this limit in successive years. It was raised from £2,000 to £2,500 in November 1982. In the course of a year, therefore, the main capital disregard will have risen by £1,000 - a 50 per cent increase.

"Fourth, the capital limit which applies to single payments under the supplementary benefit scheme is to be raised also - from £300 to £500. The new limit will allow more people to qualify for a single payment rather than have to use up some of their small savings when a special need arises.

"Fifth, a new disregard of capital is to be introduced into the supplementary benefits scheme. Up to now, the surrender value of a life assurance policy has been treated as capital and set against the main capital limit. In future, up to £1,500 surrender value will be ignored. Any amount above that will count towards the new, main £3,000 limit.

"Those three changes will all take effect in November 1983. They represent a clear indication of the Government's concern not to penalise thrift and to help people with small savings or a modest lump sum redundancy payment when they are most in need of help.

Early retirement

"Sixth, from 5 April men over 60 will no longer be required to attend an Unemployment Benefit Office to sign on as unemployed and make themselves available for work, if their only reason for doing so is to obtain national insurance credits, particularly to protect their State basic pension rights. Instead, they will be given the necessary credits automatically, under regulations to be made shortly. This will relieve some 90,000 people of the requirement to sign on. Details will be available at Unemployment Benefit Offices at the end of this month.

"Seventh, a further measure designed to help this age group is that some 80,000 men over 60, whether sick, disabled or unemployed, will be eligible for the long-term rate of supplementary benefit immediately instead of having to wait for one year on the lower short-term rate. This change will take place in June, as soon as the necessary amending regulations have been introduced. In addition, we shall remove the requirement for those over 60 to register as unemployed. The extra benefit will be worth up to £7 a week for a single householder and up to £10.60 a week for a married couple, at a cost of £23 million in 1983/84.

"These changes will assist men aged 60 and over who have either effectively retired from work or wish to retire early. The Department of Employment will also be extending the Job Release Scheme for a further year and applying it from October to part-time as well as full-time work.

Unemployed people

"Eighth, the 5 per cent abatement of the uprating of unemployment benefit introduced in 1980 is to be made good at the next uprating in November. This will help some 900,000 beneficiaries and their families at a cost of about £20 million in 1983/84 and £60 million in 1984/85.

Sick and disabled people and war pensioners

"Ninth, steps are to be taken to remove the so-called invalidity trap. At present, people receiving invalidity benefit cannot qualify for the long-term rate of supplementary benefit. The decision to allow men over 60 to qualify for the long-term rate immediately will remove the effects of the trap on them. This will benefit 37,000 people over 60. In addition 30,000 people under 60 will be removed from the trap from November 1983. A year in receipt of incapacity benefits will be counted as meeting the qualifying period for eligibility to the higher long-term rate. This will mean that they will qualify for extra weekly benefit up to £7 a week for a single householder and up to £10.60 for a married couple. In addition, they will be eligible to claim additional payments under the supplementary benefits scheme, for example, to help with heating, diet and other special needs. This will cost £3 million in 1983/84 and £10 million in 1984/85.

"Tenth, the Government intends to introduce more flexible provisions for war pensioners with mobility needs by introducing a cash mobility supplement in place of the existing vehicle scheme which will be progressively phased out. This supplement will be set at a rate £2.10 a week higher than the civilian mobility allowance (£18.30 a week at present), thus maintaining the traditional war pensioners' preference. Recipients of the new supplement will be able to choose how to provide for their mobility needs - they will be able to use this money to run a car, or to obtain greater mobility by other means. If they wish to run a car of their own they will be able to take advantage of the Motability leasing arrangements. About 11,000 war pensioners will be entitled to the new supplement. Of these, some 700 do not drive now. They are unable to benefit under the present arrangements, which provide a car or a cash sum for the upkeep of the pensioners's own car, but a cash allowance will help them. Details of the new scheme will be given in due course.

"Eleventh, the therapeutic earnings limit (at present £20) is the amount which people on incapacity benefits (such as invalidity benefit) can earn before their benefit is withdrawn, so long as the work done will not prejudice their recovery. The ability to earn some money without loss of benefit allows people to ease their way back into work, and can be a useful aspect of rehabilitation. The limit was given a boost in real terms last year, and in November 1983 will be increased again from £20 to £22.50 - a 12½ per cent increase."

EFFECTS ON MAIN GROUPS OF BENEFICIARIES

Under the present forecast method of uprating, pensions and other benefits would have increased by 3.3 per cent - based on a forecast movement of prices of 6 per cent from November 1982 to November 1983 less 2.7 per cent to reflect the 1982 overshoot. It is not possible to say by how much benefits will increase in November 1983 under the historic method since the rates will not be finally determined until June. But on an illustrative assumption of a 4 $^{1}/_{4}$ per cent increase pensions will have increased by 75.6 per cent under the present Government against an expected rise in prices of 70.7 per cent between November 1978 and November 1983.

The increases in child benefit and one-parent benefit will mean that the value of each benefit is higher than ever before. Child benefit went up to £4 in April 1979. The proposed level of benefit in November 1983 is £6.50. This represents an increase of 62.5 per cent since April 1979. By comparison, prices are expected to go up by 61.4 per cent between April 1979 and November 1983. One-parent benefit (then called child benefit (increase)) went up to £2 in November 1978; there was no further increase in April 1979. The proposed level of benefit in November 1983 is £4.05. This represents an increase of 102.5 per cent since November 1978. By comparison, prices are expected to go up by 70.7 per cent between November 1978 and November 1983.

MR PAGE

FROM: D L WILLETTS
15 March 1983

cc Principal Private Secretary
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Mr Littler
Mr Middleton
Mr Kemp
Mr Monck
Mr Peretz
Mr Turnbull
Mr Hall
Mr R Allen
Mr Bailey
Mr Ridley
Mr Harris

Mr Scholar

You may wish to see this Treasury note on Base rate cuts prepared this p.m.

15/III/83

THE CUT IN BASE RATES

At 10.30 this morning Lloyds reduced its base rate to 10½ per cent from 11 per cent effective today. Midland Bank followed at noon. (We have no news yet of any reductions by the other major clearers.) This cut in rates reverses in part the 11 January increase in base rates to 11 per cent from 10 per cent (from 10¼ per cent in the case of Midland).

2. At 12.30 today the Bank dealt with the discount houses at the rates set out below (the figures in brackets are the previous dealing rates).

Band 1	10 9/16	(11)	
Band 2	10½	(11)	
Band 3	10 7/16	(11)	
Band 4	10⅜	(11)	- (the Bank have not dealt in Band 4 since 23 February)

The cut in base rates follows a downward trend in interbank rates over the past weeks. A fortnight ago on Tuesday 1 March, 3 month interbank rates stood at 11⅜% (having been as high as 11⅝% at the beginning of the month) whereas this morning before the cut in base rates it stood at $10\frac{7}{8}$ per cent. Inter-bank rates represent the marginal cost of funds for the clearers and therefore the fall in base rates can be directly related to inter-bank rate movements, just as the increase in rates in November and January were both responses to upward movements in inter-bank rates. The wider factors that were relevant to this downward move include the OPEC agreement and optimism about the Budget.

3. Although the exchange rate strengthened overnight on the OPEC news, it has eased this morning partly on fears that the OPEC agreement would not hold and partly on expectations of the cut in base rates.

4. The table below shows how interest rates now compare with their level a year ago and at the time of last year's Budget.

	3 month interbank	Base rate
9 March 1982	$13\frac{1}{4}$	$13\frac{1}{2}$
15 March 1982	13 5/16	13
15 March 1983	10 11/16	$10\frac{1}{2}$

Base rates fell immediately after the Budget, in response to it, rather than anticipating it as has happened this year. The fairest comparison is therefore with rates a year ago: on this basis they are $2\frac{1}{2}$ per cent lower.

5. Question and Answer briefing is attached.

D L Willetts

D L WILLETTS

BRIEFING ON THE CUT IN BASE RATE

Did it fall or was it pushed? Was it fixed to coincide with the Budget?

Base rate respondsto market forces: it is not controlled by the Government. Today's reduction in rates is clearly related to the downward movement in inter-bank rates over the past weeks, just as the increase in base rates in January was a response to upward movements in inter-bank rates.

Is the reduction in dealing rates meant to nudge interest rates down further?

No. It is purely a response to the adjustment in market rates which has already occurred.

Does the fall in interest rates mean that monetary conditions are becoming more lax?

No. Ministers have always made clear that any falls in interest rates are a consequence of sound monetary conditions and low inflation. Monetary growth is comfortably within the target range. Inflation is well into single figures. The Chief Secretary made it clear in the House on 19 January after the last rise in rates that sticking to the fundamentals would make it possible to begin reversing recent rise in rates, as happened after the rise in the Autumn of 1981.

Implications for the Exchange Rate

Sterling's fall in recent weeks has not been a reflection of lax monetary conditions in the UK; on the contrary the evidence of domestic indicators suggested that a modest relaxation in interest rates would be appropriate. The pound's fall seems to have largely reflected the weakening in international oil markets. While the future course of the exchange rate will no doubt continue to reflect international factors such as the oil markets, there should be no doubt about the Government's continued pursuit of sound monetary and fiscal policies.

COVERING CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

FROM: ROBIN HARRIS
DATE: 15 March 1983

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Kemp
Mr Ridley (w/o attachment)
Mr Scholar - No.10

ADVISERS' BUDGET BRIEF

... The attached brief is being made available in the Whips' Office. It has been prepared by Adam Ridley and me incorporating official advice.

RH

ROBIN HARRIS

CONFIDENTIAL

1983 BUDGET

A. INTRODUCTION

The two basic goals of the Government's economic policies, as stated clearly in the 1979 Election Manifesto, were to reverse our relative economic decline, and to re-establish sustainable economic growth. The main means to those ends have been to master inflation through monetary discipline, to reduce the burdens on private enterprise by reducing public spending, borrowing and taxes, and to create real incentives for both entrepreneurs and ordinary citizens by reducing direct taxes in particular. Although progress has been less than it was reasonable to expect at the time of the last election, it has been striking both when judged against the unexpectedly difficult conditions which have prevailed and, recently, when contrasted with the progress of our competitors.

2. This Budget proposes measures and policies which reinforce those taken in the past. In giving particular assistance to the income taxpayer it balances the massive assistance given to industry in the 1982 Budget and the Autumn Statement, and by the recent fall in the pound. But it contains as well an exceptional range of smaller proposals which will be of great benefit not only to industry generally, but to entrepreneurs and small companies, construction, charities, the needy (widows, the disabled, the lower paid, the unemployed), hard-hit regions (such as the West Midlands), and families with young children.

3. It deals with two important social security issues. The 2¾% overshoot of benefits arising in the last up-rating will not be fully recovered, and a substantial part of the over-payment should remain in beneficiaries hands hereafter. Recent problems with uprating in 1980, 1981 and 1982 having demonstrated conclusively the inherently controversial and uncertain nature of the "forecast" method of uprating, the Government is proposing to return to the reliable "historic" method based on actual inflation.

4. This Budget is being announced in conditions of unusual uncertainty above all because of the state of the oil market. It has therefore to be recognised that changing conditions in coming months may necessitate further policy changes. There is no way of telling now whether these might be favourable, as last autumn, or less so, as in the autumn of 1979 and 1980.

5. However it is already clear that the economy is in so much stronger a position than it was when we inherited it that it will be far better placed to ride through any difficulties than most of our competitors. Public spending and monetary policy are now under firm control which is admired rather than questioned by the markets. Though there is further to go in mastering inflation, the risks of its resurgence become steadily more remote and there should be few difficulties in passing through the slight and transient increase in retail price inflation in prospect later this year. The balance of payments is strong, and the pound has ridden through three periods of major turbulence and several sharp falls - during the Falklands crisis, when the oil prospects weakened in late 1982, and the current OPEC crisis - without the crises of confidence and need for "measures" from the Government which would have been inevitable in the past. Internationally the UK is now viewed a "strong" economy, which is leading the world recovery.

B. PROGRESS IN THE YEAR TO MARCH 1983

6. The prospect at the time of the 1982 Budget was for continued recovery, following the modest rise in the previous year. The measures taken both then and in the autumn were designed to strengthen it. With an expanding world economy, falling inflation and interest rates, strong growth of real domestic demand (including investment) and lower oil prices than previously foreseen, a GDP growth of 1½% was projected for 1981-82. In the event GDP only grew by ½%. But this disappointing performance was, in fact, rather creditable when the circumstances are taken into account. Looking at the home economy:

- Total domestic demand grew by 2½% in real terms, fixed investment by 3½%.
- Inflation fell to 6% (RPI) rather than 9% projected for 1982 QIV, and nominal interest rates fell very sharply too, by 7% from a Clearing Bank rate peak of 16% in early 1982, which dwarfs the subsequent 2% increase to 11% since November.

7. The shortfall in GDP growth arose first because of a sudden and unpredicted weakening in world activity. In December 1981 OECD were projecting world trade in manufactures to grow by 5% in 1982. In the event it fell by around 3%. This meant that UK markets were some 8% below what was recently foreseen, the equivalent of about 2% off GDP. This is sufficient to explain the unforeseen setback to the recovery in 1982, though of course other factors were at work in both directions. Despite the contraction in world trade, UK exports of manufactures nonetheless grew by ½% in 1982 and so our share of world trade probably rose from (roughly) 7¼% to over 7½%. This increase in market share was well above that generally forecast. That, and a growth in imports which was modest given the fast expansion in home demand, makes judgements that the £ is "uncompetitive" rather questionable.

8. The second major reason was resumed stock reduction, which set in as industrial sentiment worsened here and in other countries from the summer onwards along with world trade prospects.

9. Over this period trends in GDP, industrial production, investment and the state of business sentiment were all markedly better in the UK than in other major industrial countries:

Real changes 1982/1 in	UK	Major industrial countries
GDP	+½	-½
Industrial production	-1	-4½
Fixed Investment	+3½	nil

Source: OECD

Industrial Sentiment: Changes in balances in Standard EC survey of attitudes of Enterprises

ALL INDUSTRIES	UK	EC of 10
Production	-4.6	-10.7
Order Books	+7.8	- 4.1

Source EC: Eurostatistics. "Data for Short Term Economic Analysis" 1983 No 1 pp.37-40.

C. INDUSTRY ACT PROJECTIONS FOR 1983/4

10. These are described in Section 3 of the Red Book. Key points are

- GDP to grow by 2% 1983/2, 2½% p.a. by early 1984; and manufacturing output by broadly similar rates.
- Real demand to grow by 2½% in 1983/2, 3% by early 1984.
- Real investment to continue to grow by 3½% p.a., with the fall in manufacturing halting before the end of the year.
- Exports to rise by 1% this year, 5% by 1984 H1.
- Retail price inflation to rise slightly to about 6% p.a. either side of the year end; but the general underlying trend of inflation, as indicated by the "GDP deflator", to carry on downwards.

11. Unemployment trends can never be projected with confidence, even less so after a period in which output per head in manufacturing has improved dramatically, and far faster than forecast (12½% up since end 1980). Thus, while productivity in periods of low capacity utilisation is normally lower than in previous periods of high output, output per man hour is now 9% higher than at its previous peak in 1979 H1. Output growth at the 2-2½% p.a. rates of the MTFS would, as §§3.39 of the Red Brook suggests, be consistent with no great change in unemployment hereafter.

12. However distressing and undesirable, it should be noted that today's high unemployment levels have in part to be viewed as the tragic by-product of the highly desirable process of raising competitiveness in a world recession. Higher employment today at the expense of competitiveness and orders tomorrow would not be a sensible goal, even in the short term, let alone any serious time horizon.

13. These Industry Act projections obviously depend particularly on a view of the world recovery; on oil markets; and on progress in solving the problems of the world financial system.

- World Economy. the forecast assumes 1¾% GDP growth in '83 in the 'major 6' industrial countries, and 1% growth in world trade.

- Oil revenues, which depend on both the $ oil price and the £/$ exchange rate, are expected to run at about £8bn in '83$ and '84/5, over £1½ bn higher than foreseen last year. They then ran £1.8 bn above the Budget forecast, one of the main reasons for the low PSBR outturn for '82/3.

- World Financial System. With the recent agreement to enlarge IMF resources in place [thanks very largely to the UK's initiative in greatly advancing the timetable], with progress being made in the affairs of debtor countries in difficulties, and lower real oil prices, there is justification for cautious optimism over world recovery.

D. MEDIUM TERM FINANCIAL STRATEGY (MTFS)

14. The MTFS this year is, in essentials, little changed from last year's:

- the monetary ranges for the next two years remain 7-11% and 5-10%, and 5-9% has been added for 1985/6;

- the aggregates targeted remain M_1, $£M_3$ and PSL_2, which have grown within the 8-12% range for '82/3;

- the inflation prospect over the period to 1985/6, which is measured by the GDP price index (or "deflator") falls from an increase of 7% in 1982/3 to 5½% in 1984/5;

- with the inflation and money growth assumed there is room for sustained, prudent growth of real demand and GDP over the three years 1983/4, 1984/5 and 1985/6, at a rate of around 2½% p.a. sufficient, probably, to stabilise unemployment;

- the public spending plans and course of tax revenues on this basis indicate a path for the PSBR which continues to fall as a percentage of GDP from 2¾% in 1983/4 to 2% in 1985/6, and which should make for further reductions in interest rates;

- within that framework monetary policy will continue to be managed "taking account of all the available evidence, including the exchange rate, structural changes in financial markets, swing behaviour and the level and structure of interest rates, to maintain "monetary conditions that will maintain inflation on a downward trend". [Red Book §2.13].

- given the proposals in the Budget, positive fiscal adjustments of £½ bn in 1984/5 and £4 bn in 1985/6 indicate scope for further reductions in taxation in due course, on the assumptions above.

E. THE BUDGET JUDGEMENT

15. The 1982 MTFS and Budget proposed a PSBR for 1982/3 of £9½ bn. The latest outturn is put at £7.5 bn. This estimate is unavoidably tentative, with much revenue and spending still to be accounted for at a phase in the financial year when prediction is at its most difficult. The reasons for the substantial PSBR undershoot in prospect are complex, as section 5 of the Red Book explains; and it is not obvious that they will be repeated another year. They include:

- Local Authorities. £2bn overspending on current account, £1½bn underspending on capital - mainly a definitional phenomenon, as (higher-than-expected) receipts from land and council home sales are deducted from the total of their gross investment. LA borrowing down by about £¾bn below forecast.
- Public Corporations. Borrowing over £½bn less than projected, mainly because of substantial underspending on capital, and stock reductions.
- Oil revenues £1¾bn higher than projected, due both to higher average oil prices than foreseen, and a lower pound. They thus account, alone, for over three-quarters of the net undershoot.

16. Given that over-estimation of oil revenues is less likely in 1983/4, major efforts have been made to reduce underspending in LAs and Nationalised Industries and that the recent estimates for 1982/3 and their lessons have been taken into account in the projections for later years, the £8bn PSBR proposed for 1983/4 is, on present information and assumptions, a reasonable central estimate.

Within that PSBR measures are proposed with a PSBR cost of around £1½bn in 1983/4 and £2bn in 1984/5 after indexation. In revenue terms the tax and spending measures will cost (£6m):

	1983/4	Full year
from indexed base	1.7	2.2
from un-indexed base	1.9	2.7
extra spending above PEWP programmes; (met from contingency reserve)	¼	(1984/5) ½

F. THE BUDGET'S MAIN COMPONENTS

17. The tax measures can be broken down into the following elements [£ bns, to nearest £50m]

	1983/4		Full Year	
Base	Indexed	Unindexed	Indexed	Unindexed
Income Tax allowances and thresholds	-1.2	-2.0	-1.5	-2.5
Corporation, Capital and other income and direct taxes	-0.3	-0.3	-0.35	-0.4
NIS	-0.2	-0.2	-0.4	-0.4
Excise duties	-	+0.6	-	+0.6
Total	-1.7	-1.9	-2.2	-2.7

18. A second approach is to divide the measures between persons and industry. On this basis, as against income tax, excise duties and other changes worth on an indexed basis some £1¼bn in 1983/4, and £1.4bn in a full year, the Budget announcements directly favouring business include:

DIRECT TAX AND SPENDING CHANGES FOR OIL AND NON-OIL BUSINESS £m

	'83/4	Full Year
Corporation Tax	40	70
NIS cut	215	390
Small firms & Enterprise	60	190
Technology & Innovation	40	120
Sub-total	330	715
Plus North Sea Oil tax reliefs	115	200*
TOTAL	470	970

* Average rate for next four years.

However these figures understate the full benefit to industry, since they do not allow for the unquantifiable impact on the construction industry of a higher mortgage interest relief ceiling, and some £60m of extra spending in 1983/4 on improvement grants, enveloping etc., or a number of other smaller measures.

19. Moreover, in assessing the impact of these and other recent proposals on industry and persons, other recent policy changes need to be borne in mind:

(1) The overall cut in NIS from 3½% to 1% will be worth £2bn alone to industry in a full year.

(2) The Autumn measures and this Budget will together be worth £1¼ bn to industry on a conservative estimate, as much as the 1982 Budget.

(3) Employers have been very largely exempted from financing the substantial increases in national insurance contribution rates which have taken place since the election. Had the overall NIC increase been shared equally, as was once normal, between employers and employees, employers would now be paying £1bn or so more.

(4) Were employers to carry the same share of total taxes as in 1978/9, they would be paying £3bn more than now proposed. That is only a partial measure of the assistance derived from Government policies, which have also helped by decisions on public spending, energy prices etc.

(5) Industrial borrowers gain, it is generally reckoned, some £300m for each 1% reduction in interest paid on their overdrafts, which fell sharply last year.

(6) The recent fall in the exchange rate of around 14% will greatly help exporters and those competing against importers.

Section J below gives further details of the help given to industry recently and in the Budget.

20. These are not the only reasons why it is misleading to analyse narrowly the precise allocation of the Budget proposals between industry and persons. For

(1) Income tax reliefs relieve the pressure for higher wages, and assist industry substantially at one remove.

(2) Over the lifetime of this Government, the pressures on industry have been so great that the most immediate priority has been to increase the personal tax burden, through both income tax and national insurance in order to shelter industry from tax increases.

Now that the pressures on industry are abating, it is clearly right to take the first substantial step to lighten the burden on individuals, at a time when it is possible to accompany this by still further and significant help to business and enterprise.

G. PERSONAL TAXATION AND CHILD BENEFIT

21. Chancellor's concentration of available resources on raising personal tax thresholds appropriate now given that the 1979 Budget dealt with the worst features of tax rates, and thresholds were not indexed at all in 1981 at a time when inflation was much higher than today. And

- need to tackle 30 year growing problem of poverty and unemployment traps and incentives generally;

- non-indexation of thresholds in 1981, so as to cut borrowing and beat inflation while allowing interest rates to fall, makes important to restore ground lost by personal taxpayers then.

Main Changes

22. Income tax rates unchanged. But:

- all main allowances and thresholds raised by about 14 per cent, about 8½ per cent more than indexation requires;

- investment income surcharge threshold raised to £7,100 (£850 increase - £500 more than indexation);

- widow's bereavement allowance extended to year following bereavement (see below: 6).

Cost (£m) 1983-84	Full Year
1,170	2,000

Effects

1. Change in Allowances and Thresholds

23. Thresholds 5 per cent higher in real terms than the levels inherited from Labour in 1979, 8½ per cent up on 1982-83.

- Real increase in thresholds for <u>second</u> successive year <u>reduces average rates of income tax for all taxpayers</u>.

- Weekly income tax cut in cash for basic rate taxpayers will be £2.02 per week (married) and £1.27 a week (single), £1.67 and £2.65 respectively for the retired.

Best way of helping low paid: 750,000 <u>fewer</u> low paid (and pensioner) taxpayers, compared with if indexed only, and 1.25 million less than if tax thresholds not altered; although <u>cash</u> benefits obviously greater to highest paid, <u>percentage of income</u> taken in tax drops <u>more</u> for, and so proportionately helps <u>most</u>, the <u>lowest</u> (and highest) paid, who lost most from failure to index thresholds in 1981-82.

2. <u>Tax and NIC Changes on Incomes</u> (see 7 for mortgageinterest relief)

24. Cannot predict precisely whether people better or worse off in 1983-84, after tax and NIC, than 1982-83: depends on prices and earnings movements. Also for those with mortgages, tax payments may be affected by MIRAS and effect of tax underpayment in 1982-83. But if earnings rise by 6½ per cent (assumption given by Government Actuary) and prices by 6 per cent (FSBR 1983-84 forecast) then <u>joint effects of higher allowances and thresholds for income tax, on one hand, and increase in NIC (0.25 per cent of earnings increase for contracted-in if below upper earnings limit) on the other will give</u>:

- <u>immediate effect</u> of cut in income tax <u>greater</u> than effect of NIC increases for all but a minority (900,000);

- <u>percentage</u> of income paid in income tax and NIC combined will be <u>unchanged or lower</u> in 1983-84 than in 1982-83 for all paying contracted-in NIC. Will rise slightly for <u>some</u> contracted-out;

- on above illustrative (GAD and FSBR) assumptions, <u>everyone will have higher real net earnings than in 1982-83</u> and low paid among those gaining most.

<u>NB</u> Changes in National Insurance Contributions <u>not</u> part of the budget, though coming into force at same time as budget tax proposals. It is wrong to lump together their effect and that of the budget, as Labour and other critics tend to do.

25. But NB two special groups gain <u>more</u>:

- families with children get additional gain from increase in child benefit from November (see 10 below) and so get bigger increases in real net income than childless couples;

- elderly get more advantage than most taxpayers for second year running because they gain from increase in tax threshold but do not pay NIC.

3. Comparisons with 1978-89

26a. Basic rate down from 33p to 30p since 1978-79; top rate down from 83 per cent to 60 per cent; threshold for 60 per cent tax more than 60 per cent higher in real terms - but 25 per cent reduced rate band abolished and NIC rate (contracted-in) up from 6½ per cent to 9 per cent (contracted-out up from 4 per cent to 6.85 per cent), needed to pay for higher SS costs.

26b. Allowances have been increased by 5 per cent in real terms since 1978-79 and are about same proportion of average earnings as then. Real take-home pay (on GAD assumptions on earnings) higher on average in 1983-84 than in 1978-79 at all earnings levels. NB Allowances could not be increased enough to restore the 1978-79 burden of tax and NIC as a proportion of income.

4. Incentives, Poverty and Unemployment Traps

27. Budget helps incentives by:

- taking 1¼ million people out of tax (¾ million if just indexed);

- raising allowances to improve 'poverty trap' (ie where workers through tax, NIC and withdrawal of means-tested benefits enjoys little or no net reward from higher gross income);

- taking 200,000 people out of higher tax rate;

- supplementary benefit increase in November by less than likely increase in net income in work and big increase in child benefit (see below) helps incentives.

5. The Elderly

28. Because of increase in tax thresholds and not paying any NIC, pensioners do better than most taxpayers from budget; age allowance increase for 65s and over gives weekly tax cut of £1.67 (single) and £2.65 (married. Pensioners with basic state pension only will pay no income tax. Single pensioners can have £12 income per week above basic pension without paying tax and married pensioners £19 per week above; this increasein 'clear water' between tax threshold and pension level means percentage of their other income going in tax will be cut.

29. Half of Investment Income Surcharge payers are over 65: they benefit from £850 increase in thresholds, £500 over indexation. There will be about 250,000 fewer elderly taxpayers than in 1982-83 (under statutory indexation, would have been about 50,000 more than in 1982-83).

6. Widows

30. Earlier action to help widows:

- 1979 budget exempted war widows' pensions and widows' child dependancy allowances from tax;

- 1981 budget introduced a bereavement allowance to benefit widows in tax year of husband's death.

31. Now:

- allowance increased to £1,010 (14 per cent up on 1982-83, 9 per cent more than indexation); and extended to cover year after husband's death, as well as actual year of bereavement, because many widows' income is fully covered by other allowances in the year of death. Cost of extenstion £25million in 1983-84, £30 million full year;

- will help more than 100,000 widows compared with only 45,000 benefiting from WBA at present.

7. Mortgage Interest Relief

32. Mortgage interest relief is from April 1983 to be given at source (MIRAS) rather than through PAYE. This change is not part of this

budget. But because of the date at which it takes effect and because it affects mortgage and tax payments (reducing the former and increasing the latter) it will affect pay packets from April.

33. The new scheme for net of tax interest payments is simpler for the borrower. It will in future give correct relief quickly and without need for PAYE adjustments when interest rates change since they will no longer need to be reflected in tax codes. The new scheme will also save a massive 1,000 Inland Revenue staff by 1984.

34. The introduction of MIRAS will not reduce the amount of the borrower's tax relief. But for a limited number of borrowers it can mean higher initial repayments if they so choose. It also coincides, and its effects may become confused with, with a recovery of excess mortgage interest relief for 1982-83. For administrative reasons the calculation of PAYE codes for 1982-83 could not take into account the substantial fall in interest rates which occurred last year. Indeed, this is just the sort of difficulty which a switch to the new MIRAS system is meant to avoid. Neither MIRAS nor the adjustment of the 1983-84 PAYE codes to recover excess relief paid last year means a reduction of the amount of mortgage interest relief over the duration of the repayment of a mortgage.

8. Fringe Benefits

35. Increase in scales for taxation of car and petrol fringe benefits represents a further step towards taxing such benefits on a realistic basis. However, increases of about 15 per cent in scales rather than the 20 per cent increase of the last three years show the Government's awareness of need not to move too fast at expense either of recipients of benefits or of UK motor industry. Yield of £35 million in a full year.

36. Action also proposed on: payment of cost of children's education by employers (reversing decision on ICI scholarship case); provision by employer of house rent free or at peppercorn rent; employer failing to deduct PAYE at proper time and accounting for too little tax. NB change in law affecting ICI Scholarship Scheme (and others like it) does not affect Scholarship income in hands of scholar, genuine charitable scholarships won in open competition or school fees paid while parent is working abroad.

9. <u>Secondhand Bonds</u>

37. Legislation in Finance Bill was announced by Financial Secretary on 24 June 1982, to tackle device whereby bonds (ie life insurance policies and life annuity contracts) are sold to third party to go <u>out</u> of income tax <u>into</u> capital gains tax net, thereby avoiding proper charge.

10. <u>Child Benefit and One-Parent Benefit</u>

38. The increase of 65p a week from £5.85 to £6.50 in November - by some 11 per cent - will put it at its highest level ever, at above the level set by Labour in April 1979 when the normal November increase was specially advanced for electoral reasons. Allowing for the phasing-out of child tax allowances, the value of support for children under 11 will have risen 90 per cent since 1978-79 in money terms (or 11 per cent in real terms) while income tax allowances will have risen by 82 per cent. <u>One-parent benefit</u> will be increased by 11 per cent from £3.65 to £4.05. It will then also have been more than doubled in money terms by this Government, giving a real increase of over 30 per cent.

H. <u>INDIRECT TAXES</u>

39. Changes proposed this year are straightforward and should be uncontroversial:

- No change in VAT rate.

- "Sensible presumption" (budget statement) established in successive budgets that excise duties rise broadly in line with prices.

- Overall revenue effects of excise duty changes is £595 million in 1983-84 and £605 million in full year - half the 1980 or 1982 figures, and only a quarter of 1981.

- RPI effect of only about 0.4 per cent, smallest for many years, one of the benefits of low inflation. <u>Included</u> in the forecast.

40. Again, as last budget, regard had to needs of business:

- duties on aviation gasoline (AVGAS) and road fuel gas (LPG) remain at half that on petrol;

- small widening of tax differential in favour of Derv from 12p to 13p a gallon helps limit impact on business costs;

- the duty rate on fuel oil is unchanged for the third successive year. This means that the real value of the duty on it is about 20 per cent below level of 1980, so helping industry with energy costs;

- VED rates up on selected heavy vehicles (about 195,000) which do most damage, to cover those costs; down about 10 per cent on about 315,000 lighter, less damaging lorries; duty rates still lower in real terms than under Labour;

- increases on petrol (4.9 per cent) and Derv (4 per cent) below inflation. Will only add about £10 a year to typical private motorist's bill. Duty differential in favour of Derv widened slightly. UK petrol prices will remain, with Germany and Luxembourg, markedly below those in other European countries.

I. SOCIAL SECURITY UPRATING, CHARITIES AND DELAYED DECISIONS

Benefit Increase

41. As the Budget Speech makes clear, it is not now proposed to recover the full overshoot which arose in last autumn's benefit uprating, when inflation was some 2.7 per cent less than assumed when the increase was announced in the 1982 budget. At a time when the main budget proposals provide for significant tax relief to those in work as well as to businesses, it is clearly right to be generous and leave some of this "windfall" overpayment in the hands of social security recipients. With the exception of beneficiaries with children, who will receive substantial help from the increase in Child Benefit, the bulk of social security recipients are neither in work, nor pay significant income tax, and so will not benefit as much or as directly from the budget as the bulk of the population.

42. What is now proposed will, on the assumption of year-on-year RPI increases of around 4 per cent in May 1983, be worth substantiall more

in a full year than if the overpayment was recovered. Between the November upratings of 1978 and 1983 prices are likely to have risen some 70 per cent and pensions by some 75 per cent. Thus the Government's pledge to maintain the value of the pensions will have been more than fulfilled.

43. To have left the full overpayment in place in years to come would have required accepting yet more increases in National Insurance Contributions at a time when the rates in force now are recognised as being so high as to be damaging to employment, incentives and the will to work; and every further increase in them is the cause of widespread concern both in Parliament and the country at large. In addition, it would have pre-empted resources needed to finance a number of other important reforms in social security which are needed now.

Other Important Social Security Measures

44. These include, as well as the substantial improvement in child benefit (see §38 above):

- restoration of the 5 per cent abatement of unemployment benefit;

- 12 per cent increase to £22.50 in the Therapeutic Earnings Limit, the amount the disabled and chronically sick are allowed to earn before their benefit is reduced;

- Complete removal of the "Invalidity Trap". At present those receiving Invalidity Benefit (IVB) cannot qualify for short-term SB, one year's receipt of which is the passport to long-term SB. What is now proposed is that IVB recipients over 60 will qualify immediately for the long-term rate instead of waiting a year. Some 70,000 people will gain. Those under 60 not previously eligible at all, will become eligible after a year of incapacity benefits. This is how the "trap" is being eliminated.

- Disabled War Pensioners. A new mobility supplement to replace the present vehicle scheme with the equivalent of the Mobility Allowance plus a special premium of £2.10 a week in recognition of their special status. 11,000 war pensioners should be helped by this.

- Substantial increases in Supplementary Benefit "Disregards". The capital disregard - £2,000 in 1981, £2,500 last year, will now be £3,000 - 50 per cent up in two years. The extra £300 disregard for single payments (eg bedding, heating costs) goes up by 60 per cent to £500. A new £1,500 disregard introduced for capital held as life insurance policies, over and above the £3,000 normal capital disregard.

Charities

45. The budget proposes further important assistance:

- the cost of employees seconded to charities to be a tax deductible expense; as requested by the NCVO;

- CTT exemption limit abolished (raised from £50,000 to £250,000 in 1982-83), thus ensuring that no outright bequests to charities will now be taxed;

- limit for higher rates and IIS income tax relief on covenants raised by two-thirds from £3,000 to £5,000.

46. Despite intensive investigations, it is not possible to propose recovery by charities of VAT on their purchases. A scheme of relief would probably involve at least 100,000 charities, which would necessitate a disproportionate increase in administrative manpower. Moreover it would, unavoidably, be indiscriminate, and have undesirable repercussive effects.

Change in the System of Up-rating

47. Labour's switch from the "actual" or "historic" method of up-rating to one based on the forecast RPI has an unfortunate origin and has been a source of constant trouble. It was introduced in 1976 only to excise from the uprating the worst months of inflation between March and November 1975. This reduced the benefit increases by 6-7½ per cent, worth £500 million in the prices of the day, or some £1 billion at current prices. This was clearly in breach of the commitment given by Brian O'Malley, Minister of State at DHSS, as to the purpose of what was to be the Social Security Benefits Act 1975:

> ".... I believe that I have demonstrated to the Hon. Gentleman that the historic method is in the end, the fairest method. It means that there is a consistent link between the movement of earnings on the one hand and the movement of retirement pensions and long-term benefits on the other. There are no assumptions. Once one starts to make assumptions, it is easy to make one which results in pensioners doing worse than they otherwise would." (OR Standing Committee B. 12.12.74. Col. 191).

Prophetic words indeed.

48. Forecasting inflation is always difficult. As Table 3.7 of the Budget Red Book makes clear, a Budget-time forecast of the RPI increase in the fourth quarter of the same year is liable to average errors of plus or minus 2 per cent. This is amply borne out by recent experience; the projections were 1 per cent too high in 1980, 2 per cent too low in 1981 and 2.7 per cent too high in 1982. Such errors create both needless uncertainty for beneficiaries, avoidable controversy for Governments and are impossible to correct for 12 months.

49. A return to the historic basis has been advocated by Pensioners' organisations. It has even been commended by the Opposition: Jeff Rooker described it as "very sensible considering the trouble that the Government have had over past few years" in the debate on the Social Security and Housing Benefits Bill on 22 December 1981.

50. Moving back to the old system is not only a switch back to certainty and commonsense, but it reverses the 1976 Barbara Castle decision in another important respect. While she made it in such a way as to leave beneficiaries with £1 billion less at today's prices than the indexation commitments of the Social Security Act required, the change now proposed should leave a substantialsum in their hands over and above the indexed increase required by law, even if not all the over-payment windfall. There will be no "missing months" - the period between May and November 1982 is included in the uprating formula now proposed.

J. BUSINESS AND EMPLOYMENT

51. General: Chancellor stressed in budget statement that tax cuts for people themselves help business and jobs. Direct effect of main tax and spending measures benefiting business in this budget are summarised in Section ~~E~~ para 18 above.

52. The Main Measures

- 'Small Companies' Corporation tax rate cut by 2% to 38%, profit limits substantially increased; significantly reduces marginal rate between limits: NIS to be cut by ½% to 1%, for private sector only, from August 1983.

- Measures to help small firms, enterprise and wider share ownership (see para 63 below)

- Technology and innovation package, costing £185m over 3 years for public spending measures and £48m over 3 years for tax measures; other measures: help for housing and construction, including increase in Mortgage interest relief ceiling and money for "enveloping" schemes (total cost together of £115m in 1983/84); help for North Sea Oil industry, through tax reductions (cost £115m in 1983-4); proposals on tax havens and proposed changes on ACT and double taxation relief do not between them involve any increase in total tax burden on international business;

- Employment and Early Retirement Measures (See para 60 below);

53. Para 19 sets out some of the benefits to industry attributable to this Government's policies. Other points to note are that:

- Budget measures alone help business by £¾bn in a full year. The reflects assistance worth about £1½bn, as set out in 18, less the effects of increases in petrol duty, DERV, & VED. On top of £½bn help in Autumn announcements.

- the real burden of tax and NIC on (non-oil) industry and commerce in 1983-84 will be some £2bn less than in 1978-9.

54. There is no assistance in this budget with industry's energy costs. But particularly since exchange rate fell, vast majority of UK industry pays prices comparable to EC competitors; and over £250m of help given in <u>last two</u> budgets. In addition this year there is to be no increase (on average) in electricity prices and the freeze on price of contract gas is extended to 1 October 1983;

Main individual measures

1 NIS

55. Labour introduced and increased NIS. Liberals, during Lib-Lab pact, pressed for increase too. Government has slashed it:

- Rate inherited in 1979, and up to 1981-82: 3½%
  Effective Average Rate in 1982-83: 2%
  Rate from April to July 1983: 1½%
  Rate from August 1983: 1%

- present cut is worth £215m to private employers - 1983-84, £390m in a full year, will be clawed back as before from Government and NI cash limits:

- even taking account of NIC increases since 1978-9, the over all effect of NIC and NIS changes worth some £1.4bn to private sector employers in full year;

- overall NIC/NIS rate on contracted-in employers up from 8½% to 13½% under previous government. <u>Now</u> down to 11.45%. Contracted-out rate down from 9% to 7.35%.

2 Housing and Construction

56. Government recognises importance of healthy construction industry for employment. Within public spending plans, provision made for spending on construction in 1983-84 of over £10bn, 10% increase on previous year's outturn.

Measures to help construction introduced in last three budgets provided help worth some £350m

57. 1983 Budget introduces 8 measures:

- mortgage interest relief ceiling increased to £30,000; £50m in 1983-4;

- mortgage interest relief extended to some self-employed who did not previously qualify;

- stock relief extended to houses taken in part exchange by builders, helps private housebuilders;

- local authorities to be given additional spending allocations for 1983-4 for approved 'enveloping' schemes ie repair of external fabric of terraces and streets, often in inner city areas: helps builders and socially deprived areas; and elegible expense limits for home improvement grants increased by 20%;local authorities able to spend without limit on improvement grants in 1983-4 including (about £10m)cost of these higher limits;

- change in industrial buildings allowance to allow greater proportion of non industrial space to qualify, accords more flexibility to builders:

- important rule change in small industrial workshop to help conversion of old buildings into small units;

- two year extension of deferment of DLT liability on development for "own use".

3. Innovation and Techology

58. As in last budget, Chancellor announced major package to help technologies and industries of future: Total cost of £230m over next three years. Of this,£185m (over 3 years) is a package of additional spending on innovation, in addition to existing DoI help with industrial R and D of over £300m per year. Main item is reintroduction of Small Engineering Firms Investment Scheme at £100m over three years. Also, extra aid for computer software, advisory services, and new schemes to plug gap between development and commercial production (Details to be announced by S of S for Industry). This will cover:

- help to industry to invest in new technologies for tomorrow's jobs and bring new products and processes to market;

- SEFIS, very successful in 1982, and of special help in West Midlands.

- Teletext: 100% first year allowances for spending by trade on teletext sets for renting out to consumers extended for further year, till May 1984.

  - helps information technology growth;
  - helps UK electronics; teletext a UK invention and rented TV sets mostly British made.

Technology-based industries also benefit from increase from 10% to 25% in permissible office space in buildings which qualifies for industrial buildings allowance.

59. Films: extension of 100% first year capital allowances for British firms for further 3 years to 31 March 1987.

4. Employment and Early Retirement

60. Government recognises need to reduce labour force where practical and prudent to do so, so as to help tackle unemployment. Budget contains three new measures of this sort to help employment:

- from April unemployed men aged 60-65 will no longer have to register first to get contributions credits so as to protect their pension rights (affects 90,000).

- from June unemployed men over 60 on Supplementary benefit will qualify for higher long-term rate of benefit without having to wait a year or until they reach 65 (affects 42,000);

- from October (till March 1985) men over 62 and women over 59 able to retire under new part-time Job Release Scheme, allowances paid at half full-time rate, should provide part-time jobs for up to 40,000 unemployed people. Has no net expenditure cost in 1983-4, because of savings in benefit payments.

And - Enterprise Allowance extended to whole country Allowance, which encourages unemployed to set up in business by paying £40 a week for first year to offset loss of unemployment benefit if then start a business. Nationwide extension (cash limit for 1983-4 of £25 m enough for 25,000 places) builds on experience of 5 pilots set up in January 1982: attracted 2000 successful applications.

5. Other Company Taxation

61. Budget also proposes action to deal with group relief avoidance, whereby a goup arrange for profits/loss to be available for group relief proposes in another group; necessary to take action because of actual and potential revenue loss.

62. Taxation of international businesses

Revised draft clauses issued last December on proposals for new charge on some UK controlled companies in tax haven countries. Measures to apply from 6 April 1984. Represent sensitive response, after 3 rounds of consultation, to business community's criticism of earlier proposals. But real need to stop significant loss of UK tax, currently estimated at £100 million p.a. This move will be accompanied by a change in the Set-Off of ACT and Double Tax Relief. These proposals are of benefit generally to companies with overseas income for allowing double taxation relief to be set against corporation tax in priority to ACT. Credit for tax paid on foreign income now to be available against UK corporation tax before relief given for ACT paid (previously, ACT relief given first).

Cost: nil 1983-4, in long term up to £100 million.

Overall these two measures offset one another in revenue terms, lower taxes on companies which should send profits home onto those who accumulate them in taxhavens. There are No measures this year on company residence and up stream loans.

K. ENTERPRISE AND SMALL FIRMS

63. Fifteen measures in budget to help enterprise and small firms. Fourth successive year in which Budget has included such a package. Demonstrates continued commitment to small and medium sized businesses as source of new jobs.

- Business Expansion Scheme, extending Business Start-Up Scheme.
- Changes in Corporation tax to help small and medium firms.
- Nationwide extension of Enterprise Allowance.
- Increase in VAT registration and de-registration thresholds.
- Tax encouragement of profit sharing and share option schemes.
- Extension of interest relief on borrowing for employee buy-outs.
- CTT changes, improving business and agriculture reliefs.
- CGT changes, increasing retirement relief.
- new rules for tax treatment of deep-discounted stock.
- new tax rules for raising finance through acceptance credits.
- new non-tax rules to help raising finance through Eurobonds.
- raising ceiling for loan guarantee scheme.
- increasing limit below which investment income of close companies apportioned to individuals not assessed for tax.
- changes in small workshop scheme.
- introduction of free ports at two or three places as experiment.

100
Estimated revenue cost of package is £1/1m in 1983-84 and £275m in full year. In addition, Enterprise Allowance has gross cost of £25m in 1983-84. Brings total cost of package up to £135m in that year.

Main points:

64. Business Expansion Scheme major initiative, building on BSUS, introduced in 1981. Now scheme will apply not just to new companies but also to many existing unquoted trading companies too. Also relief available at full income tax rates (including IIS) doubled to £40,000 per person per year. Previous 50% limit on proportion of company's shares qualifying for relief now dropped. Life of scheme extended by 3 years to 5 April 1987. Full year cost, perhaps £75m.

65. Profit Sharing and Share Option Schemes. Government's commitment to wider ownership and to giving employees incentives again demonstrated. Over 550 profit sharing and share option schemes now set up cf 30 when we took office. Over 100,000 employees now involved in approved share option schemes. Now,

- in addition to current limit on allocation of shares per employee of £1,250 pa a new alternative limit of 10% of earnings up to £5,000 pa;
- upper limit for monthly contributions under 1980 SAYE share option schemes raised from £50 to £75;
- extension from 3 to 5 years of instalment period over which income tax paid on share options exercised outside 1980 approved schemes.

66. Buy-Outs. Government commitment to helping NFC-style management/employee buyouts shown by relief to be extended on borrowing by employees to buy shares in employee -controlled company as part of employee buyouts.

67. Capital Taxes. Government recognises capital taxation, if too heavy, can suffocate enterprise and discourage investment.

- CGT: This budget builds on major reforms in last Budget, above all indexation of capital gains; so annual exempt amount raised in line with RPI. Now more than five times level when government took office and three times 1978-79 level in real terms. Maximum retirement relief for those aged 65 or more doubled from £50,000 to £100,000 and proportionate increase for those retiring between 60 and 65: will encourage business owners to reinvest profits in business, rather than in pension schemes.
- CTT: Again, builds on 1982 budget reforms. Last budget introduced indexation of CTT threshold and rate bands; so raised in line with inflation now. Threshold now 40% higher in real terms than 1978-79.
- Also, rate of business relief for minority holdings in unquoted companies and of agriculture relief for tenanted land each increased from 20% to 30%.

68. <u>Small Companies Corporation Tax Rate</u>

- Lower limit <u>more</u> than re-valorised this year and limit <u>doubled</u> since Government took office;
- big increase in upper limit helps medium-sized companies with profits up to £500,000; increased almost six fold since we took office;
- marginal rate applying between lower and upper limits reduced from 60% to 55½%.

All show Government's commitment to small and medium sized businesses.

69. <u>VAT Registration and Deregistration</u>. Thresholds raised from £17,000 to £18,000.

70. <u>Loan Guarantee Scheme</u>. The total sum for loans to be doubled from £300m to £600m. So far some 9,000 loans have been made, over half to new businesses.

71. <u>Measures to encourage Industrial Finance</u>. Reductions in the PSBR, judicious recourse to index-linked gilt-edged borrowing and a high target for national savings have all been vital in allowing long term interest rates to fall. Indeed in 1982-83 it was possible to dispense with long term fixed interest gilt-edged stocks almost entirely. As a result, long term interest rates (eg on 20 year gilts) have fallen by as much as short term rates (5% or so in each case), whereas in normal circumstances they would have been expected to fall much less. This is a major factor favouring <u>revival of the corporate bond market</u>. This is receiving further direct encouragement in severals ways:

- <u>Deep discount stock</u>. New tax regime following removal of embargo in June 1982, and consultative document from Inland Revenue. Borrowers will get <u>relief against income annually for accrued discount</u>; investor to be taxed on disposal or redemption, income tax on accrued income, CGT on balance of gain or loss.

- Convertible Loan Stock. Incidental fees to be allowed against tax.
- Acceptance credits. To encourage companies to use bills of exchange, discounts and incidental costs to be allowed against tax.
- Interest on Eurobonds for non-residents to be payable "gross".
- Close company investment income limit for not making tax assessment for an individual to be raised from 1973 figure of £200 a year to £1,000; £250 more than revalorisation.

L. NORTH SEA OIL

72. Chancellor recognises importance of further development of North Sea off-shore industry to Britain, source of wealth and jobs. Major, well-judged changes in fiscal regime intended to maintain balance between interests of Exchequer (and taxpayer) and health of the industry and employment it provides, as oil market becomes more difficult.

- Advance Petroleum Revenue TAX (APRT) to be phased out by 1 January 1987 by reducing rate at which charged (currently 20%).
- New PRT relief for spending incurred after budget on exploration appraisal outside area of existing oil field or development.
- New fields for which development consent given after 1 April 1982 - except onshore fields and fields in Sourthern Basin of North Sea - to get double existing oil allowance. And same new fields will not pay any royalties.
- Other changes in PRT, including abolition of restriction on PRT relief for expenditure on assets where oil (including gas) producer shares assets with other field (eg pipe lines).

Cost of whole package of measures: 1983-84 £115m. Average cost 1983-84 to 1986-87: about £200m.

73. Measures: - through phasing out APRT, removes a charge which is not related to profit and payable early in field life, so creating cash flow problems;

- new PRT relief should encourage exploration and appraisal of UK reserves;

- help for future fields espcecially, will pay no special tax or royalties till costs recovered from income and marginal rate for such field significantly improved.

M. PUBLIC SPENDING

74. Main points are:

- public spending under firm control; held within levels of earlier plans; ratio to GDP down from 44½% in 1981-82 to planned 43½% in 1983-84;

- meausres in budget total £238m in 1983-84 but all charged to Contingency Reserve in 1983-84 so will not add to planning total;

- public sector capital spending in 1983-84 as shown in White Paper amounts to £11¼bn, increase of 12% over estimated outturn for 1982-83, local authorities told they can spend without limit on home improvement grants, if necessary additional allocations will be given retrospectively; 50% of forecast levels of capital receipts by local authorities will be included in basic allocations; because of reduction in inflation more real output possible with giving cash plan for capital spending. All show that Government determined to achieve right balance of capital and current spending, without jeopardising objective of curbing total spending.

- Civil Service manpower under control: on course for 630,000 target by 1 April 1984 and down 11% since 1 April 1979; since 1979 staff reductions in civil service have saved £600m on Civil Service salary bill, centrally organised efficiency programme 1979-82 has yielded potential savings of £317m a year, and £44.5m once-for-all savings.

Michael Scholar No 10.

This compact pocket note is going via the Whips to backbenchers who are known to be going on TV or Radio today

With the Compliments

of

ADAM RIDLEY

Special Adviser

AR 15/3.

Treasury Chambers,
Parliament Street,
S.W.1.

KEY POINTS

A BUDGET FOR PEOPLE: A BUDGET FOR RECOVERY.

1. Sustains successful strategy for lower inflation and interest rates; still further support for enterprise, industry, jobs, recovery, on top of extensive assistance in '82 Budget and Autumn Statement; major but not extravagant or vote-buying, cuts in income tax; complemented by generous measures to help families, disabled, poor and charities.

2. THE ECONOMY NOW. Inflation level lowest for 13 years, 1/5th of its recent peak. Economy picking-up - witness latest CBI survey, 2% jump in industrial and manufacturing production indices published 15 March. UK exports rose in '82 despite 3% fall in world trade, so export market share up. Competitiveness 25% better than 1981 trough. Real home demand rising by 2 to 3% p.a. since end '81, set to continue.

3. THE PROSPECT. Slight rise in inflation to 6% round end '83, but set to go on down after. GDP to grow by 2% '82/3, perhaps 2½% in later years. Investment to rise 3½% in '83 for second year running. Balance of Payments current account to remain in surplus. Falling PSBR burden to continue, favouring still lower interest rates.
N.B. Continuing oil price uncertainty: Government ready to act to keep economy on course.

4. VALUE OF MEASURES. Revenue cost, excluding indexation, nearly £2bn in '83/4, about £2¼bn full year. [PSBR cost, less, about £1½ amd £2bn respectively].

5. INCOME TAX CUTS. Allowances up 14%, 8½% over prices, to levels 5% above those inherited from Labour in '79. Adds to weekly income of average basic rate payer by £1.27 if single, £2.02 if married; and more to retired - £1.67 for single, £2.65 for married. IIS threshold raised generously too. Real take home pay should be higher for all than in '78/9, or in '82/3. 1¼m less tax payers than if allowances untouched, ¾m less than with indexation alone. Specially helps poverty trap, low paid.

6. INDUSTRY & ENTERPRISE. Assistance worth a further £1bn in a full year. NIS cut 3 times in a year from 3½% to 1%, cuts worth £2bn p.a. in total. Corporation Tax cut for small companies. Business Expansion Scheme to help new and expanding smaller businesses. Three-year £185m Technology and innovation package, and £100m SEFIS for small engineering firms investment. More on popular improvement grants and enveloping; helps construction. Tax reductions averaging £200m a year to encourage North Sea exploration. Nationwide Enterprise Allowance. Many other measures: Teletext, Films, workshop scheme, Freeports, share options, Loan Guarantee Scheme, deep-discounted stocks, etc.

7. FAMILIES, NEEDY, POOR, DISABLED. Child Benefit up to £6.50, one parent benefit to £4.05, higher ever real values. Widows Bereavement Allowance extended to help twice as many.

Invalidity trap removed - recipients will now get long-term SB. Unemployed - 5% abatement restored, JRS extended, help for early retirement (helps 150,000). Charities - further reliefs. Last year's Social Security Benefit overshoot not fully recovered. Restoration of reliable up-rating system based on past RPI, not forecasts.

8. MISC. N.B. Also Mortgage interest relief limit to £30,000, CTT Reliefs for Business and Agriculture. No increase in Heavy Fuel Oil duty.

9. INDIRECT TAXES. Duty increases in line with prices generally. Impact on prices 0.4% only, vastly less than in recent years.

BUDGET SECRET until after Budget Speech,
15 March 1983

BUDGET SNAPSHOT 15 MARCH 1983

Budget proposes significant cuts in taxes on individuals and business consistent with the Medium Term Financial Strategy for effective control of the money supply, lower public borrowing and further progress on inflation. The Chancellor stressed that: "The requirement we saw, and the country accepted in 1979, was for resolve, for purpose and for continuity. My proposals in this Budget are rooted in that same resolve, and will maintain that purpose, and that continuity. They are designed to further the living standards and employment opportunities of all our people and to sustain and advance the recovery for which we have laid the foundations."

A. Main Proposals (FSBR, Part 1; detailed proposals listed in Part 4)

(i) Relief for persons - personal income tax allowances and thresholds increased by 14 per cent - 8½ percentage points more than required for by statutory indexation.

(ii) Child benefit increased to £6.50 a week - more than restoring its 1979 purchasing value - highest ever level in real terms.

(iii) 5 per cent abatement of unemployment benefit to be restored.

(iv) Measures to assist housebuilding and home ownership, including increase in mortgage interest relief limit to £30,000.

(v) Additional employment measures include extensions of the Enterprise Allowance and Job Release Scheme.

(vi) National Insurance Surcharge reduced to 1 per cent from 1 August.

(vii) "Small companies" rate of Corporation Tax cut from 40 per cent to 38 per cent.

(viii) Further assistance to small firms and to help enterprise and wider share ownership includes new Business Expansion Scheme, extending and improving the present Business Start-up Scheme, and help for technological innovation.

(ix) Changes to North Sea oil taxation include the phasing-out of Advance Petroleum Revenue Tax and special relief for future fields.

(x) Excise duties increased broadly in line with inflation.

(xi) Measures aimed at fringe benefits and tax avoidance.

In addition proposed changes in the method of uprating social security benefits were announced.

B. Autumn Measures

The following measures were announced in November 1982 to take effect from April 1983:

(i) National Insurance Surcharge cut by 1 per cent to 1½ per cent from 1 April 1983.

(ii) National Insurance Contribution rates (employers and employees) increased by ¼ per cent. Increase was less than the 0.4 per cent needed to balance the National Insurance Fund.

Revenue costs in 1983-84 of NIS cut and hold-back on NIC - some £1 billion.

C. Effects of Budget

Compared with conventional indexation, and taking account of expenditure measures, Budget measures will add £1.6 billion to public sector borrowing requirement (PSBR) in 1983-84.

Direct revenue effects of tax changes:

(£ million)

	Effect in 1983-84		Effect in a full year	
	Change from indexed base	Change from non-indexed base	Change from indexed base	Change from non-indexed base
Income tax allowances and thresholds	-1,170	-2,000	-1,490	-2,545
Other income and direct taxes	-295	-310	-365	-410
National Insurance Surcharge*	-215	-215	-390	-390
Excise duties	10	595	10	605
Other indirect taxes	-	-5	-	-5
	-1,670	-1,935	-2,235	-2,745

* Estimates exclude public sector payments.

+/- indicates an increase/decrease in revenue.

Additional public expenditure on technology and innovation, housing improvements, social security and employment measures, will cost £238 million in 1983-84 over and above what is already provided. This is all charged to the Contingency Reserve and thus will not add to the total of planned public expenditure.

The latter is now expected to be £112.5 billion in 1982-83, £0.5 billion less than the estimate in the Public Expenditure White Paper, Cmnd 8789. The planning total in 1983-84 is reduced from £119.6 billion in Cmnd 8789 to £119.3 billion, compared with the £120.7 billion planned at time of the 1982 Budget.

The full year revenue cost of the Budget is of the order of £2¾ billion. The bulk of this - around £2 billion - goes to individuals. But business benefits to the extent of about £¾ billion. Businesses have been helped by the measures announced in the autumn - worth around £½ billion after taking account of the increase in the employers' National Insurance Contribution - as well as by the falls in the exchange rate and oil price. If revenues from taxes paid by business (NIS, NIC, corporation tax and rates) - apart from the North Sea industries - were the same share of total taxes in 1983-84 as they were in 1978-79, then these businesses would have to pay some £3 billion more than is forecast for the coming year.

The changes in excise duties will add 0.4 per cent directly to the RPI (but have a negligible effect compared with an indexed base). This has already been taken into the forecast.

D. Medium Term Financial Strategy (FSBR Part 2)

MTFS - updated and extended to 1985-86. Ranges for monetary growth will be the same as those planned this time last year, showing a continuing steady downward path. These ranges - which, as last year, are constructed on the assumption of "no major change in the exchange rate" apply both to broad measures of money (£M3 and PSL2) and the narrow measure (M1):

[per cent]	1983-84	1984-85	1985-86
1983 FSBR	7-11	6-10	5-9
1982 FSBR	7-11	6-10	na

A PSBR of 2¾ per cent of GDP - around £8 billion - is planned for 1983-84, consistent with the figure published in the Autumn Statement. The PSBR ratio will continue to show a downward path over the medium-term. The fiscal projections assume real GDP growth of 2½ per cent per annum, and money GDP growth of 8 per cent.

PSBR* [£bn]	1982-83		1983-84		1984-85		1985-86	
1983 FSBR	7½	(2¾)	8	(2¾)	8	(2½)	7	(2)
1982 FSBR	9½	(3½)	8½	(2¾)	6½	(2)	na	

* Figures in brackets show PSBR as a % of GDP.

E. Economic Developments and Outlook (FSBR, Part 3)

Budget is presented against a world background which, though still full of risks, is looking more hopeful. Lower interest rates and inflation, particularly in the US, and a number of recent indicators, are pointing towards some increase in world activity in 1983. The fall in oil prices in recent weeks improves the prospect for both recovery and lower inflation.

In the UK, a pause in the downward trend in RPI inflation is likely this year. Total output (GDP) should rise by about 2½ per cent in the year to first half of 1984, and manufacturing output by much the same percentage. The growth in output now foreseen, if sustained, is probably consistent with no major change in unemployment. The surplus on the balance of payments current account is forecast to remain sizeable (but smaller than in 1982). Exports are forecast to rise as world trade recovers, but imports are also likely to increase as the rundown in stocks comes to an end.

Summary of Short-Term Forecast

	GDP (% change on year earlier)	Current Account Balance of Payments (£bn)	PSBR(2) (£bn and % of GDP)	RPI (% change 4th quarter to) 4th quarter)
1982	½	4	7½ (2¾)	6
1983	2	1½	8 (2¾)	6
1984 (first half)	2½	2(1)	-	6(3)

(1) At annual rate

(2) Financial years 1982-83, 1983-84

(3) Second quarter 1983 to second quarter 1984

F. Personal Income Taxation

Main rates - including basic rate of 30 per cent - remain unchanged. Allowances and thresholds increased by about 14 per cent as follows:

(£)	1983-84 (proposed)	1982-83
Married	2,795	2,445
Single (and wife's earned income)	1,785	1,565
Additional personal (and widow's bereavement)	1,010	880
Aged - married	3,755	3,295
Aged - single	2,360	2,070
Basic rate limit (starting point for higher rates)	14,601	12,801
Aged income limit	7,600	6,700
Investment income surcharge threshold	7,100	6,250

G. Social Security and Other Benefits

Uprating of social security benefits will be based on the outturn figure of inflation to May 1983. Next November's uprating will therefore be announced in June. May's inflation figure expected to be in the region of 4 per cent. Linked public service pensions to be increased by same amount.

Child Benefit increased by 65p to £6.50 from November 1983; one parent benefit up 40p to £4.05. (Gross cost £122 million in 1983-84 as compared with no increase at all, £340 million in 1984-85.)

5 per cent abatement of unemployment benefit to be restored from November 1983 (cost £22 million in 1983-84, £60 million in a full year).

A number of measures to provide substantial help to the sick, disabled, war pensioners and the less well off. Main changes:

a. Amount the severely disabled can earn before benefit is up from £20.00 to £22.50.

b. "Invalidity trap" to be ended - people under 60 on incapacity benefit for a year will qualify for long term rate of Supplementary Benefit. Over 60s will qualify immediately.

c. Capital disregard for entitlement to Supplementary Benefit increased from £2,500 to £3,000. Additional disregard of £1,500 for life assurance policies.

H. Widows and Charities

Entitlement to widow's bereavement allowance extended to cover year after husband's death. (Cost £30 million in a full year.)

£250,000 ceiling for CTT exemption on bequests to charities abolished: outright bequests to charities will not be taxed.

Annual ceiling for tax relief at higher income tax rates for payments under deeds of covenant to charities raised by £2,000 to £5,000.

Companies to be able to deduct for tax purposes costs of staff seconded to charities.

I. Indirect Taxes

Changes reflect need to broadly maintain real value of excise duties.

Indirect Tax Yields(+) and Costs(-) (£ million)

	1983-84	Full year
VAT	-5	-5
Tobacco	95	100
Drink	140	145
Petrol	190	190
Derv	40	40
VED - cars/light vans	93	93
- lorries	37	37
Total all duties	590	600

VAT. Basic rate remains 15 per cent; registration limit increased from £17,000 to £18,000.

Tobacco. Duty (inclusive of VAT) up 3p a packet of 20 cigarettes (from 18 March 1983). No change in rate of duty on pipe tobacco.

Drink. Duty (inclusive of VAT) up 1p on a typical pint of beer, 5p on a bottle of table wine, 7p on a bottle of sherry, 25p on a bottle of spirits, 1p on a pint of cider (from 16 March 1983).

Petrol. Duty (inclusive of VAT) up 4p a gallon; derv up 3p a gallon.

Heavy fuel oil. No change.

Vehicle Excise Duty (on or after 16 March). Car duty up by £5 to £85. Approximate 10 per cent reduction in rate for 315,000 lighter, less damaging lorries; increase of between 5 per cent and 26 per cent for selected lorries; heaviest, most damaging lorries suffer largest increase. New 33 to 38 tonne lorries to cover their road costs from the outset.

J. Housing, Home Ownership and Construction

Ceiling for mortgage interest relief up from £25,000 to £30,000 (cost £50 million in 1983-84). Relief extended to self-employed in tied accomodation buying houses elsewhere.

Limit on expenditure eligible for home repair grants increased by 20 per cent. Additional resources to "enveloping" schemes - external repairs to whole streets or terraces in inner city areas. (Cost of these 2 measures - £60 million in 1983-84.)

Stock relief available on houses accepted by builders in part exchange.

Industrial buildings allowance - permitted proportion of office space up from 10 per cent to 25 per cent (full year cost £25 million).

Development Land Tax deferment scheme on developments for owners' own use extended from April 1984 to April 1986.

K. Employment Measures

Enterprise Allowances to help unemployed people set up their own business extended to whole country.

90,000 men between 60 and 65 no longer required to register solely in order to protect pension rights.

42,000 unemployed men on Supplementary Benefit will no longer need to wait a year (or to reach 65) to qualify for long term rate of SB.

New scheme for part-time job release.

L. National Insurance Surcharge

The NIS is to be cut by another ½ per cent to 1 per cent from 1 August. Benefit to be confined to private sector. (Cost £215 million in 1983-84, £390 in full year).

M. Small Firms, Enterprise and Wider Share Ownership.

Measures to foster growth of small and medium sized enterprises and improve their competitive environment. The new VAT registration limit and the changes in capital taxation will also help small firms.

Business Expansion Scheme extends and improves the Business Start-up Scheme. The life of the scheme is extended to April 1987, it will now be applied to new and established unquoted trading companies and the maximum yearly investment limit will be raised from £20,000 to £40,000.

Corporation Tax - small companies rate cut from 40 per cent to 38 per cent; profits limits raised - lower limit up £10,000 to £100,000 - upper limit up £275,000 to £500,000. (Cost £40 million 1983-84; £70 million in full year.)

Interest relief extended to share purchases in employee buy-outs.

Deep-discounted stock - borrowers to get relief for accrued discount; investors to pay tax only on redemption and sale.

Profit Sharing and share options:-

a. profit share limit - £1,250 annual limit plus alternative of 10 per cent of salary to maximum of £5,000;

b. save-as-you-earn monthly limits raised by £25 to £75;

c. for other share options, 3 year instalment period over which income tax can be spread extended to 5 years.

Loan guarantee scheme - ceiling for total lending raised from £300 million to £600 million.

Small Industrial Workshop Scheme - averaging of size requirement for conversions of old buildings.

Freeports - legislation to be introduced; a few experimental locations to be authorised.

N. Technology and Innovation

Small Engineering Firms Investment Scheme re-opened.

First year allowances for rented teletext receivers extended to June 1984, and for British films until March 1987.

Also includes help with information technology, innovation linked investment and extension of science parks. (Total cost of technology and innovation measures package - £240 million over three years).

O. North Sea Oil Regime

Total North Sea revenues expected to be about £8 billion in 1983-84 similar to 1982-83 estimated outturn. A package of reliefs totalling £800 million over four years for existing fields, together with a substantially more favourable regime for future fields. Total cost of Budget tax reductions estimated at £115 million in 1983-84.

Advance petroleum revenue tax (APRT), 20 per cent rate from 1 July 1983 cut to 15 per cent; to be phased out completely by the end of 1986.

PRT relief for expenditure incurred in searches or appraisal of discovered reserves, other than in existing oil fields or developments.

New fields (consent given after 1 April 1982) will get double existing oil allowance of ½ million tonnes each six months (total limit 10 million tonnes) and will not pay royalties. (Does not apply to onshore and Southern Basin oil fields).

Abolition of restriction on PRT relief for expenditure on shared assets (eg pipelines).

P. Capital Taxation (Capital Gains Tax, Capital Transfer Tax) and stamp duty.

CGT. Annual exempt slice raised £300 in line with inflation to £5,300.
Retirement relief doubled from £50,000 to £100,000.

CTT. Thresholds and rate bands raised in line with inflation; threshold up £5,000 to £60,000. Certain business and agricultural reliefs extended.

No change in Stamp Duty rates and thresholds. Consultative document to be issued.

Q. Fringe Benefits, Tax Avoidance, International Taxation

1984-85 scale charges for company cars up by about 15 per cent from those applying in 1983-84.

Certain special tax advantages for directors and higher paid employees removed (eg on cost of children's education, expensive houses).

Measures to be brought in to prevent manipulation of group and consortium relief.

Legislation on "Tax Havens" to be introduced as per consultative document "Taxation of International Business". Between them, proposals on tax havens and on ACT and double taxation relief will not involve any increase in the total tax burden on international business. No measures on company residence or upstream loans.

H M Treasury
15 March 1983

BROADCASTING OF PARLIAMENT (ANNUAL REVIEW)

Dr. Edmund Marshall accordingly presented a Bill to provide for the annual review of arrangements for the broadcasting of parliamentary proceedings: And the same was read the First time; and ordered to be read a Second time upon Friday 15 April and to be printed. [Bill 100.]

WAYS AND MEANS

Budget Statement

Mr. Deputy Speaker (Mr. Bernard Weatherill): Before I call the Chancellor of the Exchequer, it may be for the convenience of hon. Members if I remind them that, at the end of the Chancellor's speech, as in past years, copies of the Budget resolutions will not be handed around in the Chamber but will be available to hon. Members in the Vote Office.

3.38 pm

INTRODUCTION

The Chancellor of the Exchequer (Sir Geoffrey Howe): The longest Budget speech that I have been able to trace was given by Mr. Gladstone on 18 April 1953—*[Interruption.]*

Mr. Deputy Speaker: Order. Perhaps the Chancellor would like to start again.

Sir Geoffrey Howe: I am content, Mr. Deputy Speaker, to recognise that, although Liberals have long lives, they do not live that long. The date to which I refer, of course, was 1853. The speech lasted for about 4¾ hours. The then Leader of the Opposition said of the speech:

". . . it was so extensive that it is impossible, without consideration, to weigh its disadvantages and advantages".

That could have its merits in certain circumstances. But I can assure the House that I shall not try to rival Mr. Gladstone. Instead, I shall try to follow Disraeli, who delivered a Budget speech in 1867 lasting only 45 minutes. I am afraid that I cannot quite match that; but at least this will be one of the shortest—perhaps the shortest—of my Budget speeches, or at any rate the shortest so far. And that will not be its only attractive feature.

I begin, as last year, by making it clear that I shall today be proposing further significant cuts in the taxes paid both by businesses and by individuals. These proposals will be consistent with our medium term strategy for effective control of the money supply, for lower public borrowing, and for further progress on inflation.

The requirement we saw, and the country accepted, in 1979, was for resolve, for purpose and for continuity. My proposals in this Budget are rooted in that same resolve, and will maintain that purpose, and that continuity. They are designed to further the living standards and employment opportunities of all our people and to sustain and advance the recovery for which we have laid the foundations.

WORLD ECONOMY

In 1979 it was clear that the long-term decline of Britain's relative position in the world economy called for a fresh start, for a radical new beginning. And it soon became apparent, as the effects of the second oil price shock hit home, that that fresh start would have to be made in an international setting that was increasingly difficult.

Last year world output and trade were lower than generally expected. In the major industrial economies output fell; and more than 30 million of their people were unemployed.

Developing countries have faced similar difficulties. Weak markets for their products, high oil import costs and

[Sir Geoffrey Howe]

high interest rates have led to a sharp rise in their short-term debt. They have had to cut their imports; and that has added to the fall in world trade.

It is worth recalling that in 1979-80 the world price of oil rose by about 2½ times, and that it was this sharp rise, coming in the aftermath of the 1973 surge, that triggered off the deepest economic recession the world has experienced since the war.

Now, however, there are signs that the worst of the problems of the world economy are beginning to abate.

Oil prices have now weakened. For the world as a whole this means lower inflation, and hence an encouragement to increased activity.

More important still, there are clear signs that the world is breaking the inflationary habits of the 1970s. In many countries the rate of increase in prices has fallen more steeply than expected.

At the same time, interest rates have declined substantially almost everywhere, including, of course, here. In the United States, though real interest rates remain high, three-month rates have almost halved from last summer's peaks.

Looking ahead, 1983 should see recovery in the major economies gathering pace as the year goes on. This should be accompanied by a recovery of world trade.

Even so, we cannot expect a year of trouble-free progress. Transition from a period of high inflation is bound to be uncomfortable, internationally as well as nationally. The process of adjustment by major debtor countries has to be encouraged, and world recovery nurtured and sustained.

There is a major task here for the international financial institutions, which deserve—indeed require—our full support. The need is not for blue-prints for new institutions, but for increased commitment—political and financial—to the existing ones. That is why, as chairman of the Interim Committee of the International Monetary Fund, I worked this winter for an early increase in the resources available to the fund for lending to countries in difficulty, and why I pressed for a major increase. The decisions reached in the Interim Committee in February require ratification by national Parliaments, including this House. But their effect should be substantially to increase the usable resources at the fund's disposal—and I hope that the House will share my view that this is a wholly welcome development.

The agenda for international discussion remains a full one. Differences in performance by individual industrial countries remain wide and create tensions which are reflected in the foreign exchange markets. The threat of protectionism, which in the long run benefits nobody, continues to grow. The efforts of the United States Administration to cut back their daunting structural deficit are crucial to the prospects for interest rates and future inflation, and hence recovery prospects, for us all.

It is sometimes suggested that countries which have made most progress against inflation should speed the recovery process by a resort to reflation. But nothing could be more dangerous for recovery.

Lower inflation and lower interest rates are themselves the right foundations for economic recovery, a recovery which can be sustained. The days when Governments by spending more could guarantee to boost activity are far behind us—as the right hon. Member for Cardiff, South-East (Mr. Callaghan) pointed out almost seven years ago. But lower interest rates, and lower inflation, reduce costs and provide the opportunity for greater real growth of activity.

The prospect now is for just such a recovery. It will be gradual, but it should be steady, provided anti-inflationary gains are not thrown away; and the international consensus is that they must not be thrown away.

This is the heart of the strategy agreed at last year's Versailles summit and recently reaffirmed by the Interim Committee. Carrying it through will need persistence and political will, but it is backed by a broad measure of international commitment, on which we hope to build in the series of international meetings leading up to the Williamsburg summit.

THE DOMESTIC ECONOMY

At home as abroad, the need is for steadiness and resolve.

Government spending is being restrained. The public sector deficit, as a percentage of our domestic product, is now one of the smallest in the industrialised world. Monetary growth is towards the middle of the eight to 12 per cent. target range; and inflation, at five per cent., is lower than at any time since 1970.

Last year saw a surplus on our balance of payments current account of some £4 billion. In 1983 too we now expect a significant surplus. Total official external debt now stands at around $12 billion compared with $22 billion when we took office. This overseas debt burden is now smaller in relation to our trade than at any time since the second world war.

In our own economy domestic demand has been growing—at almost three per cent. a year in real terms—since the spring of 1981. This is a stronger growth of demand than in most other industrial countries. Indeed, in the industrial world as a whole demand has tended to fall. With this weakness in overseas demand and a rise in our imports, total output in this country increased last year by only 0·5 per cent. This year we expect domestic demand to grow by over three per cent. and output to rise by some two per cent. This is likely to be in line with, or a little faster than, the projected growth in world output.

In the last quarter of 1982, output in the construction industry was six per cent. higher than a year before. In the three months to January housing starts were more than 13 per cent. up on the previous quarter. And for manufacturing industry too the prospects look better. After a slight fall last year, the current evidence suggests a rise in 1983. Figures published today show a 2½ per cent. rise in manufacturing production in January, which follows a one per cent. rise in December. All these are clear indicators of recovery, and should be welcomed in all parts of this House.

UNEMPLOYMENT

Unemployment, however, remains intractably high, even although it has been rising more slowly than in 1980 or 1981. In many countries it has recently been rising faster than here. Over the past year, for example, it went up by 1·6 percentage points in the United States, by 2·3 percentage points in Germany, and by nearly 4 percentage points in the Netherlands, as against only 1·4 percentage points here.

Because unemployment throughout the Western world is likely to remain high for some time, we have established a wide range of programmes, designed to help particularly those without jobs who are bearing the sharpest pains of the long recession. These special employment and training measures will next year bring direct help to almost 750,000 people. We now propose to extend this help in four further ways.

First, some 90,000 men between the ages of 60 and 65 now have to register at an unemployment benefit office if they wish to secure contribution credits to protect their pension rights when they reach 65. From April, they will no longer have to do this. Even if those concerned subsequently take up part-time or low-paid work on earnings which fall below the lower earnings limit for contributions, their pension entitlement will be fully safeguarded.

Second, there are some 42,000 men over 60 who are registered as unemployed and on supplementary benefit but who have to wait a year, or until they reach 65, before they qualify for the higher long-term rate of benefit. From 1 June they will qualify for the higher rate as soon as they come on to supplementary benefit. For this purpose they will in effect be treated as if they had already reached retirement age.

Third, the job release scheme. As the House knows, this scheme allows men over 62 and women over 59 who so choose to retire early, and so to make room for employing someone else who wants a job. I can now announce a new scheme for part-time job release. It will apply to the same categories of older people who are willing to give up at least half their standard working week, so that someone else who is without a job can be taken on for the remaining half. The allowances will be paid at half the full-time rate. The scheme will take effect from 1 October and should provide part-time job opportunities for up to 40,000 more people who are at present unemployed.

Fourth, enterprise allowances. These encourage unemployed people to set up in business by paying £40 a week for their first year to offset their loss of unemployment benefit. Pilot schemes were set up in five local areas in early 1982. The response has been very encouraging and there is already evidence that many of the 2,000 or so new businesses created under the scheme are generating extra jobs. I can now announce that from 1 August to the end of March 1984 enterprise allowances will be available throughout the country, within an overall cash limit of £25 million in 1983-84. Individual allowances will run on for a full year, so that the scheme will cost a further £29 million in the next financial year. The net public expenditure cost is about two thirds of this gross cost. It should help some 25,000 unemployed people to set up in business. We shall be monitoring the scheme closely, and I hope it will show a continuing benefit to those concerned and to the whole economy.

The gross cost of these four measures is estimated at £55 million in 1983-84 and £100 million in 1984-85. The net public expenditure cost will be much less than this—some £40 million in 1983-84 and £55 million in 1984-85. In 1983-84 we shall be spending over £2 billion in all on the full range of special employment and training measures.

There is one other matter which has, I know, been a cause of concern to hon. Members on both sides of the House. As the House will recall, the November 1980 uprating of unemployment benefit was abated by 5 per cent. We said then that we would review the position once the benefit was brought into tax. That happened in July last year. As my right hon. Friend the Secretary of State for Social Services said when the House last considered the issue, the Government accepted in principle the case for restoration of the abatement. It is right now to redeem that pledge. In the uprating that takes place in November this year, the abatement of unemployment benefit will be restored in full.

INFLATION

But it is not enough simply to mitigate the effects of unemployment. It is our purpose as well to secure a sustainable growth in job opportunities. So we must look for a larger share of rising demand to be translated into British output and British jobs.

Progress on inflation is crucial to the prospects of higher output and lower unemployment. High inflation destroys savings, impairs efficiency and undermines stability. So lower inflation is good in itself. But it also underpins a return to lasting growth and to new jobs.

Lower inflation will lead to higher real demand and output, provided we hold to the medium-term financial strategy. Lower inflation helps consumer spending, as savers no longer have to put aside so much simply to maintain the real value of their capital.

Lower inflation encourages higher spending by companies, both on stocks and on investment. For lower inflation contributes to lower interest rates, so improving cash flow; and lower inflation helps keep down other costs. This is one reason why industrial profitability, though still by historic standards very low, has begun to recover. This too should encourage new investment and the creation of new jobs.

Lower inflation and interest rates also ease the burden of mortgage interest, helping house buyers and in turn house building.

With lower inflation the cash programmes of the public sector go further: they buy more goods and services.

Lower inflation will provide the stability and confidence needed for further progress in securing the improvement in Britain's economic performance needed to reverse the long years of relative decline.

Finally, of course, inflation has long been the enemy of good sense in pay bargaining and so too the enemy of jobs. The understanding that Government will not finance higher inflation has done much—though still not enough—to bring common sense back into wage bargaining. The way in which excessive pay increases destroy jobs is now much more widely understood.

More moderate pay settlements combined with improved productivity are two of the reasons why last year, in a shrinking world market, British manufacturers succeeded in enlarging their market share. Still lower pay

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settlements and still higher productivity remain vital to our competitive position. Provided they come through, British business is now better placed than for many years to make inroads into markets at home and overseas—and provided we go on achieving success against inflation.

Inflation was on a rising trend when we came to office. It peaked at some 22 per cent. in 1980. The reduction since then has been dramatic, with retail price inflation now down to 5 per cent. The benefits of this transformation are felt throughout the country—it results from the firmness and consistency of the policies we have pursued in the past four years.

We shall not change course. Downward pressure on inflation will be maintained. With the lower exchange rate some check in our progress now is unavoidable. In the fourth quarter of this year inflation in retail prices may for a time be running at about 6 per cent., a little above what it is now, but still substantially below its level of a year ago. And it seems likely that the rate of increase of the GDP deflator—which is a measure of prices across the whole economy—will continue to fall, from 7 per cent. in 1982-83 to 5½ per cent. next year.

The trend of rising inflation that appeared irresistible has been decisively broken. We are now certain to be the first Government for a quarter of a century to achieve a lower average level of inflation than did their predecessor. In the next Parliament it will be our purpose to do even better.

MONETARY POLICY

One weapon we shall certainly continue to use is effective monetary policy. That monetary policy has a key part to play in the fight against inflation is recognised by the markets and by Governments abroad. However much they may deny it now, it was, of course, a pillar of the last Government's counter-inflation policy—and rightly so.

In judging monetary conditions we look at the measures of money supply and at other financial indicators such as the exchange rate, real interest rates, and of course at progress in reducing inflation itself. The Red Book includes a full discussion of these matters. Until now, Chancellors have published their thoughts rather like Chairman Mao, in a little Red Book. This year, however, the book is larger and very much easier reading. There are no more pages and much more information at almost the same price. I shall only try to summarise it at this stage.

Since the last Budget, financial conditions have developed much as I foreshadowed. In the year to February, the growth of all three target aggregates was within the target range of 8 to 12 per cent. Other financial indicators also pointed to moderately restrictive monetary conditions.

But with the satisfactory development of financial conditions and rapid progress in reducing inflation a significant fall in interest rates was possible. By mid-November, short-term rates had fallen to 9 per cent. They subsequently moved up to around 11 per cent., but they are still very substantially below the 16 per cent. of November 1981. The House will have seen that, following the recent easing in market rates, there has this morning been a further cut in bank base rates.

For most of the year the exchange rate was strong. The weakening in November and December seemed mainly to reflect external factors such as concern about oil prices and sharp movements in the world's other major currencies. Opposition statements and election uncertanties, here and abroad, may also have played a part in currency movements.

But this winter's movements in sterling rates were certainly not due to any laxity in the Government's financial policy. On the contrary, our manetary and fiscal objectives were achieved. Provided we continue to meet them—and we are determined to do so—our policies give no reason to expect anything more than a temporary rise in inflation from the fall in the exchange rate that has taken place.

The lower exchange rate gives industry an opportunity to improve its competitiveness, but only if other costs are tightly restrained. I make no apology for repeating that this requires still greater moderation in pay bargaining. Without that there would be only a temporary improvement in our competitive position and no long-term help in providing a sustainable basis for the improvement in output and employment that is now within our grasp.

That is why I cannot emphasise too strongly our view that devaluation brought about by monetary and fiscal laxity would be damaging and that to seek it as a deliberate act of policy would be a grave mistake. It would be a signal to the world of a willingness to accommodate rising inflation—inflation that would undoubtedly be fuelled by demands for higher wages to offset its effects. Confidence would collapse and jobs would be destroyed.

That is not the way we intend to go. That is why, by contrast, last year's medium term financial strategy again set out a declining path for monetary growth in future years. After growth of 8 per cent. to 12 per cent. in 1982-83, a target of 7 per cent. to 11 per cent. was suggested for 1983-84. I confirm now that the 1983-84 target will indeed be 7 per cent. to 11 per cent. Once again it will apply to both broad and narrow measures of money, though, as I said last year, M1 may for a time grow rather faster than indicated by the range. Given the prospect for inflation, this range gives scope for a healthy rise in output.

The establishment of the medium term financial strategy has been more than justified by its value as a framework of fiscal and monetary discipline. Another innovation has similarly proved its worth, namely, our decision to diversify our funding policy.

We have made available indexed as well as conventional assets; and we have secured a larger contribution from the personal sector in the form of national savings. I intend to continue this policy.

The Department for National Savings is close to achieving this year's target of £3 billion. For the coming year I am again setting a target of £3 billion. Nearly £2 billion worth of indexed gilts have been issued over the past year and it has been possible to dispense almost completely with long-term fixed interest stocks, which has helped bring long rates down very nearly as much as short rates.

PUBLIC SECTOR BORROWING

Control of money needs to be supported by firm control of public sector borrowing, otherwise the result is to push up interest rates and create strains that sooner or later prove intolerable. Other countries understand this. All too many have had to learn the hard way.

A substantial reduction in the trend of public sector borrowing over the medium term is a necessary part of the process of reducing inflation. We have made good progress. During the latter half of the 1970s public borrowing represented on average about 6 per cent. of gross domestic product. In 1975-76 the figure was nearly 10 per cent. By 1981-82 it had fallen to 3½ per cent. of GDP.

For the year now ending I budgeted for a public sector borrowing requirement of £9½ billion. The outturn is likely to be substantially lower, principally because oil revenues during the current year have been very much larger than could have been expected. The latest estimate of the outturn for this year's borrowing requirement is about £7½ billion—or 2¾ per cent. of GDP. However, the year is not yet over and there are large sums on the expenditure side yet to be brought to account and on the revenue side to be collected. So this year's outturn figure is still subject to a considerable margin of error.

For 1983-84 last year's Budget statement suggested a PSBR of 2¾ per cent. of GDP as consistent with the desired trend to lower borrowing. That is equivalent to about £8 billion at the level of money GDP now forecast. In judging whether that figure is still appropriate I have taken account of developments over the past year and of the main uncertainties which now confront us. On interest rate grounds, there is a clear case for continued fiscal restraint. Interest rates, though lower than they were, are still undesirably high both in nominal and in real terms. The fact that the exchange rate has now moved to a lower level eases the financial pressures on companies, but we need to remember that holding to the medium term financial strategy as inflation falls is the best way of helping the recovery of output.

I have also had to consider the implications of the recent fall in North sea and other oil prices. Of course, lower oil prices reduce the value of our own oil production. But North sea oil accounts for only 5 per cent. of our national income and tax on it for only some 6 per cent. of Government revenues. Moreover, the health of a much larger part of our national economy depends on the state of the world economy. Though sharp swings in the oil price are in no one's interest, moderate reductions mean lower inflation abroad and lower prices here. The fall in the general level of world oil prices is therefore to be welcomed. A more prosperous world will in time mean more output and jobs in Britain.

It follows from this that it would be unnecessary, as well as impractical, to react to every deviation in the oil market by changing the general level of taxes. The forecast published in the Red Book reflects the prices currently offered by BNOC to North sea producers. Clearly there could be a change in oil prices sufficient to affect the balance of revenue and expenditure in the Budget, though not all the effects would be one way. There is no simple arithmetical guide for dealing with this, let alone allowing for it in advance. Much would depend on the extent of the change and the attendant circumstances. If any further reduction in oil prices seemed likely to compromise the success of our economic strategy, I would be ready to take appropriate corrective action; but the lesson for today is that it is prudent to keep planned borrowing down.

Taking these factors into account, I have decided to hold to the previous plan and provide for a PSBR in 1983-84 of 2¾ per cent. of GDP—that is, some £8 billion. Last autumn I announced measures with a revenue cost of some £1 billion in 1983-84. Most of this was directed to reducing the burden on private industry and commerce. It included a cut in the national insurance surcharge.

After allowing for that and for the other changes announced in November, the latest forecasts suggests that a borrowing requirement of £8 billion in 1983-84 permits further real tax cuts with a net cost to the PSBR of some £1½ billion. The full year revenue costs of my proposals will be rather larger than that.

The Red Book gives revenue and expenditure projections for the period up to 1985-86. These allow for a further reduction in public sector borrowing as a percentage of GDP over the medium term. There is of course no certainty about the precise figures, but they show how lower borrowing can be combined with lower taxes within the framework of policies designed to reduce both inflation and interest rates. This was indeed illustrated by my last Budget.

PUBLIC EXPENDITURE

Central to the restraint of borrowing is the restraint of public expenditure, and the key to effective control of public expenditure is that finance must determine expenditure, not expenditure finance.

The House debated last week the public expenditure White Paper which set out our plans for the years to 1985-86. Public expenditure is being held within the levels set in earlier plans. The ratio of public expenditure to GDP, which is the measure of the burden which public expenditure places on the rest of the economy, has been reduced from 44½ per cent. in 1981-82 to a planned 43½ per cent. in 1983-84.

In working to get and keep public spending down we have been helped by an important institutional innovation which we have introduced—cash planning. Improved control of expenditure has been an essential factor in making possible the tax reductions I am announcing today.

The additions to certain public spending programmes which I am announcing today will all be met from the contingency reserve and so will not add to the planned total of expenditure.

We have also maintained a strict control over the running costs of Government, in particular manpower. By the end of this month we shall have reduced the numbers of the Civil Service to 651,000—a fall of 80,000 since 1979. The target of 630,000 by April 1984 which we set ourselves on taking office and which some thought unattainable is thus now within reach. Civil Service numbers will by next year be lower than at any time since the war.

SOCIAL SECURITY AND CHARITIES

I now turn to social security. This is much the biggest single element in public expenditure—more than one-quarter of the total.

About half of social security expenditure is on benefits for pensioners. The costs are borne mainly by contributors

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and we had in November to announce further increases in national insurance contribution payments, which take effect from next month.

The House will remember that, because prices have been falling faster than expected, the provision in last November's uprating for the rise in prices in fact exceeded it by 2·7 per cent.

The forecast method of uprating, which gave rise to this situation, has never worked well, for a forecast made at Budget time of what the rate of inflation will be at the time the uprating takes place in the following November is necessarily uncertain. Increases can therefore be larger or smaller than intended. There have been years when prices have been under-estimated, as in 1981, when there was a 2 per cent. underprovision, which we made good in the following year, and other years such as 1980 and 1982, when the error has gone the other way. In each case there has necessarily been a year's delay before the error of the previous year could be corrected.

The system of trying to forecast inflation, introduced in 1976, is a fragile basis for calculations of such importance to millions of our fellow citizens. Given the experience of the past seven years, the Government believe that it would now be right to restore the more certain system that prevailed before 1976. This is the system by which benefit upratings are calculated on what has actually happened to prices, rather than on what might happen in future—if the forecast proves right.

From this November, therefore, we shall return to the historic, or actual, method. The necessary legislation will be introduced immediately.

The uprating this November will be based on the rise in prices in the 12 months to May of this year. That figure will be announced by the Department of Employment in the usual way, and will be the basis for the uprating statement as soon as possible after that. We have chosen the May figure because it is the latest month we can use as the basis of the calculation and still make sure that all recipients get their increase in November.

The uprating will be based on whatever the May figure turns out to be. At this stage, of course, it is impossible to say exactly what it will be.

It seems likely, however, to be in the region of 4 per cent. Of course, in November, as I have already told the House, the annual rate of inflation may for a time be running at about 6 per cent. but if we had retained the old system, and taken full account of last year's 2·7 per cent. overpayment, the increase in benefits would have been significantly smaller than is now proposed.

There will be no question of asking pensioners to return any of the pension money they have already received, no question of any so-called clawback. Beneficiaries will retain the full benefit of the extra payment they are now receiving; and part of it is likely to continue into 1984.

Linked public service pensions will be raised in November by the same percentage as benefits. For unemployment benefit, the increase will be in addition to the restoration of the 5 per cent. abatement which I have already mentioned.

On the basis I have described, the position for pensioners over the lifetime of this Government is this. Between the November upratings of 1978 and 1983 prices are likely to have risen by some 70 per cent. and pensions by some 75 per cent. Our pledge to maintain the value of the pension over the lifetime of this Parliament will thus have been more than fulfilled.

There is one other social security benefit to which we attach no less significance. It plays a major part in easing the unemployment trap, and so in our strategy of improving incentives for everyone. It is important for families, and particularly for the low paid. Indeed, it is the benefit which provides the greatest help to many of the poorest families in the country. I refer, of course, to child benefit.

I am glad to be able to tell the House that from November 1983 the rate of child benefit will be increased from £5·85 to £6·50. One-parent benefit will be correspondingly increased to £4·05. On the basis of our inflation forecast, both benefits will then be worth more than ever before. I know that the House, and the country, will welcome this news very warmly.

The Government also gives special priority to help for the sick and disabled, and for widows, and I am proposing further measures to increase that help.

In my first Budget I exempted from tax war widows' pensions and widows' child dependency allowances. In 1980 I introduced a bereavement allowance to benefit widows in the tax year of their husband's death. However, because their income in that year is already covered by other allowances, many newly widowed women receive no financial benefit from that allowance. Accordingly, it will now be extended to cover the year after the husband's death as well, at a cost of some £30 million in a full year. This means that more than twice as many widows will benefit.

We also intend to provide significant new help for about 55,000 invalidity pensioners. Until now the so-called invalidity trap prevented them from receiving the long-term rate of supplementary benefit. I announced earlier that the unemployed over 60 will now be entitled to the long-term rate. We shall extend this concession to those over 60 who are sick and disabled, so that they, too, will qualify straight away for the long-term rate. In addition, I am glad to be able to tell the House that people under 60 who have been on incapacity benefits for a year will also qualify for the long-term rate. This will get rid of the invalidity trap—and quite right, too. There will also be an increase from £20 to £22·50 in the amount which disabled and chronically sick people can earn before their benefit is reduced.

While we need to ensure that social security benefits go to those most in need, I am concerned that we should not discourage people from saving. We shall therefore increase from £2,500 to £3,000 the limit above which savings disqualify people for supplementary benefit. There will be an additional disregard of £1,500 for the surrender value of life assurance policies. We shall also increase to £500 the corresponding limit for single payments of supplementary benefits to help with exceptional expenditure.

We will also help over 11,000 war pensioners by replacing the existing vehicle scheme by a more flexible and equitable cash allowance, set at a rate which will preserve the war pensioners' traditional preference over civilian benefits.

These measures, taken together with the increase in child benefit and one-parent benefit and the ending of the abatement of unemployment benefit, will cost over £140 million in 1983-84 and around £400 million in 1984-85.

The increases over the existing provision in the social security programme will be charged to the contingency reserve. This is in addition to the cost of the extension of the long-term rate of supplementary benefit to the over-60s, to which I referred earlier.

But caring means more than cash. Many of the key needs, for example, of the elderly, are met by voluntary groups and charities. If they are to do all they can, we must help the helpers.

Once again we have been pressed to reimburse charities for VAT on their taxable purchases. But, however exhaustively and sympathetically we examine this proposal, the difficulties remain and cannot be swept aside. I have been able in previous years to extend VAT reliefs for the disabled and charities serving them. But a VAT refund scheme would be expensive to operate and indiscriminate in its effects, benefiting not only those charities which do valuable work in the community but also—and sometimes disproportionately so—many other bodies with very limited or controversial aims which do not command public support. So, as before, I have been forced to conclude that we are right to channel our help in other ways.

But I intend to give some extra help. In 1980 I introduced substantial new tax reliefs for convenanted donations to charities, by allowing relief against higher rates of income tax up to a ceiling of £3,000 a year; and last year I increased the limit on exemption from capital transfer tax for gifts made within a year of death from £200,000 to £250,000. I propose now to carry these two measures further by raising to £5,000 the ceiling on higher rate relief for gifts made by deed of covenant and by abolishing the ceiling on exemption from capital transfer tax for charitable bequests. All outright gifts and bequests to charities will now be entirely free from CTT.

I have had representations about the position of companies which would like to second their staff, with pay, to charities. At present the employee's salary is not allowable for tax because it is not an expense incurred by the company wholly and exclusively for the purpose of its business. For normal business expenses we must continue to stick to that general principle. But I am satisfied that it is right to make an exception in this limited case. Companies which lend staff to work for charities and continue to pay their salaries will now be able to treat the cost as an allowable expense for tax purposes.

HOME OWNERSHIP, HOUSING AND CONSTRUCTION

I come now to housing and the construction industry. The whole House is anxious to see more activity in this sector. Within the public expenditure plans there is provision for capital expenditure on construction in 1983-84 of over £10 billion, a 10 per cent. increase on this year's expected outturn. We want this money used effectively for the purpose for which it is intended.

One of our highest priorities has always been the extension of home ownership. This Government have done more than any other to encourage this. Since we came to office almost half a million public sector tenants have bought their homes; and the fall in mortgage rates over the past year has made it easier for first-time buyers to meet the costs of a mortgage.

But it is now clear that the £25,000 limit on mortgage interest tax relief is beginning to hinder a growing number of families who want to buy their first home, or to move. I have therefore decided to increase the limit—this figure may reassure the right hon. Member for Norwich, North (Mr. Ennals)—to £30,000. This will cost some £50 million in 1983-84. It will help potential home owners and the construction industry alike. At the same time, I intend to remove an anomaly whereby a borrower may get tax relief in excess of the ceiling for both an ordinary mortgage and an interest-free loan from his employer.

I also propose to extend mortgage interest relief of the kind already enjoyed by many employees, whose duties prevent them from living in their own homes, to self-employed people, like tenant farmers and tenant licensees, who have a contractual requirement to live in accommodation provided for them but who are also buying their own homes. This will be accompanied by a similar extension of the capital gains tax relief applying to a private residence.

We want to help people not only to own their own homes but also to keep them in good repair. Last year I announced a major attack on disrepair by increasing the rates of repairs grants. This has proved very successful. Expenditure in 1982-83 will be twice that in 1981-82 and a further increase is expected next year.

We have already announced that the higher rates are to continue until the end of 1983-84; and local authorities have been told they may spend without limit on all improvement grants next year. To ensure that we get the greatest impact from this initiative, the limits on expenditure eligible for grant will be increased by 20 per cent.

Our main aim, of course, is to help people to help themselves. But there are some areas, particularly in the inner cities, where decay in the private housing stock is so bad that concerted action is needed. We are encouraging local authorities to tackle such areas by the process known as enveloping—where the authority repairs the external fabric of whole terraces or streets of houses on behalf of the owners. This has proved a cost-effective way of improving an area, and we will be allowing local authorities to undertake additional expenditure in 1983-84 on any approved enveloping scheme.

These two measures are likely to lead to additional expenditure of some £60 million in 1983-84. In addition my right hon. Friend the Secretary of State for the Environment is today announcing further measures to encourage local authorities to make full use of the resources available to them for capital investment.

Today I can announce three further steps to help the construction industry.

First, in 1981 I introduced a scheme to defer development land tax on developments for the owners' own use. The scheme, which is due to end in April 1984, has proved valuable, and I propose to extend it to April 1986, at a cost of £4 million in a full year.

Secondly, stock relief will from today be available for houses accepted by builders in part exchange on the sale of a new house for the personal use of an individual or his family. This will cost £5 million in a full year.

Thirdly, I propose to increase from 10 per cent. to 25 per cent. the proportion of office space in buildings qualifying for the industrial buildings allowance—an allowance which I increased in 1981. The cost will be about £25 million in a full year.

INDIRECT TAXES

I come now to the indirect taxes.

I propose no change in the present rate of value added tax.

In successive Budgets I have sought to establish the sensible presumption that the excise duties should be adjusted broadly in line with the movement of prices from one year to the next. This is essential if we are to maintain the right balance between direct and indirect taxes.

This year, too, I intend to follow the same approach. But our success in reducing inflation means that the increases I shall be announcing will be much smaller than in recent years. The additional revenue I shall be seeking from duty changes this year is about half of the comparable figure in 1980 and 1982 and about a quarter of that in 1981.

I start with the duties on alcoholic drinks. I propose to increase the duties from midnight tonight by amounts which represent, including VAT, about 25p on a bottle of spirits, 5p on a bottle of table wine, 7p on a bottle of sherry and 1p on the price of a typical pint of beer. On cider, which is increasingly competing with beer, I propose a similar increase of 1p a pint.

As for tobacco, I propose to increase the duty by the equivalent, including VAT, of 3p on the price of a packet of 20 cigarettes. There will be consequential increases for cigars and hand-rolling tobacco, but no increase for pipe tobacco. That is not just in deference either to my hon. Friend the Member for Birmingham, Selly Oak (Mr. Beaumont-Dark) or to the right hon. Member for Huyton (Sir H. Wilson), but it gives me the opportunity to reassure the right hon. Member for Huyton that the pipe in his pocket has not been devalued. These changes will take effect from midnight on Thursday.

Next, the oil duties. I am conscious of the concern felt by a number of my hon. Friends about the effects of increases in duties on petrol and derv. But at a time when world oil prices are falling it would not be right to allow the real value of the duties to be eroded significantly. I propose therefore to increase the duty on petrol by about 4p a gallon, including VAT. In the case of derv I propose an increase, including VAT, of about 3p a gallon. These changes will take effect for oil delivered from refineries and warehouses from 6 pm tonight.

As in the last two years, I propose no change in the rate of duty on heavy fuel oil. The real burden of this duty will thus have been reduced since 1980 by some 20 per cent. This will be of considerable continuing assistance to industry, since it will help to hold down its energy costs.

I also propose a number of changes in the rates of vehicle excise duty. For cars and light vans the duty will be increased by £5, from £80 to £85. On goods vehicles, the new duty structure introduced last year allows me to spread the burden more fairly. In order to bring the rates of duty more nearly into line with the costs the various categories of lorry impose on the road system, I propose to increase the duty on some 190,000 heavy vehicles. This means that I shall, on the same lines, be able to reduce by approximately 10 per cent. the rates of duty on some 315,000 lighter commercial vehicles. These changes will take effect from tomorrow.

The total effect of all the changes in excise duties will be to raise additional revenue of some £600 million a year. But let me emphasise again that this implies virtually no change in the real burden of indirect taxes in 1983-84. The immediate effect will be to add about 0·4 per cent. to the overall level of prices. This has been taken fully into account in the price forecasts which I have given to the House.

OIL TAXATION

I come now to North sea tax. The development of the North sea is a notable achievement of private enterprise and the result of a huge co-operative effort involving hundreds of companies and thousands of people. We want this to continue into the future, despite changes in oilfield economics. Tax is not the only factor in sustaining North sea potential. Steps taken by the industry to cut costs and the future level of oil prices will be at least as important. But the tax structure must adapt as well.

I am therefore proposing a substantially more favourable regime to assist the companies as they move on to develop new fields, and, in order to help finance new activity, a package of relief on current fields. The industry will benefit from these changes by more than £800 million over the next four years, starting with £115 million in 1983-84.

To encourage further exploration and appraisal, I propose immediate relief against petroleum revenue tax for expenditure incurred after today in searching for oil and appraising discovered reserves.

For future fields I propose two important new incentives. First, the oil allowance, which is the quantity of oil production exempted from PRT, will be doubled for such fields. Secondly, my right hon. Friend the Secretary of State for Energy will be taking steps to abolish royalties for these fields. The changes will apply to future fields where development consent has been given on or after 1 April 1982, with the exception of the relatively more profitable southern basin and onshore fields. I am ready to discuss with the industry whether there is a need to extend these incentives to the southern basin fields. If I were to be persuaded of the need, any extension would be backdated to development consents issued after today.

Most existing fields make good profits, but to improve current cash flow I have decided progressively to phase out advance petroleum revenue tax. As a start, the 20 per cent. rate will be reduced to 15 per cent. from 1 July, and APRT will disappear completely by the end of 1986.

An Inland Revenue press release will give further details, and also describe other proposed changes in oil taxation. They include, following the consultative document published last May, proposals on PRT reliefs for expenditure on shared assets such as pipelines, and for charging related receipts. The proposals will give significant additional relief on expenditure and will exempt tariffs on 500,000 tonnes of oil a year from each field using a pipeline. This will encourage the shared use of these assets.

I believe that my proposals will provide the industry with the right fiscal incentives for the further successful development of the country's North sea resources.

NATIONAL INSURANCE SURCHARGE AND COMPANY TAXATION

From one key industry I turn now to business and industry as a whole. Our living standards and jobs depend on our ability to sell and compete, producing the right goods and services at the right time and the right price. the main responsibility for achieving this lies with industry and commerce. But the Government can help by reducing the burdens they place on business. These can be twofold. High inflation and excessive public borrowing have in the past kept interest rates and business costs higher than they need have been. We have made progress in putting that right. But Government also impose direct burdens on business, and here too we have acted to help cut costs. I have given high priority to reducing the national insurance surcharge, the tax on jobs first introduced and then increased by our Labour predecessors.

In last year's Budget I cut NIS from 3·5 per cent. to 2·5 per cent. In November I announced that, for 1983-84, the rate would be further cut to 1·5 per cent. On top of this I made special arrangements to enable half of that further cut of 1 per cent. to be brought forward into 1982-83.

I now propose that the rate be reduced from 1·5 per cent. to 1 per cent. from August 1983. As before, the benefits will be confined to the private sector. This cut is worth another £215 million in 1983-84 and nearly £400 million in a full year.

The surcharge was 3·5 per cent. when this Government took office. We are now well on the way to abolishing it. the reduction from 3·5 per cent. to 1 per cent. will be worth nearly £2 billion to private business in a full year.

On corporation tax, we issued a Green Paper over a year ago. I am grateful for the many thoughtful responses, which we have examined carefully. There is one impression that stands out, and that is the overwhelming desire on the part of industry for stability in the corporation tax regime. I recognise the force in this. Change is not costless. I have therefore concluded that there should be no change in the broad structure of the present arrangements. As regards the taxation of inflationary profits, I await the outcome of the accountancy profession's further considerations.

There are, however, some useful changes on which I can make a start today.

At present, advance corporation tax can be carried back two years to be set against corporation tax. I propose to extend this over a period to six years. I also propose that the incidental business costs of issuing acceptance credits and of issuing certain convertible loan stocks should be allowable expenses for corporation tax purposes. There are other areas where we need to make progress, including the tax treatment of groups and capital allowances for the mineral extraction industries. I am authorising the Inland Revenue to look further at these issues, and to consult on them where necessary.

On the taxation of international business, I have considered carefully the responses to the latest round of consultation. I have decided not to proceed this year with measures concerning company residence and upstream loans. Both need further consideration.

On tax havens, however, I propose to move clauses which take account of the recent consultations. These will not come into effect until April 1984.

This change should be considered alongside one other proposal that flows from the corporation tax Green Paper. At present, credit for foreign tax on overseas income is only allowed against such part of a company's corporation tax liability as remains after deduction of ACT. As a result of representations received in response to the Green Paper, I propose that from April 1984 this double tax relief should be allowed against the full corporation tax liability before ACT is deducted.

As I have said, my proposals on tax havens and on ACT and double tax relief have to be seen together. Between them they will not involve any increase in the total burden of tax on international business, but they do mean a switch in the tax burden away from those who remit profits home and on to those who accumulate surplus cash balances in tax havens overseas. I am sure that the House will agree that this is right.

To turn to a different area, I announce each year the future scale rates for measuring the benefits from company cars. Recent increases have been at a rate of 20 per cent., but the levels still fall short of any objective measure of the true benefit. This year I am proposing further increases with effect from April 1984; but they will be held to about 15 per cent. These increases will also apply from the same date to the new car fuel scales which come into operation next month.

I have also decided to legislate to bring back into tax the benefit from scholarships provided by employers for the children of their higher paid employees. There will be a transitional exemption for awards made before today so that scholarship income in respect of an existing award will continue to be exempt until the child leaves his present school or college.

I propose, too, to remove an anomaly by which some people have their tax bills artificially reduced because their employers do not account for PAYE at the right time and then pay over too little. I also propose with effect from April 1984 to increase substantially the tax measure of the benefit gained by an employee who occupies rent free, or at a very low rent, expensive accommodation owned by his employer.

The House will be aware of instances of tax avoidance through the exploitation of group relief, and through the exploitation of so-called second hand bonds. I propose legislation to deal with these abuses and also to improve the arrangements for collecting DLT on disposals by non-residents.

Now I wish to say a word about banks. I said last year that we would be giving further thought to the problem of how best to ensure a sufficient contribution to tax revenues by the banking sector. I have examined the position with great care in the light of current circumstances, and have concluded that it would not this year be sensible to tighten the tax regime for banks.

Finally, for the company sector, I propose some changes that are designed specifically to help small and medium-sized companies. At present the so-called small companies rate of corporation tax is 40 per cent. and applies to taxable profits up to £90,000. The 52 per cent. rate is payable at £225,000. I propose to reduce the 40 per cent. rate to 38 per cent., to raise the lower limit of £90,000 to £100,000, and to raise the upper limit from £225,000 to £500,000.

Between these two limits profits are subject to a marginal rate which stood at just over 66 per cent. when this Government came into office. I have already reduced

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it to 60 per cent. The changes that I am proposing today will bring it down to 55·5 per cent.—only a little above the main 52 per cent. rate.

These changes will concentrate the help that I can give on the many small and medium-sized companies with taxable profits of up to £500,000. The cost will be £40 million in 1983-84 and £70 million in a full year.

ENTERPRISE

Small and medium-sized enterprises are a major source of new wealth for the nation and, above all, of new jobs. I shall, therefore, propose today a further series of measures which will foster their growth, greatly extending those which I have already introduced, and whose results are already evident. I am told that Britain now offers a more attractive tax environment than Germany for venture capital and for the microelectronics revolution. That was not so five years ago.

I now propose further action in a number of areas.

I want more people to share in the ownership of the companies for which they work. It is both a good incentive and a good way for people to build up a capital stake. The measures so far introduced have already brought us to the position where about 250,000 employees receive shares each year.

But I want to make these employee profit sharing schemes more attractive and more flexible, while still open to all employees. Already companies can give tax-free shares to employees each year up to the value of £1,250. I propose to add an alternative limit of 10 per cent. of the employee's earnings, up to a maximum of £5,000. This new freedom will provide still further encouragement to management, upon whom so much depends.

Share options for senior managers also provide an important incentive. Last year I introduced arrangements to spread the income tax burden that can arise when an option is exercised. I propose this year to increase the instalment period from three years to five years.

Save-as-you-earn linked share option schemes already cover over 100,000 employees. The monthly limit on contributions with tax relief now stands at £50. In order to encourage further growth I propose increasing it to £75. The total cost of all these share incentive measures will be £20 million in 1983-84 and some £35 million in a full year.

I also want to ease the path for employees of a company who seek to buy the business for which they work. The transformation that followed the employee buy-out of the National Freight Company shows how valuable this can be. In order to help those who borrowed to take part in this buy-out, and to encourage similar success, I propose that where an employee-controlled company is being set up the employees should benefit from interest relief on loans they take out to buy shares in it.

Capital taxes can suffocate enterprise. Last year we took the major step of indexing capital gains. It is clearly appropriate to provide a period of stability to let the new structure settle in. We have already announced that administrative measures will be introduced to help large institutional investors. I now propose that, as the legislation provides, the annual exempt amounts for individuals and for trustees should be increased in line with inflation; and I propose to increase to £20,000 the limits on the relief for small part disposals of land and for residential letting.

I propose to double the present retirement relief, raising it to £100,000. This will further encourage entrepreneurs to keep money in their business where it can work to best effect. I have received a number of representations that other features of the present relief cause difficulty, and we shall therefore be conducting further consultations later this year.

The cost of the CGT measures I have announced will be £15 million in a full year. There will be no cost in 1983-84.

On capital transfer tax, I propose to increase the threshold and rate bands broadly in line with indexation. As a result the threshold will rise from £55,000 to £60,000.

I am concerned that the prospect of capital transfer tax may still discourage those who are contemplating investing capital in small businesses. It may also be one of the factors reducing the number of farms available for letting. I therefore propose to increase relief for minority shareholders in unquoted companies and for let agricultural land from 20 per cent. to 30 per cent.

The cost of these changes in capital transfer tax will be £20 million in 1983-84 and £55 million in a full year. Other minor changes to CTT and CGT are set out in Inland Revenue press notices.

I propose two other measures to help small firms. The VAT registration threshold will be increased with effect from midnight tonight from £17,000 to £18,000, at a cost of £5 million in a full year.

I propose to increase from £200 to £1,000 the de minimis limit for assessment of investment income apportioned to the members of a close company.

I come to the question of innovation and technology. I have already announced an increase in the proportion of office space in buildings qualifying for the industrial buildings allowance. This additional flexibility will be of particular value in the high technology industries, which often need relatively large amounts of space for design and computer-based activities. It will cost about £25 million in a full year. On the tax side I also propose to extend the 100 per cent. first year allowance for rented teletext receivers until May 1984, and for British films until March 1987. The full year cost of these two measures will be £10 million and £30 million respectively.

On the public expenditure side, I propose a range of measures for the encouragement of industry and enterprise worth £185 million over the next three years.

The west midlands has been particularly hard hit by the current recession. Small engineering firms are even more important in that region than in other parts of the economy. They need help to modernise and rebuild their strength. I propose, therefore, to make available an extra £100 million over the next three years to enable my right hon. Friend the Secretary of State for Industry to reopen the small engineering firms investment scheme.

The scheme is already a proven success: 1,750 applications were received last year and more than 1,400 offers of assistance have been made. It is open to qualifying firms in any area, but, as one would expect, a high proportion of the first allocation went to firms in the west midlands. This new, and much larger, allocation should bring substantial further help to the region, as well as to small engineering firms generally.

In information technology, further assistance will be available to enable firms to evaluate the benefits of computer aids for production management, and for the development of innovative software products.

At the moment grants are available for research and development, but there is no special facility for encouraging the marketing and investment stages of the innovation process. To fill this gap a new scheme will be introduced, which will be of special value to small and medium-sized companies.

There will also be an increase in expenditure on the Department of Industry's manufacturing and design advisory services. These provide small firms with a free introduction to private sector consultancy services, and have proved highly successful.

My right hon. Friend the Secretary of State for Industry may have an opportunity, later in this debate, to describe these measures in more detail. Taken together with measures previously announced, they will mean that Government assistance on new technology and innovation will have doubled since this Government took office.

Last year I extended the small workshop scheme by two years for very small industrial units. The scheme is proving very effective in promoting the provision of premises for new businesses. This year I want to encourage the conversion of more old buildings into productive workshops. I propose to allow all such units in a single converted building to qualify for 100 per cent. first year allowances if on average they meet the size requirements.

Now I come to the important matter of finance for business, on which I have major improvements to propose.

Companies and monetary policy alike would both benefit from a revival of the corporate bond market. Lower long-term interest rates are the key to this. But there are also a number of ways of giving companies greater flexibility in the nature and timing of the bonds they issue.

A consultative document on deep discount stock was issued on 12 January. It set out a range of options, and I am grateful to those who responded.

I now propose to introduce attractive tax arrangements for this stock. The borrower will get relief on an appropriate accruals basis, but the investor will pay tax only at redemption or on sale. There was considerable support for such tax treatment.

Companies will still be able to issue conventional or indexed bonds. My proposal extends their range of options.

I also propose certain reliefs to enable companies to issue Eurobonds in this country and to ensure that full tax relief is available for discounts paid on acceptance credits.

We shall be issuing on 21 March a consultative document on the possibilities for the simplification of stamp duty.

The loan guarantee scheme is another important innovation that we have introduced. My hon. Friend the Under-Secretary of State for Industry has conducted a thorough review of the scheme with the help of outside consultants. He will be making a full statement tomorrow. It is clear that the scheme has usefully encouraged lending to the small firms sector. Nearly £300 million has been lent to some 9,000 companies, about half of them new businesses. As a result, the scheme is now close to its present ceiling of £300 million. This ceiling will therefore be raised to £600 million to enable the scheme to run its full three-year course to May 1984, and we may need to seek the House's approval for an increase in the statutory limit for this purpose.

On 3 March I informed the House about the publication of the report of the working party on free ports, under the chairmanship of my hon. Friend the Economic Secretary to the Treasury. I can now tell the House that the Government accepts the report and will implement its recommendations. Legislation will therefore be introduced in the Finance Bill to enable selected free port sites to be designated.

Free ports are a new trading concept for the United Kingdom and I regard it as essential to make a careful test of the facilities they offer. As the report recommended, the first step is to establish free ports on an experimental basis in a limited number of locations. Widespread consultation will be needed before the sites are chosen.

Last, but far from least, the business start-up scheme. This scheme, announced in my 1981 Budget statement, offers uniquely generous tax incentives to outside investors in small companies. It is not bettered anywhere in the world. But I now intend to better it.

When I introduced the scheme I thought it right to give priority to investment in business start-ups, where there is often the greatest difficulty in raising outside equity finance.

I now propose a major extension of the scheme. It was due to end in April 1984. The life of the new, extended scheme will run to April 1987. From 6 April the coverage will be greatly widened to include not only new companies, but qualifying established unquoted trading companies as well. I propose also to double the allowable maximum investment in any year from £20,000 to £40,000. A number of other changes will be made to improve the scheme. In particular, the 50 per cent. limit on qualifying shares will be dropped. The cost of these changes is difficult to estimate, but could be £75 million in a full year.

Those proposals will transform the position of unquoted trading companies seeking outside equity. It is a further move towards removing the bias in the tax system against the personal shareholder, and a further measure to encourage wider share ownership. By concentrating help on those companies which do not have ready access to outside capital the scheme will assist many more small and medium companies to realise their undoubted potential for growth. The new, extended scheme will be known as the business expansion scheme.

Our constant concern as a Government has been to improve the competitive environment for businesses and people who work in them. These proposals mark a further major step in that direction.

FISCAL BALANCE

In judging the right balance to strike in this Budget I have taken into account the measures I announced in the autumn which will directly reduce business costs. I have also taken account of the lower level of the exchange rate. As I said in my Budget speech two years ago, exchange rate changes alter the distribution of incomes between companies and persons. A higher exchange rate boosts personal spending power, but it squeezes the profits of companies exposed to international competition. Consequently, in my 1981 Budget, personal income tax thresholds remained unchanged in order in part to be able to offer some help to companies.

The same considerations led me to direct over two thirds of the real tax reductions in my 1982 Budget towards business and industry in order to help cash flow and rebuild profits. In this Budget, too, the measures I have

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announced so far go largely in the same direction. Taken together with the net effect of the changes that I announced last autumn, they will provide help for business and industry that is worth around £1¼ billion in a full year.

And that is less than half the story. For, if revenues from taxes paid by business—apart from the North sea industries—were the same share of total taxes in 1983-84 as they were in 1978-79, then these businesses would have to pay some £3 billion more than is forecast for the coming year. But profits have fallen, and over the years I have acted deliberately to lighten that load in recognition of the case for helping business which has been strongly, and rightly, argued in debate after debate, and from all quarters of this House. I do not believe any hon. Member would suggest that business and industry should pay more tax.

But I have had to recoup the £3 billion, alongside the need both to hold down borrowing—not least to secure lower interest rates, and hence reduce business costs—and to finance public expenditure. Although spending is now being restrained, it is worth noting again that there are few hon. Members who have not called for increases rather than cuts.

It is considerations of this kind which have led to the burden of tax on people, under successive Governments, becoming so unacceptably high. The House and the country must face this reality: spending at current levels, which some still regard as too low, together with current levels of tax on business, which many regard as too high, have brought successive Governments to a position where there has been no alternative to high levels of tax on people.

But the fact is that reductions in personal taxation themselves help business and employment. Indeed, it is the individuals who work in business who largely determine business success. Yet for years in Britain the tax system and the tax burden have discouraged individual effort, commitment and enterprise. By strengthening incentives through lower personal taxes, Government can help increase the commitment to business success at every level. And when the state takes less of what people earn there is less justification for excessive pay demands and settlements. Cuts in personal tax provide a vital stimulus for lasting growth and jobs.

Happily, because we are reining back public spending—though not yet far enough—the choice is less stark now than in the past. I am able to combine the significant measure of direct tax relief to industry and enterprise which I have just announced with a substantial measure of direct tax relief to people.

Acknowledged unfairnesses and anomalies produced by the overlap between the tax and social security systems give further compelling reasons to move in that direction. It makes no sense that people on low incomes should be paying tax at all. And low tax thresholds are of course an important part of the poverty and unemployment traps. These traps mean that some of those out of work who could find a job, and some of those in work who could find a better one, do not do so because they would end up no better off, with all or more of their increase in income taken in tax and national insurance contributions, or lost in benefits forgone.

That is the situation that demands reform. But those who claim to have found a quick, cheap way to dispose of the poverty and unemployment traps deceive themselves. The problem has grown up almost entirely because Governments for 30 years or more have increased benefits in line with earnings, but raised personal tax thresholds only in line with prices, which have grown much more slowly over the years. In 1950 the tax threshold for a married man was about two thirds of average earnings. Today it is barely more than one third.

A situation that has built up over 30 years cannot be put right in one Budget or even in one Parliament. These problems have arisen, and the point cannot be emphasised too strongly, not because Government spend too little, but because successive Governments have spent and taxed too much. The substantial increase which I have proposed in child benefit will improve work incentives for the low paid; and several of the measures we have taken since 1979 have reduced the unemployment trap. But it is only by limiting public spending, as we have done, that we can begin to get to grips with the problem along the lines I now propose.

PERSONAL TAX

In 1979 I reduced the basic rate of income tax from 33 per cent to 30 per cent. and cut the top rates. That was one of the first, and most radical, of the many changes that found a place in my first four Budgets. This year we can cut personal taxation again. But I do not propose any further reductions in rates. For the reasons I have just given it is thresholds and allowances that must take priority.

Two years ago, in order to curb inflation and allow lower interest rates, income tax allowances were not raised at all. That was a difficult decision, but necessary in the circumstances, and it has since brought great benefits. It was the firmness of that 1981 Budget which paved the way towards the lower inflation and lower interest rates which today offer the prospect of lasting economic recovery.

It is right that the benefit of the sacrifices of 1981 should be enjoyed now by those who made them then.

Last year I increased tax thresholds and bands by 14 per cent. This year I also propose an increase of 14 per cent. But because inflation is today so much lower that now represents a real increase of not 2 per cent. as last year, but 8·5 per cent.

Income tax thresholds will be increased for the single person from £1,565 to £1,785 and, for the married man, from £2,445 to £2,795. The additional personal allowance paid to single parents, and the widow's bereavement allowance, will be increased in consequence from £880 to £1,010 The age allowance for a single person will go up from £2,070 to £2,360, and for a married person from £3,295 to £3,755.

Corresponding increases will be made in the higher rate thresholds and bands and the threshold for the investment income surcharge.

Effect will be given to these changes under PAYE as from the first pay day after 10 May. For a married man on the basic rate they will be worth £2 a week. The cost to the PSBR, above indexation, will be £1 billion next year. Including indexation, the total revenue forgone will amount to some £2 billion in 1983-84 and £2·5 billion in a full year. Some 1,250,000 fewer people will pay tax in 1983-84 than if thresholds had remained at their present levels.

CONCLUSION

At the start of my speech I referred to the objectives this Government adopted in 1979, objectives to which we have held and still hold. From my first Budget we have pursued those objectives with consistency and firmness of purpose and so laid the foundations for sustainable recovery.

This is a Budget for that recovery: a Budget for the family, a Budget for enterprise—and, most of all, a Budget for Britain's continuing recovery. I commend it to the House.

Mr. Deputy Speaker: Under Standing Order No. 94, the first motion, entitled "Provisional Collection of Taxes", must be decided without debate.

PROVISIONAL COLLECTION OF TAXES

Motion made, and Question,

That pursuant to section 5 of the Provisional Collection of Taxes Act 1968 provisional statutory effect shall be given to the following motions—

(a) Spirits (Motion No. 2).
(b) Beer (Motion No. 3).
(c) Wine (Motion No. 4).
(d) Made-wine (Motion No. 5).
(e) Cider (Motion No. 6).
(f) Tobacco products (Motion No. 7).
(g) Hydrocarbon oil (Motion No. 9).
(h) Vehicles excise duty (Motion No. 10).—*[Sir Geoffrey Howe.]*

put forthwith, pursuant to Standing Order No. 94 (Ways and Means Motions), and agreed to.

Mr. Deputy Speaker: I shall now call on the Chancellor of the Exchequer to move the motion entitled "Amendment of the Law". It is on that motion that the Budget debate will take place today and on succeeding days. The remaining motions will not be put until the end of the Budget debate next week and they will then be decided without debate.

Budget Resolutions and Economic Situation

AMENDMENT OF THE LAW

Motion made, and Question proposed,

That it is expedient to amend the law with respect to the National Debt and the public revenue and to make further provision in connection with finance; but this Resolution does not extend to the making of—

(a) any amendment with respect to value added tax so as to provide—
(i) for zero-rating or exempting any supply;
(ii) for refunding any amount of tax, otherwise than by a provision relating to supplies to, and importation by, a government department, within the meaning of section 19 of the Finance Act 1972;
(iii) for varying the rate of that tax otherwise than in relation to all supplies and importations; or
(iv) for any relief other than relief applying to goods of whatever description or services of whatever description; or

(b) any amendment relating to the surcharge imposed by the National Insurance Surcharge Act 1976 and applying to some only of the persons by or in respect of whom the surcharge is payable, other than—
(i) an amendment providing for a different rate of surcharge to be paid by the bodies specified in section 143(4) of the Finance Act 1982; and
(ii) an amendment relating to the Commission to be established under the Act resulting from the National Heritage Bill *[Lords]*.—[Sir Geoffrey Howe.]

[Relevant documents: European Community Documents Nos. 10337/82, Annual Economic Report 1982-83, together with the final version as adopted by the Council, and 10480/82, Annual Economic Review 1982-83, together with paragraph 7 of the Fourth Report from the Select Committee on European Legislation, House of Commons Paper No. 34-iv of Session 1982-83, and paragraph 4 of the Eleventh Report from the Committee, House of Commons Paper No. 34-xi of Session 1982-83.]

5.2 pm

Mr. Michael Foot (Ebbw Vale): It is part of the ritual of Budget day that the first speaker from this side of the House congratulates the Chancellor of the Exchequer on his performance. I certainly do not wish to depart from that tradition, at least for the first few minutes of my speech. I naturally accord him congratulations of the kind that previous Chancellors of the Exchequer have been accorded on the way in which they have presented the Budget to the House. I congratulate the right hon. and learned Gentleman on that basis.

Those of us who have been in the House for some time with the right hon. and learned Gentleman know that he has a great capacity for being clear when he wants to be and that when he is obscure it is also intentional. We must take that into account, particularly when examining the right hon. and learned Gentleman's proposals for dealing with pensioners. It appears that the right hon. and learned Gentleman may have received some assistance from the Secretary of State for Employment on these matters, and if that is so we must examine them all the more carefully. We shall do so with great care during our Budget debates and I shall return to that shortly.

The Chancellor of the Exchequer recalled some previous Chancellors of the Exchequer, such as Mr. Gladstone and Mr. Disraeli. In my judgment, he was not

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quite as witty as Mr. Disraeli or quite as wise as Mr. Gladstone. Indeed, he reminded me more of another 19th century Conservative Chancellor of the Exchequer, particularly when he approached the more agreeable parts of his speech. I refer to Sir Robert Peel, of whom it was said that his smile was like a silver plate on a coffin. The right hon. and learned Gentleman approached the issue somewhat in that spirit. He announced his measures with a certain grissly bonhomie, and we must give him credit for that.

If I may say so without any disrespect, perhaps the wisest words that have been uttered today were those said by the Deputy Speaker just as the Chancellor of the Exchequer began his speech. He said that the Chancellor should start again, and that is no doubt what the right hon. and learned Gentleman should have done. Both we and the country wish that we could return to that day four years ago when the right hon. and learned Gentleman presented the first of his Budgets. I remind the House, and particularly those who cheered a few minutes ago, that it was Mr. Iain Macleod who, I think, suggested that the Budgets that received the loudest cheers were those that brought disillusion the quickest. When the words of the Chancellor of the Exchequer are examined, disillusion often follows very quickly.

That will be true of this Budget, mainly because the Chancellor of the Exchequer had made no real effort to deal with the fundamental industrial and economic situation facing Britain. This Budget, this Chancellor of the Exchequer and this Cabinet are squalidly inadequate to deal with the problems of industrial decay and mass unemployment that face the nation. The overriding factor in the world in which we live is hyper-unemployment. That is the major problem that faces the nation. The Government claim that they have not in any way caused that hyper-unemployment. Indeed, they say that they can do nothing about it. The right hon. and learned Gentleman says that unemployment is intractably high. Of course it is appallingly high, but the right hon. and learned Gentleman uses the word intractable to suggest that nothing can be done about it. The Government have sought to preach that to the country over the weeks and months.

The Government say that the situation is worse in other countries, that our unemployment is just part of the world slump, that nothing can be done about it or that there is no alternative. We must show the country how this Budget merely extends that interlocking network of falsehoods and does nothing to deal with the problems.

The Chancellor of the Exchequer referred with some pride to his 1981 Budget, but that Budget is one of the reasons for the record unemployment in this country today. The clearest and starkest failure has been the destruction of jobs. The Government have destroyed jobs on a scale unknown since 1945. In three and a half years, one in 10 jobs in this country has been destroyed. This Government will be the first since the war to have destroyed jobs. For 35 years after the war jobs were created, but in three short years this Government have reversed all that. In few other countries have jobs been destroyed at all, and where jobs have been, the scale of destruction has been negligible compared with that in Britain.

Job destruction in manufacturing has been even more spectacular. More than one fifth of manufacturing jobs have been lost in Britain. Again, that is on a scale unmatched in any previous period of British history or by any other country in the present period. Although the Government have recently cited one or two other countries—I think that the Chancellor of the Exchequer mentioned them again today—such as the Netherlands or Germany, where the rise in unemployment is similar to our own, they are the exceptions and in neither case is the scale of job loss anything like as great as it is here. That is the result of the collapse in output. Nothing that the right hon. and learned Gentleman said will restore the situation.

None of this is surprising if we look at what has happened to production. The fall in output under this Government far outstrips anything suffered by any other country for which figures exist. With the exception of Canada, no other industrial country has suffered a loss of output during the period for which the Chancellor has presided over our economic affairs.

The right hon. and learned Gentleman has predicted recovery once again today, although his predictions are a great deal more tentative than they were a few years ago. This time he plumped for a figure of 2 per cent. as the likely increase. Up till now output has fallen by 5 per cent. from the first half of 1979, so a huge increase is called for and there is a huge backlog to be made up. Even with the increase predicted by the Chancellor, manufacturing will be 18 per cent. down from the second quarter of 1979, and the construction industry will be 10 per cent. down. Of all the trivial measures in this trivial Budget, nothing was more trivial than that offered to the construction industry. The measures offered to it were pitiful.

The Budget fails to deal with the real world. I went the other day to the Shildon works, which is part of the real world. The threatened closures there will add to the heavy unemployment figures. They will destroy a whole community and help to spread the industrial disease to many other parts of the country, because the coal and the steel used at the Shildon works will no longer be required, and that will have its reverberations.

The Government do not seem to understand the interlocking industrial measures between these great industries. They hit one industry and do not understand how that hits the others. What do they think will happen in the years to come? Are we not to want any of the wagons made at Shildon? In two or three years' time, once the Government have destroyed the industry, scattered the community and destroyed the capacity and the skill to produce these wagons in Britain, we shall have to import them. What is happening at Shildon is what has happened up and down the country. One can multiply it on a huge scale. It is only an example of the catastrophe wrought by this Government.

Why does not the Prime Minister listen to her favourite industrialist on this subject? The Government appear to deride spending and the Chancellor almost repeated the creed that spending is a dirty word. However, Mr. MacGregor said a few months ago:

> "Greater spending on major projects, like roads, bridges and sewers, is called for . . . It was tragic that the Prime Minister was having to tell local authorities to avoid spending money on capital projects. This would be costing jobs in the British Steel Corporation."

One can multiply that up and down the country. That is why we have a steel crisis.

If the right hon. Lady and the Chancellor do not understand that, they had better ask Mr. MacGregor whether he agrees with us. The collapse of the market in steel and the injury to the market in coal are reverberating from one major industry to another, but they may not understand these things in Finchley or Surbiton, where they do not produce the real wealth of the nation.

The right hon. and learned Gentleman had the nerve to speak of small businesses and what he was proposing to do for them. He spoke of his start-up scheme for small businesses. What about his close-down scheme for small-businesses? The Prime Minister and the Chancellor have been responsible for closing more small businesses than any other Government in British history. Bankruptcies have been running at an all-time record of 30 a day during recent months. That is what is happening to the small businesses of this country. Under this Government company liquidations have been 50 per cent. higher than under the previous Government. In 1982 the number of liquidations was twice as great as in any year before 1979. The Government should have a little diffidence in approaching the problem of how they are to help small businesses. There is a long queue of small business men whom they have driven to the wall.

All this is partly due to the policies and the theories to which the Prime Minister and the Chancellor are wedded. They are wedded to the course outlined by the right hon. and learned Gentleman today. The most menancing phrase that he used was that he was determined to continue along the same course. The course is one of impoverishment for the industry and people of this country.

That was the indictment by someone who is as expert on these matters as any of the monetarist theorists who advise the Government. It would be a poor compliment to him to mention him in the same breath as the Government's advisers. Perhaps hon. Members have read the article that appeared in *The Observer* a few weeks ago by Sir Alec Cairncross on the obligations of Governments to those who become unemployed and on employment policy. He said, and this is very much concerned with what is not in the Budget:

"The most remarkable thing about the depression into which the world has plunged is that Governments seem determined to wash their hands of it as if it were none of their business".

We had another exhibition of that nature today.

Sir Alec went on to say:

"Employment policy, born in 1944, is officially dead. Yet it has been Governments that have brought about the depression and their policies that are continuing to drive up unemployment and put the world at risk.

There is no mystery about the world slump. The prime cause has been the efforts of Governments to try to get on top of inflation by tight monetary and fiscal policies. These have reduced purchasing power and effective demand well below the potential of which their economies are capable.

That is what is happening in this country and in so many other countries where similar policies are applied. It applies also to the right hon. and learned Gentleman's boasts about bringing down inflation. Of course, in a world slump prices go down. One can cure inflation by the methods of the world slump. In the 19th century, Cavour said that any fool can govern by martial law and any fool can cure inflation by massive slumps. The necessity is to try to deal with the problem without forcing us into a recession.

That is what Sir Alec Cairncross said in the article in which he gave his warning a few months ago, before the inflation rate started to go up again. He said:

"Inflation has not been 'cured'. The fact that it is lower now than it was last year, or the year before, provides no insurance that prices will not increase faster once employment at last begins to rise again".

While we are cursed by a Government who are determined to make none of the efforts necessary to escape the slump of a recession in which we are fixed, that will always be true.

Some of the measures that the right hon. and learned Gentleman has proposed deal with taxation. I understand that some Conservative Members do not like to discuss the real world outside before we come to these problems, but this is real enough for those who are queuing on the dole queues, on a scale that the country has not known for generations. The taxation policies of the Conservative party, and in particular the taxation policies introduced by the right hon. and learned Gentleman in his first Budget have been a major contribution to the recession and are a breach of the election pledges on which the Government were elected. Far from reducing income tax at every level, the Government reduced it at only one level, the very rich level. Today's measures do not make up for the heavier taxation imposed over the past year—nothing like it.

Only one tiny bit of the £9 billion taken away by the Government has been restored. Nothing like the 9p mentioned by my right hon. Friend the Member for Stepney and Poplar (Mr. Shore), which would have been required to restore what has been taken away, has been proposed. Nothing has been done about the increase in VAT introduced by the Chancellor of the Exchequer in his first Budget, contrary to his election pledges. The increase in VAT from 8 to 15 per cent. in 1979 is still taking £5 billion out of the economy. It is all part of the Government's determined, persistent deflationary policy. There is a list of people who have had huge sums taken from them by the Government's taxation policies and have not had them restored by what the Government have done today.

Today's *Financial Times* article on the background to taxation was not by Labour party propagandists but by a brokers Laing and Cruickshank, who say:

"The United Kingdom tax burden in 1982 represented 32·5 per cent. of total national income. This has risen steadily during the period of the present Government from 28·4 per cent. in 1979."

That is the background against which these taxes are proposed. Some of the huge increases and burdens imposed upon different sections of the community have been partially restored. We are glad to see child benefit increased, although we believe that it should be increased further. We introduced child benefit and it was one of the major social reforms of the period. We want to see it built up, and although we welcome the increase we believe that it should have been a £2 increase.

We are glad that the mean, miserable and utterly indefensible 5 per cent. cut for unemployed people has been restored. However, the mass of unemployed people who have been thrown out of their jobs through no fault of their own have considerably lower incomes than would have been the case if the Government had sustained the forms of employment insurance and benefit that they inherited from us.

The right hon. and learned Gentleman attempted to claim that the 5 per cent. pension increase—if we accept his figure—was a tremendous advance. We shall examine with the utmost care how he is proposing to deal with pensions, how he is proposing to change from the present

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system and the percentage inflation figure to be applied. Even so, pensions do not come within miles of the form and rates of advantage to pensioners that were provided by the Labour Government.

During the period—*[Interruption.]*—from 1974 to 1979 the value of the pension was increased by between 20 and 25 per cent. The right hon. and learned Gentleman is proposing and boasting today about an increase which in real terms is less than 5 per cent. The increase during the Government's term of office is far smaller than that sustained by the Labour Government. The right hon. and learned Gentleman should at least return to the rates for pensions that we established, and he should restore the link between earnings and pensions introduced by our legislation.

We welcome any relief that will assist in bringing people out of tax. If the Chancellor had taken the advice that we offered two or three years ago many people would not have been in tax throughout the period and taxation would have been considerably lighter, and in that case many more people would have been in employment.

That brings us back to the major reason why we say that the Budget, the Cabinet and the Government are utterly incapable of dealing with our problems. I quote again what Sir Alec Cairncross said on this subject—*[Interruption.]* —I know that Conservative Members are determined not to listen to what he said about how we might be able to restore some employment, but none the less, they have to listen. He said:

"We cannot escape from the present depression without a large increase in demand and there is no likelihood of such an increase without an initiative on the part of Governments. It is pure fantasy to suppose that output is bound to recover by itself;"

—which is the Chancellor's theory—

"that, amid the scenes of industrial collapse, new businesses will be founded and flourish in the number required while old businesses take heart as never before."

That is what the right hon. and learned Gentleman said in his perorations would happen, but the exact opposite has happened.

The Chancellor says that the Government will not change course. We are determined that the country shall have the opportunity to change course. The loss that the country has suffered during the industrial collapse of the past three years is of historic proportions. It has been greater perhaps in terms of wealth than even the 1930s, although the comparisons are not so easy to make. Keynes said:

"There is the far greater loss to the unemployed themselves, represented by the difference between the dole and a full working wage, and by the loss of strength and morale. There is a loss in profits to employers and in taxation to the Chancellor of the Exchequer. There is the incalculable loss of retarding for a decade, the economic progress of the whole country."

During the Chancellor's tenure of office he has held back this country's advance by something like a decade. We are now told that the same course will be persisted in. These measures certainly will not change it.

There is to be a continued trail of human misery for the poorest in the community—the increasing number of people who have to rely upon supplementary benefit to keep families together. A huge mountain of waste for the nation is involved in these figures. There are deep divisions in our society between rich and poor, north and south and between those who want to secure our escape from this position and those who are denied the right to do so by the Government's policy.

The Budget offers no prospect of recovery to the real world outside even though it received a few ephemeral cheers in the House today. The country needs an entirely new course, and the sooner the Government get out and allow us to put it into operation, the better.

5.27 pm

Mr. David Atkinson (Bournemouth, East): I congratulate my right hon. and learned Friend on another first-class, sound and responsible Budget statement. What a contrast this Budget statement has been with those that we have had at the end of the fourth year in office of every previous Government during the past 18 years.

The House will recall that by this stage in the life of every Government since 1964, every Chancellor has reversed the economic strategy upon which his Government had been elected. Chancellors have either been compelled to reduce public expenditure when they would have increased it, or increased public expenditure when pledged to reduce it. Each one introduced wage or price controls when he had pledged not to. The result was that in almost every case inflation and, consequently, unemployment were higher at the end of each term in office than at the start. Each Government subsequently, and many would say deservedly, lost office as a result.

The great hope for the unemployed today lies in the fact that my right hon. and learned Friend has at least clearly taken control of public expenditure. Inflation and interest rates have fallen as a result, and this must mean new jobs in due course. I am, of course, disappointed that my right hon. and learned Friend has not yet reduced public expenditure in real terms. If he had, he would, by this year, and certainly today, have been able to cut the basic rate of income tax beyond what it is at the moment. I believe that this is what he set out to do in 1979. I appreciate fully the reasons why he has not yet been able to achieve this aim.

No party anticipated at the last election the depth of the recession following the rise in the price of oil that took place within weeks of that election. Without the cost of today's unemployment and the massive support that the British taxpayer still gives British industry, we would now be enjoying much lower personal taxation. The aim of my right hon. and learned Friend or his successor must be to reduce the basic rate of income tax. At least, no other party in this country aims to spend less of the nation's income and wealth than do this Government. I hope that the country will bear that in mind when the next election comes.

I congratulate my right hon. and learned Friend for keeping his cool over the past four years and for sticking resolutely to his medium term financial strategy. His refusal to panic means that Britain is today better placed than other countries to prosper from the upturn that more and more evidence suggests is now occurring on the other side of the Atlantic and will, in due course, come to Europe. A feature of every one of my right hon. and learned Friend's Budget statements has always been his enterprise packages for industry in general and small businesses in particular. He has not let us down this time. I welcome particularly the further reduction in Labour's tax on jobs, the national insurance surcharge. Abolition of the remaining 1 per cent. must surely be a manifesto commitment for the next election if my right hon. and learned Friend has not been able to achieve it before then.

I welcome particularly the further reduction in small companies' rates of corporation tax, the measures to help the building industry, the measures to encourage greater share ownership in companies and especially the expansion of the enterprise allowance to help unemployed people to create new businesses. One of the most encouraging statistics publised recently has been the increase in the number of self-employed people to its highest ever level at over 2 million. I know from my experience that there is nothing better for those so inclined than to accept personal responsibility for working for oneself, running one's own business and enjoying the job satisfaction that is to be gained from the service that one gives others. Our continuing aim must surely be the removal of all unnecessary obstacles to and restrictions on enterprise including, where possible, any avoidable burdens placed on small businesses by the imposition of value added tax.

Here, I come to my first complaint about today's statement. I believe that an opportunity has been missed. My right hon. and learned Friend announced that he has increased the value added taxable turnover threshold to £18,000. I welcome this as the greatest value of the registration limit since value added tax was introduced. If my right hon. and learned Friend had announced that he was raising the value added taxable turnover threshold to £30,000 a year, no less than 300,000 small businesses would be freed of the burdensome commitment of charging and administering VAT. The gross loss of revenue to the Exchequer would be £65 million which works out at £217 a business. Since the average cost of collecting VAT per business is £105, the net loss of such a move of revenue to the Exchequer in removing these 300,000 small businesses from VAT liability would be £32 million. That represents £112 per business which, I suggest, will be made up in no time from the corporation tax that will be generated by the activity resulting from being freed of such constraints.

We will be told that such a move is contrary to article 24(2)*(c)* of the European Community directive on VAT. The logic of my argument surely applies to every similar sized business throughout the European Community. As this year is the European Parliament's year of small and medium sized businesses, designed to focus on the role and needs of the smaller business in Europe, it would be an appropriate year for Britain to urge on the Community that it can make a major contribution towards improving the climate for enterprise by raising the real level of VAT threshold and freeing many small businesses from this commitment——

Mr. John Evans (Newton): Does the hon. Gentleman not agree that the greatest opportunity missed today was the Chancellor's failure to reduce VAT back to 8 per cent., its level when the Tory Government took office, which would have affected millions of people?

Mr. Atkinson: We have always made clear that we prefer to encourage incentive in the economy by reducing direct taxes instead of indirect taxes. I believe that that is right. I hope that my right hon. and learned Friend will consider that such an initiative would earn the gratitude of every small business in this country and in Europe.

There are two other disappointments that I should like to express about VAT that are directly relevant to businesses in my constituency. I appreciate that they may be regarded by some hon. Members as significant. They are, however, significant to the industries and businesses concerned. I am sorry that my right hon. and learned Friend has not responded to the representations from the industry to remove VAT from—no less—ice cream. Far more ice cream is eaten today as a food than as a confectionery. Food is VAT-free. Ice cream is not. That anomaly, I regret, has not been corrected. I hope that the Government will introduce an appropriate amendment in Committee.

My next complaint concerns the continued imposition of VAT on language schools, of which there are many in my constituency. The teaching of English as a foreign language is education. As hon. Members know, education is zero-rated for VAT. The schools, however, are not zero-rated because they are regarded as businesses. Yet language schools are everywhere classified as schools of further education. They are also an export business. They have long been a source of earnings to this country, competing strongly against teaching organisations and schools that do not suffer from the imposition of VAT in other countries. I hope that further thought will be given to eliminating this anomaly.

My retired constituents—there are many of them—will be delighted by my right hon. and learned Friend's announcement that he has been able to abandon his proposed clawback of last year's award because he had underestimated his success in reducing inflation. If it had been the other way round, there would have been instant demands to make up the shortfall. I had thought at this stage that I would be saying that a better system could surely be found than that under which pensioners have to wait half a year before receiving their announced increase, by which time they believe that it has been eroded by inflation. Instead, I can congratulate my right hon. and learned Friend on his plans to return to the old system based on the actual rise in prices. This will put an end to much cynicism among pensioners.

One disappointment that pensioners, like all those who have accepted a greater responsibility for their health needs, will feel is my right hon. and learned Friend's failure to use his statement to introduce tax reliefs for individual and family subscribers to private health insurance schemes. These people, by and large, do not use the National Health Service extensively. However, they still pay for it and, in my view, they deserve tax relief. This is just as important as the raising of the mortgage tax relief threshold for young couples buying their first home.

I shall nitpick no more. The Chancellor of the Exchequer has again presented a first-class Budget. It may well be his last. I believe that this country will have cause to thank my right hon. and learned Friend for the foundations that he has laid for the prosperity that has been brought closer by his statement today.

5.39 pm

Mr. Roy Hughes (Newport): The Budget is the occasion when the Chancellor of the Exchequer presents his progress report to the nation. He tells us what additional revenue is required and what concessions, if any, can be made to the taxpayer. He is the manager of the nation's economic affairs. It could be said of the

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present incumbent of that important office that he is a record-breaker in a quite unique way. He has brought about record unemployment, a record fall in output, together with minimal investment in our manufacturing industry, which is vital for the future of our country. It is apparent that manufacturing industry has been brought to its knees, as the director general of the CBI, Sir Terence Beckett, points out from time to time.

The verdict on the Chancellor's management of our economic affairs is borne out by the length of the dole queues. So the whole purpose of my intervention, which will be very brief, is to pose the fundamental question: will the Budget reverse the upward trend in unemployment? The answer must be a categorical no.

Let me deal with the specific proposals in the Budget. There is to be a massive intervention in pay-as-you-earn. There is to be £2 per week for a married man paying the standard rate of income tax. That is a monumental proposal in view of the present economic state of the country. I do not doubt that it is a step in the right direction, but it is minimal, to say the least.

In the proposals that were put forward a week or so ago by my right hon. Friend the Member for Stepney and Poplar (Mr. Shore), the shadow Chancellor, he suggested that those on or below £250 a week would pay less taxation and those above that figure would pay more. It is not difficult to see the egalitarian nature of those proposals. My right hon. Friend's suggestions on tax allowances would take 1 million people out of tax. The Chancellor's proposals are pretty puny by comparison. The same applies to the increases in child benefit. We proposed an increase of £2 a week. Compared with that, the Chancellor's measure is inadequate.

Then there is the need to help those who are in the unfortunate position of being unemployed, particularly as a result of the slump, which is essentially Government-created. Again, the help for those people is inadequate, to say the least. At one time my constituency of Newport was a booming industrial town, but now it has almost 20 per cent. male unemployment. A group of social workers carried out in certain districts a study in my constituency into the effects of unemployment. It vividly illustrated the poverty, despair and mental illness caused by unemployment. I should have thought that the Chancellor's prime duty today was to try to combat the massive unemployment that has swept our country.

The Chancellor of the Exchequer could have helped by a massive increase in social spending, and not only for the younger elements in our society. One cannot help but admire the way in which the pensioners put their case. A range of options was open to the Chancellor today to help pensioners. The Christmas bonus could have been doubled to £20. That would have been most welcome. The Chancellor could have introduced free television licences, at a pretty low cost. I, and no doubt many other hon. Members, have received many representations about an increase in the death grant, but the Chancellor chose to do nothing about that.

Pensioners need a better deal on heating arrangements. Many of the ailments and complaints of old people can be attributed to that source. Then, too, the Chancellor could have done something about a national concessionary scheme for fares on public transport, to keep old people mobile and interested in affairs, and to enable them to visit relatives, go shopping and visit places of interest which they were unable to do during the course of their hard working lives. In particular, he could have helped pensioners who have a little capital—those who have saved a little money during their working lives. The supplementary benefit scheme should be modified on a sliding scale to ensure that those people are not unduly penalised for their small amount of capital.

The upper ceiling of national insurance contributions of £220 could have been abolished, with no hardship to the people in that income bracket. The 45 per cent. tax band could have been lowered. The change in the mortgage relief limit from £25,000 to £30,000 is again a gift to the better-off section of the community and is most unfair when one thinks how council house tenants have been hammered with increased rents.

There is the usual taxation of motorists. This year it has been made more plausible in that it is alleged that it is merely keeping in line with inflation. That does not alter the fact that the motorist is always caned, year after year. What is more, the money is not going back into our roads.

The Labour party has put forward proposals to help the poor and the needy. Such proposals are met with cynicism. We are asked how they will be paid for by the same people who readily vote £10 million for the Trident project. The steelworks at Llanwern are fighting for a concast plant to preserve jobs. I understand that the cost will be about £100 million. I compare that with the £800 million that is to be spent on a runway at Port Stanley airport in the Falklands.

Perhaps the greatest scandal of all is the £15 billion that is paid annually to people in the dole queues. Above all else, we must put those people back to work so that they can do something useful and produce new wealth. I agree that the Chancellor has moved a little this afternoon, but what he has done is a mere pinprick compared with what is needed to answer Britain's problems. The position is essentially one of despair, when our people need hope.

The media, in support of the Conservative Party, have not focused on the real issues of unemployment at all. They have merely been involved in the character assassination of some Labour leaders, whether it be my right hon. Friend the Member for Bristol, South-East (Mr. Benn), Mr. Scargill, Mr. Livingstone or Mr. Tatchell. Some people are being fooled by that, but all the people cannot be fooled all the time. I forecast that after the general election we shall see a Labour Chancellor steering Britain once again on the road to recovery.

5.51 pm

Mr. John Lee (Nelson and Colne): That my right hon. and learned Friend the Chancellor of the Exchequer had a fairly pleasant task in the drawing of his Budget was because of the courage and steadfastness that he has shown in his earlier Budgets, despite criticisms from Back Benchers including, from time to time, me. However, overall the Budget is excellent. It is prudent and humane yet enterprising. It strikes a fair balance between benefits to industry and help to the individual and the family.

The further reduction in the national insurance surcharge will be most welcome to industry. The reintroduction of the small engineering firms investment scheme will be much appreciated by many engineering firms in Britain—those in north-east Lancashire as well as those in the west midlands to which my right hon. and learned Friend referred. In addition, the reduction in interest rates during the past 12 months and, again, today will be welcome.

For the family and for individuals there is the restoration of the 5 per cent. abatement in unemployment benefit for which several of my hon. Friends have campaigned, and all credit to them for doing so. A further 1·25 million people are being taken out of tax by the increase in personal allowances. The pension increases are welcome. Between 1979 and 1983 they have increased by 75 per cent. compared with a 70 per cent. increase in prices. There is also a welcome increase in child benefits, help for bereaved widows, the removal of the invalidity trap, as it was described by my right hon. and learned Friend this afternoon, and the capital threshold for the provision of supplementary benefit has been raised to £3,000.

A series of measures have been announced this afternoon to help and encourage the establishment of new businesses. The business start-up scheme has been improved, the loan guaranatee scheme has been extended and free ports have been announced. I particularly praise the decison to go national on the enterprise allowance scheme. I have perhaps spoken more on the enterprise allowance scheme than any other Back Bencher. I have seen the scheme work successfully in one of the pilot areas in my constituency in north-east Lancashire. We have led the field nationally in the application of that scheme. It has been operational for just over a year and more than 1,000 people have applied to start business under it.

In my local authority of Pendle 200 people started up in business because of the enterprise allowance scheme and the vast majority are extremely successful. They cover a range of business activities—service industries, retail businesses and small manufacturing operations. Having monitored and promoted the scheme in north-east Lancashire, my experience has been that many of the businesses that were set up under the scheme would probably have been set up anyway. That was one criticism of the amount of money that has been spent on the scheme. However, I am convinced that the fact that there was £40 a week available for small businesses for 12 months has finally pushed some of those who were hovering on the brink to start up in business on their own. It has provided them with that extra guaranteed liquidity and income in the vital first 12 months when a business is most at risk. It was an excellent innovation. In addition, it has helped to bring some small businesses out of the black economy.

I am delighted that the Chancellor announced a £25 million national cash limit for that scheme for 1983-84 which is designed to provide about 25,000 new small business opportunities for applicants under the scheme. I encourage all hon. Members to do everything possible in their constituencies to promote the enterprise allowance scheme. It is a first-class scheme, as I have seen from its operation.

I made my maiden speech in the Budget debate of June 1979 in praise of the Budget presented then by my right hon. and learned Friend. I am happy this afternoon to make what will probably be one of my last speeches in this Parliament in support of my right hon. and learned Friend's 1983 Budget.

5.57 pm

Mr. Jim Craigen (Glasgow, Maryhill): Everyone expected that this would be a good Budget. After four years of this Administration, we deserve at least one good Budget. There seemed little doubt of that, because the Chancellor has two forthcoming by-elections on his mind. Frankly, I think that Budget day is a somewhat overrated occasion. With the complexity of present day issues I wonder whether it is the best way to manage the nation's economy.

The Chancellor missed an ideal opportunity to make amends for the adverse measures that he imposed on the low-paid in Britain when he abandoned the 25 per cent. lower band rate. After spending some time this afternoon talking about the problems of those on low incomes he more or less dismissed the opportunity to put right that error. It is not good enough to suggest that to restructure tax would take more than a Parliament. After all, he has had a longer term than most Chancellors in which to do something in that area. The Government have cheated the low-paid, because there is little incentive in the Budget for those families that are in difficult financial circumstances. Those who made the sacrifices in 1981 will not necessarily be the beneficiaries of the 1983 Budget.

One is pleased that the pledge to restore the abatement of unemployment benefit is being redeemed on this occasion, but what a struggle it was to convince the Government that that should be done. What anguish there was on the Government Back Benches on the various occasions when abatement was debated. A good many Government Back Benchers were sorely tried on those occasions. Some of them had the courage to vote against their Government on the issue and others abstained.

It appeared to me that as the Chancellor was unfolding the four special measures to deal with the problem of the long-term unemployed he relied even more than he did last year on measures such as job splitting and part-time employment. In effect, three of the schemes are designed to take people off the unemployment register in circumstances where it is felt that there would be no other way of removing them from it. This hardly seems an inspiring approach at a time when the Manpower Services Commission is warning that by the end of this year 1·25 million people will be in the long-term unemployed category, although I believe that the figure is more likely to be 1·5 million.

In addition, a dangerously large number of people have been unemployed for more than six months but just under 12 months. For the time being it appears that we will have to rely totally on the rather inadequate community programme, which proposes only 130,000 jobs, some of which will be full-time and some of which will be part-time. This, in effect, is the mismatch between the level of long-term unemployment and the provision which the Government feel is necessary to make.

One always welcomes measures to help the construction industry, because, by and large, it is a cost-effective means of introducing employment opportunities into the community. The Chancellor mentioned the special problems of inner city areas. I know something about such areas and one of the greatest difficulties facing many of our inner city areas is that, by constant retrenchment on the rate support grant and on the availability of Government support for local authorities around the country, those with responsibility for inner city areas are having to cut back on the level of services.

Maintenance and repair budgets are invariably a prime target for local authority economies. The maintenance and repair budget under the various departmental headings is

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usually quite substantial. It is easy to make what appears to be a saving today but which, in a few year's time, becomes a false economy. When the Chancellor is trying to juggle about with types of assistance that might be made available to inner city areas he should bear in mind that the level of assistance available to local authorities largely determines the quality of services in those areas.

My hon. Friend the Member for Newport (Mr. Hughes) referred to public transport. Many of our constituents depend upon public transport. There is little in the Budget to suggest that the Government recognise the need to assist the bus industry and the travelling public. This involves not only pensioners travelling about but people travelling to their work or the unemployed, who find it rather difficult to bear the travelling costs of job search.

We like to see measures designed to assist the development of small businesses, although my experience from talking to business men is that problems arise not in starting up a small business but in keeping it going. Here the level of demand is the great determining factor in how successful many of these small businesses will be. If a careers adviser were suggesting new growth areas for would-be applicants in the foreseeable future, work as a liquidator or a receiver would be good suggestions. There has been an unhappy buoyancy in that corner of the market.

With regard to inflation, which has become central to this Government's economic policy—in so far as one can discern an economic policy—the retail prices index has now taken on an importance in the management of economic affairs which it does not deserve. We should examine more closely the way in which the retail prices index is compiled and the shift that has taken place in the weights attached to the measurement of the retail prices index. It means different things to different people in different parts of the country. There is little doubt, especially on a day on which the Chancellor has announced an increase to £30,000 for interest relief on mortgages, that many folk could not consider a £30,000 mortgage, far less get hold of one.

While I am in favour of measures to assist home ownership, the number of people now in the home buying category who are benefiting from the reduction in interest rates is influencing the measurement of the retail prices index. If we consider this more closely, we see that those who pay rent are disadvantaged because there has been a sizeable jacking up, as a result of Government policies, in the level of rents. That trend has been accentuated by measures such as mortgage interest relief at source. Such a measure may not help the building societies cash flow, but it helps the cash flow of those paying mortgages. It therefore widens the gulf between the north and the south, in that the preponderance in the south is of home ownership, whereas the preponderance in the north is largely of rented accommodation. I earnestly suggest that the way in which the retail prices index is made up should be examined. There are all sorts of implications for wage bargaining, as the Chancellor pointed out this afternoon, for the allocation of Government resources to the rate support grant and indeed, for the general conduct of economic management in this country.

There is an absence from the Budget of adequate measures to deal with unemployment. What is happening on the unemployment front should worry Members of Parliament. A teacher told me the other day that he had asked his class of 16-year-olds how many expected to get a job when they left school. Not one hand out of 24 went up. When he asked how many of them expected to get a job by the time they were 21, only three hands went up. That is depressing. The enterprise allowances will not overcome that brick wall, which, unfortunately, faces too many young people when they leave school.

This country needs a sense of direction. There is no doubt that more people are ceasing to be kidded by the fiscal measures every March or April in the Budget. There is a lot more cynicism and sophistication about those matters than politicians will openly admit.

When the Chancellor was unfolding the contents of his Budget I wondered where the money that was being handed out was coming from for many of those small and, at the end of the day, relatively unimportant little schemes or projects that he mentioned to stimulate activity here and there. It was interesting that he paid special attention to the west midlands. That area has felt the full blast of the Government's economic mismanagement. I should have liked to hear a little more about special measures to help areas such as Scotland, which have equally lost out due to the Government's economic policies.

We have now had five budgets from the present Chancellor. I suspect that he is still keeping his options open in case there is a sixth Budget, because the election could be in 1984. However, I hope that for the sake of the economy we are spared a sixth Budget from him.

6.12 pm

Mr. Chris Patten (Bath): As the hon. Member for Glasgow, Maryhill (Mr. Craigen) said, the Budget is one of the great ceremonial moments in our political and economic calendar. Taken with the public expenditure White Paper, which we debated in an even more crowded Chamber last week, it represents a distillation of the Government's economic strategy and political philosophy. It is in that sense that I shall talk about the Budget.

I should first, however, like to make one or two microjudgments about the Budget. I am extremely pleased that the Chancellor increased tax thresholds as he did. It is the best way of helping the poorer-paid workers and undoes some of the problems that resulted from the Budget in 1981. The Chancellor believes that his decision that year was unshakeably right. It is part of the Chancellor's admirable consistency and charm that he believes that most of the decisions that he has taken about the economy have been unshakeably right. We are all entitled to our opinions. At least on this occasion I agree with what he has done about the thresholds. I also agree with what he has done on child benefits. I am pleased about the restoration of the 5 per cent. abatement in unemployment benefit, on which some of us have made speeches and done other things in the past. I am also delighted that he has not clawed back the pension as at one time he seemed to be threatening to do. I did not think that that was likely as there will be an election in the next 12 months, and even Treasury Ministers—we hope all of them—have elections to fight.

I was also pleased that the Chancellor made a further cut in the national insurance surcharge, albeit only a small 0·5 per cent. cut in that iniquitous tax on jobs. That is that, as far as the Budget is concerned. There are one or two measures to help small businesses. I do not think that it is unfair to say that the impact of those measures is unlikely to exceed by a substantial margin the magnitude of their cost.

I refer now to the overall impact of the Budget. I do not want to sound too excitable. It is sometimes said about those of us who believe that the present levels of unemployment are too high, which at one time we were told would be a passing phenomenon as inflation was abated, but which are now more permanent, that we are underestimating the robust spirit and independent-mindedness of those who are out of work for 6, 9, 12 or 18 months. It is also said that we underestimate the political cynicism of the 87 per cent. of the population who have jobs.

That might be all true. Perhaps that is what the world is like. Perhaps we can be reasonably relaxed about so many young people spending so much of their lives on the dole, even after they have done a training scheme. Perhaps we shall not have to pay the consequences in terms of the alienation of that generation from society, although I would not have thought that that was necessarily the lesson that one would take from Northern Ireland. Perhaps our industrial democracies can withstand the strain on our social fabric and institutions of continuing high unemployment. Perhaps *The Times* was right in the staggeringly insensitive and intellectually Neanderthal leading articles on the economy recently that made Montagu Norman sound like a cross between William Beveridge and John Maynard Keynes. Perhaps *The Times* was right to argue that numbers do not matter when one is talking about unemployment, whether it is five, 50, 500, 5,000, 50,000, 500,000 or 500 million. Perhaps that is right, but I do not believe it for a moment. People who suggest that that is so are taking a terrible risk and are almost literally playing with fire.

I am not claiming that we can tackle the problem of unemployment and the recession alone. In that sense the Budget is to some extent irrelevant. It does no harm. It is conceivable that it may have done a little good. However, even within the constraints in the international sphere that stop us doing much more on our own, we could have done more to hurry recovery along and make sure that it is not anaemic and shortlived.

I have disagreed with the Treasury for a long time about the level of the public sector borrowing requirement. It is too low, it is restrictive and has a contractionary effect on the economy. I accept that it is true that the markets believe what the Chancellor tells them about the central importance of the PSBR as a yardstick of fiscal rectitude, but let it be said that it is a yardstick that no other country like us would dream of using. If that is so, it is time to educate the markets as well as the Treasury. We should remind them that by any economically literate criterion, the country is in a surplus on its accounts. That is what the Institute for International Economics in Washington said before Christmas last year. It is true, as the stockbrokers Lang and Cruikshank said recently, if one adjusts the figures for inflation. It is interesting that only Treasury Ministers nowadays, when looking at their own sums, suffer from the money illusion. It is true, as the stockbrokers, Simon and Coates said, if one adjusts for unemployment.

As Helmut Schmidt, whom we used to quote a great deal as our favourite Social Democrat, said in an article in *The Economist* a few weeks ago, the British fiscal stance is too contractionary and we could and should be a great deal more expansive in the next few weeks and months. We should read that article to the markets and explain to them that it is a little odd to expect the American economy by being more expansionary in fiscal policy to pull us out of the recession, when we seem to be unwilling to try to escape by being a little more expansionary at home. I accept that even with a slightly larger PSBR and even if we had been able to scrap, as we should have done, the national insurance surcharge, we could not have made a great deal of difference.

My main criticism of the Government in that sense is that we have not always done even that little which we could effectively do. But for substantial results we shall have to look forward to the Williamsburg summit and to the agreements reached there. I hope that there will be an agreement on stabilising exchange rates; I hope that there will be an agreement that the OECD countries should do a little more to concert the expansion of our economies. In other times we might have used the word "reflation".

There are one or two comforting signs. We saw Mr. Volcker giving evidence to Congress the other day and saying:

> "We cannot build a successful policy against inflation on continued recession."

Then we heard Mr. Shultz speaking to Congress and saying:

> "the only lasting solution to the income-earning problem of the less developed countries, as well as the serious problems of the industrialised countries, is sustained economic growth . . ."

I am sure that that is absolutely true.

What we need is not the discovery of a new plan, a new theory, but a display of old-fashioned political will to make the international decisions to concert an economic recovery. It is time the visible hand of politicians rather than the invisible hand of the market took a part in the proceedings. Only if we do that will we stand the remotest chance of restoring our prosperity, of saving welfare capitalism—I am serious in making that point—and thus safeguarding our democracies. I believe that the threat of this recession is much more profound than any of the leaders of our democracies have been prepared to accept.

6.22 pm

Mr. Tom Clarke (Coatbridge and Airdrie): The hon. Member for Bath (Mr. Patten) made, in the circumstances, a most gracious and thoughtful speech. I thought during the Chancellor's speech—and the right hon. and learned Gentleman paid more attention to the pipe which is used by the hon. Member for Birmingham, Selly Oak (Mr. Beaumont-Dark) than to other matters—that he might have been more grateful for the contribution of the hon. Member for Bath in persuading not just the Chancellor himself but the Government and their supporters to take the view that the decision on the 5 per cent., which has led to at least two Divisions since I came to the House, was a mean-minded decision. It is one which I am sure we are all very grateful is being reversed. I therefore think that the hon. Member for Bath deserves the thanks of the House, if not of the Chancellor, for his contribution to that change of mind.

The Budget presented this afternoon seemed to me to be a very dull Budget presented in a very dull manner. It offers very little hope to my constituents and will lead to great disappointment in Scotland, and indeed in many other parts of the United Kingdom. It cannot be divorced from the problems that we face as a nation—economic and

[Mr. Tom Clarke]

industrial problems and problems of the social fabric of our society, problems which the Chancellor and the Budget failed to address.

We are discussing this Budget at a time when unemployment stands in real terms at about 4 million. In my constituency over the last few days even more redundancies have been announced in the steel industry. At the Imperial plant in Airdrie and the Calder plant at Coatbridge—tube manufacturing plants which have a very proud record and which have provided tubes for oil and for the North sea—redundancies were announced by the British Steel Corporation even ahead of the decision of OPEC. Those of my constituents and their families who have had to face these decisions and deal with the realities of them will find very little, if any, comfort, in the measures that we have heard about this afternoon.

The Chancellor has addressed himself to a number of issues which have led to a great deal of debate, discussion and speculation not just in the press over the past few weeks but over the past four years. I believe that as a nation we were entitled to expect more from the Chancellor in view of the sacrifices that we as a nation have made since the 1979 election. This is a pathetic little mouse of a Budget which will lead to very little improvement in our economy and our industry or the rightful aspirations of our people.

That might have been forgiven if as a nation we were poorer in resources than we are, but this Budget has been presented by the Chancellor at a time when we have oil revenues, and other great resources which are being squandered in a way that not only is intolerable to our people but would, I believe, have been rejected by such people as Ian Macleod, who would not have been proud to present the kind of Budget that the House has heard today.

There is a need for the House to address itself to the prospects for real job creation. In my constituency more than 10,000 people are unemployed. Like my hon. Friend the Member for Glasgow, Maryhill (Mr. Craigen), I find that young people are disenchanted. There are simply no job opportunities available. What we expected to hear about in our debate last week on the Government's White Paper on public expenditure and in today's debate was measures which left open to local authorities, public agencies and others the prospect not just of improving services but of ensuring that more jobs became available. That simply has not happened.

The Chancellor referred to local government and to the Civil Service. I should like to refer to them too.

First, in recent months the Government have apparently taken the view that capital has been provided and that there is evidence of underspending in local government. This evidence, incidentally, does not apply to Scotland and it might be helpful if Government Ministers pointed that out from time to time. Even in England and Wales, however, it is not good enough for the Government, having criticised local authorities for 3½ years for alleged overspending, now to remind local authorities that capital is available, if only because the local authorities have to address themselves to the real problems which they face.

One of the problems is that local authorities, in drawing up their budgets for capital expenditure, have to bear in mind the revenue consequences of that commitment. If the rate support grant is not to reflect the real level of wage settlements, inflation and the rest the local authorities are not being helped by the Government's reminding them that capital is available without taking revenue into account.

We have continually heard in recent weeks references to the reductions in the Civil Service. It would be helpful if Ministers from time to time, acting as an enlightened employer—although I agree that that would be an unusual role for this Government—would recognise that civil servants have made a remarkable contribution to that achievement. If there is a reduction to the extent that we have heard about this afternoon, the burden on the civil servants, particularly in Departments such as the DHSS and others dealing with the public and the increasing public demands, ought to be recognised. They are making a greater contribution to bringing about these reductions than any Minister has acknowledged. The Government should not go too far in that direction, and they should remember that morale in the Civil Service is not high.

The Government still owe an answer to the British people whom they promised reductions in taxes at the last general election. There was no substantial attempt to meet that commitment in today's Budget. VAT has still not been reduced to the level at which it stood when the Labour Government fell, and no account has been taken of the increased fuel charges that people now have to pay.

In my constituency, 80 per cent. of the electorate live in council houses. Although I welcome the very modest improvement for owner-occupiers, such measures offer no help or hope to people living in council houses. We need a sign that the Government appreciate the need to invigorate our industry, to give hope to manufacturing industry and to examine the imports that are being allowed almost to wreck the economies of some parts of the United Kingdom. The Budget provides no such sign and will be a great disappointment to many people, especially those in Scotland.

Finally, when the Prime Minister took office she quoted St. Francis of Assisi. I remind the right hon. Lady and her colleagues that St. Francis also said that we should seek not just to be understood but to understand. Nothing in the Budget suggests that the Government understand the enormous problems facing our country. I only hope that the many people, especially young people, who will be profoundly disappointed by the Budget will not cease in their campaign for a more responsible Government and a new society, which I believe can be offered only by the Labour Government that I believe will follow the general election.

6.32 pm

Mr. John Stokes (Halesowen and Stourbridge): I am sorry that the Leader of the Opposition could not remain, as he made some rather ungracious remarks about my right hon. and learned Friend the Chancellor. The right hon. Gentleman referred to Disraeli, Gladstone and Peel. He then went on to Italian history with references to Cavour and so on. In all modesty, I should inform the House that the comment on Peel was made by Disraeli himself. He said that Peel's smile was like not the silver plate but the brass plate on a coffin. That was at a time when the Tory party was undergoing similar convulsions to those now afflicting the Labour party.

I listened with great attention and interest to my hon. Friend the Member for Bath (Mr. Patten). If he does not address the House very frequently, he certainly regales us with regular articles in *The Times*. Incidentally, I note that he criticised the editorship of*The Times* rather heavily. I do not always agree with what my hon. Friend says. Certainly, he must accept from me, as one whose constituency has probably twice as much unemployment as his, that I care every bit as much as he does about unemployment. I do not believe, however, as my hon. Friend appears to believe, that the Government can do a great deal about it. That is the difference between us.

My constituents—hardworking, honest decent, patriotic people who have never suffered hard times before—never complain to me. They do not blame me, the Prime Minister or the Government. They know that the troubles besetting us now are due partly to history, partly to the world slump and partly to the many mistakes made by management and unions in the past 30 years. To imagine that those problems can be solved by a Budget is absolutely puerile.

Mr. Chris Patten: Whatever my hon. Friend's constituents think about the recession and the slump, does he believe that the policies pursued by Governments in all the industrial democracies in the past few years have anything to do with the present level of demand in the world economy?

Mr. Stokes: My hon. Friend has anticipated my next comment. I agree entirely that more should be done on the international scene about all kinds of things.

What we want from the Budget is encouragement, hope and better morale. Morale is as important in peace as in war. I believe that my right hon. and learned Friend the Chancellor, despite his typically quiet tone, has given us both confidence and hope. Industry needs help to reduce its costs and my right hon. and learned Friend was right to concentrate on assisting our vital manufacturing base. Individuals, too, need help and hope, and the reductions in personal taxation will go some way towards that. My right hon. and learned Friend has presided over many Budgets. He has stuck to his principles and I believe that in time he will see his reward. The strict control of borrowing and spending has reduced inflation significantly. In time, that will have profound and beneficial effects on every aspect of commercial and industrial enterprise.

I welcome the cut in national insurance surcharge, although it is not great. I should have liked to see more help to reduce energy costs in industry. The burden of rates still bears very hard on industry, and some Labour-controlled councils seem not to realise the benefits that factories bring to their communities and the losses suffered if they are driven away.

Industry looks anxiously for a substantial reduction in interest rates. Today's 0·5 per cent. decrease is welcome, but, in view of the fall in inflation to five per cent., interest rates are still far too high and place too heavy a burden on the new and expanding industries so greatly needed in the midlands with its more traditional engineering and metal working base. Governments cannot do everything, of course, and I believe that the fall in the pound will now give exporters much that they need and expect to expand their overseas markets. I also believe that the fall in the price of oil will probably do more to increase production and the sale of products both here and elsewhere not just in the West but in the underdeveloped countries.

I am glad that my right hon. and learned Friend has not hit the motorists too hard as they always seem to have to bear a heavy burden. I accept the changes in taxation on tobacco and wines and spirits, which are roughly as I had guessed.

I also welcome the increase in defence expenditure. I believe that the proportion of our taxes devoted to defence will be borne cheerfully by all but a sullen minority who are prepared to see us overrun by the Soviets.

Above all, I welcome the help given in pensions, child benefit, widows benefits and all the other increases in social security benefits.

I also welcome the help given to small firms and to small business men starting up their own firms, an operation that is already going well in the midlands.

Health Service charges impose a huge burden on the economy. If they can be re-cast to give better value for money, only the most prejudiced will object.

I wish that regional aids could be abolished. They have done nothing but harm to the west midlands. It would be far better to get the economy right as a whole, throughout the United Kingdom, than to try to tinker with regions. Nevertheless, I accept gratefully the help given to small engineering firms as we have so many in my part of the world.

The increase in the house mortgage allowance is to be welcomed. I hope that it will help the housing market and the building industry.

My right hon. and learned Friend has rightly reduced personal taxation although I am sorry he was unable to reduce the standard rate of income tax. Even now taxation on lower incomes is too high; there is still not enough difference between those receiving social security benefits and those in work but in receipt of low earnings. There must be every incentive to work.

I welcome the raising of the investment income surcharge threshold. Every effort must be made to encourage savings which can be channelled into profitable investment. Investment by itself may be useless. It must be profitable and must be used properly.

The Chancellor is not an excitable man. He has not given us an exciting Budget, but he has given us a sound and sensible Budget such as we would expect from him. It will be well received not only in this country but throughout the world. As I said earlier, Governments can do only so much. As a historic Tory, I believe in original sin, as I am sure my colleagues do too. Therefore, efforts must be made by all of us. We cannot expect the Government to pull all of our chestnuts out of the fire. It is up to all of us to put the past behind us and to make the most of the opportunities that the Chancellor has given us.

6.42 pm

Mr. Richard Page (Hertfordshire, South-West): I congratulate my right hon. and learned Friend on his Budget. Perhaps he needs to be congratulated not so much on his Budget today as on those of the four previous years, by which he has been able to create the basis for this Budget without the consequent and attendant inflation and growth of the public sector borrowing requirement that might have resulted some time ago.

I welcome very much the increase in the tax thresholds. It will put a little more money into people's pockets. I make a fervent appeal: when people have that extra money in their pockets, for God's sake let them make sure that they buy British goods if the quality is the same, because the purpose is to create jobs in this country rather than in manufacturing industry abroad.

[Mr. Richard Page]

I shall resist the temptation to range long and far over the Budget and confine my remarks to two specific sectors, the small business sector and North sea oil. I am delighted that the Government have confirmed their commitment to the small business sector. The measures proposed by my right hon. and learned Friend today mean that over 100 new measures have been introduced to help smaller businesses. Those are in addition to the changes that have taken place because of the movement on inflation.

In a previous Budget my right hon. Friend—if I may call him that—the Member for Down, South (Mr. Powell) said that the solution to this country's problem lay with the people. I echo that sentiment. In the past there has been a widespread belief that Government can solve all our problems and that individuals do not have to do anything. That is a view that is apparently still held by Opposition Members. Within the country there is a growing belief that the solution lies in our own hands if only we are prepared to grasp it. The Government have helped to remove some of the barriers and the people, especially through the small business sector, will bring about improvements.

Whenever I have spoken in the past about the small business sector I have ended up, like Oliver Twist, asking for more. I shall try not to do that now, because my right hon. and learned Friend has removed more from my list of wants and my begging bowl is getting smaller.

A major reason why our industrial competitors and other nations abroad help their small business sector is that it gives political stability to the economy. The smaller business sector gives a broader economic base. We have only to look at the strike record, or rather the non-strike record, of the small business sector to see the validity of that point.

I welcome the improvements to the loan guarantee scheme. I know from personal experience that this has helped businesses to get started and has contributed to the battle to win back business which has been sliding abroad. More and more small firms are moving into the export market. It is only by exporting and turning aside import penetration that we will create new jobs.

I am delighted to see the improvements proposed to the business start-up scheme. I have been a critic of the scheme for some time. I hope that confidence will once more be generated in the accountancy profession and that more and more people will be able and prepared to put their money into this imaginative scheme.

Time moves against me and I shall find it difficult to mention many parts of the Budget that I should have liked to mention. I must express appreciation of what is proposed about small firms corporation tax. I and colleagues in the small business sector have made continual representations about the inhibiting effect of the profits limits on development and growth. I am pleased that the rate of corporation tax for small companies is to be reduced from 40 to 38 per cent.

I also echo what was said by my hon. Friend the Member for Nelson and Colne (Mr. Lee) about the enterprise allowance being available throughout the whole country. No doubt more and more people will be prepared to take the plunge and start in business on their own.

On the North sea oil regime, in Committee on the Finance Bill for the last two years I and several of my hon. Friends have expressed our concern over the fact that the tax regime is having an inhibiting effect on the development of small fields. Unless we can find new, large fields in the North sea we shall have to rely on the smaller fields to provide oil for self-sufficiency. Our previous tax regime held us back from developing. What my right hon. and learned Friend has proposed will be a valuable step forward in ensuring self-sufficiency and profitable oil fields for the future.

It is a good Budget. It has been quietly produced and presented. It is an imaginative Budget which will help many areas of the economy. It will provide a basis for growth without inflation, and for real jobs. I very much welcome it.

6.49 pm

Mr. Peter Bottomley (Woolwich, West): If my right hon. and learned Friend the Chancellor had not announced an increase in the old-age pension and in child benefit I would have made a major speech criticising him strongly. I have been criticised on occasions for trying to do so much for the elderly and for people with children. It would be right on another occasion to develop what the Chancellor has said. I would welcome it much more if we could be assured that he will follow this year's good deal for the retired and for those bringing up children with similar proposals in future years. We have a responsibility to look after those who cannot look after themselves—those are the two main groups.

Next year, the effects of the Budget on the economy will be far less than the effect of the levels of pay settlements. I ask everyone who wants the Chancellor to generate more effective demand to realise that they have the opportunity to do that for themselves. If the average level of pay settlements in the next two or three years is consistent with low inflation, Chancellors will be able to gear the economy towards more effective demand. That will continue to be more competitive, more jobs will be generated and there will be more surplus for schools, health, personal social services and all the other good things that we ask for.

The Government have done well. Conservative Members who have argued for better old-age pensions, better child benefit and the restoration of the 5 per cent. abatement in unemployment benefit have done both the Government and the country a service. I am glad that we have been successful and that my right hon. and hon. Friends on the Front Bench have listened to our arguments. I hope that we have made them courteously and I am glad that they have been effective. If people want the country to prosper, I hope that they will listen to us more and more, that we remain the Conservative Government so that we can have a good impact on the country's government, and that we can discharge effectively our functions as politicians.

6.51 pm

Mr. Austin Mitchell (Grimsby): Like all of the present Chancellor's Budgets, this one has come in with a whimper rather than a bang and, as usual, at the whim of a banker. Moreover, the Budget statement was delivered with all the wit, repartee and lightness of touch as a reading of Kelly's directory for 1928. It has come in with a whimper because it has been so well trailed. It is clear that the lobby was called in on Saturday morning and effectively told the Budget's contents so that we could read them all in Sunday's papers. That was the type of thing that Dalton has to resign for in 1947. It is now the normal practice of the Government to hold back a few little goodies, which can be handed out at the last minute as a surprise gesture, once the public have been well prepared. That is now the technique of Budget preparation.

We have had a nice series from the Chancellor. In 1979, we had bludget when he bludgeoned the doubling of VAT out of the pockets of the people. Since then, we have had three budgets of fudge-it in which the Chancellor has moved furniture to distract attention from the depressing realities all around, and now we have been given grudge-it in which he has grudgingly given back some of the tax that he has been taking over the years.

It is an irrelevant Budget in which the Chancellor has turned a quick myopic gaze over the wreckage of industry that is strewn around the country and averted his eyes towards the election. This is a pre-election Budget from a Government who are so contemptuous of the people that they serve that they believe that they do not have to do much to win the election, but it is essentially an election offering.

The Budget is also irrelevant in terms of the promises that were held out in 1979. We were promised tax cuts, but taxes, even after this Budget, represent a bigger share of the average working man's earnings, and a bigger share of gross national product than before 1979. The Government promised to cut spending but have increased it. After this Budget, spending will be higher as a proportion of GNP than it was before 1979. The Government promised to make us competitive, yet they have crippled British industry's competitiveness.

Most important is the fact that the Budget is irrelevant to the real problem in Britain today—industrial decline on a scale that has never before been seen in Britain. The scale of our decline is unique in the advanced world, yet we were the world's first developed country. The decline has been precipitated by interest rates which remain high, even after the minimal 0·5 per cent. reduction that was announced today, because the Government are determined to keep them high to defend an over-valued pound. British industry must pay the price for the high exchange rate by being crippled by high interest rates. The depression has been engendered by the slump in demand and an over-valued pound. Despite its recent fall, the pound is still over-valued as compared with the currencies of our major EC competitors.

All of those policies, which are implicit in the monetarist approach, have led to the ruin of British industry. If we want a monument to the Chancellor's achievements, we have only to look around us at the state of British industry. Its condition will not be improved by today's Budget. Our depression is the worst of any advanced industrial country, our rate of unemployment is higher and our rate of production loss greater. Manufacturing production has fallen by about one fifth. One has to ask why that should be so when we have the best prospects as, for the first time, oil provides us with a chance to expand through the balance of payments problem which has bedevilled British industry and the economy since the second world war.

Oil not only makes us richer than most of our competitors, it gives us the opportunity to grow through depression and expand through the balance of payments problems. However, oil revenue is being thrown away because the effects of the balance of payments are being used to finance a flood of imports and destroy British jobs. Moreover oil tax revenues are being used to support those who have been made unemployed by the balance of payments effect. The oil revenues have been thrown away because the Government are obsessed with the piggy bank economics that were discredited in the 1920s, which have been irrelevant since Keynes, but which are still the Government's dominant approach.

What has been created by the depression that has been worse here than in any other advanced country and out of which it will be difficult to break? Not industrial success and a springboard for growth, but a graveyard. Today, the Chancellor has printed up the gravestones but left us locked in the graveyard, and the Prime Minister's sermons drift lightly and ecclesiastically over the scene. The only way out of the graveyard is by a massive boost to the economy and demand, combined with an improvement in the competitiveness of the pound by reducing interest rates. If we are to increase demand, we have to stop it washing overseas. The change in the hire purchase regulations last year simply financed a flood of imports and thus washed overseas.

The opportunity for a boost has never been greater because the scale of depression has never been greater. Such a boost would improve the circumstances of the less well-off and stimulate the economy by pumping money into it and the pockets of the people, especially those who contribute most to consumer demand. We could even use that increase in demand to cushion the inflationary consequences of the expansion that must occur. For the Chancellor to argue, obsessed with piggy bank economics as he is, that the only boost to demand that we can afford is minimal because the inflationary consequences would otherwise be so great, merely demonstrates the irrelevance of his attitude.

Simply putting unemployed people back to work would save £5,000 on each such person as £5,000 represents the revenue that is lost from someone not working and the cost of supporting that person.

We can borrow more. The Government are borrowing less, as a proportion of GNP, than any other advanced industrial country. That is clear from the most recent issue of *Lloyds Bank Review*. It is clear that our scale of counter-cyclical spending is less than that of any other country. If the worst comes to the worst, we could print money. That is effectively what the Americans are doing. They are expanding the money supply to stimulate the economy and bring down interest rates.

It would help if we did not have such a supine business community which has accepted depression and all that has gone with it. Greater love hath no man than that he lay down his firm for his prejudices. That has been CBI's attitude. It has been prepared to sacrifice firms to support the ruinous policies that the Government have pursued.

The Budget is irrevelant because it is a wasted opportunity. That is a national tragedy because as industry declines our competitiveness and our ability to survive are ruined.

Debate adjourned.—*[Mr. Garel-Jones.]*

Debate to be resumed tomorrow.

British Railways Bill

Order for Second Reading read.

7 pm

Mr. Patrick McNair-Wilson (New Forest): I beg to move, That the Bill be now read a Second time.

This is the twentieth miscellaneous provisions Bill of its kind since the reconstitution of British Rail in 1962. It comes at a time when the railway industry is very much in the public eye. It would be difficult for anyone in this debate not to be aware of the recent report into the general activities of British Rail. Although I shall be dealing with the specific points in the Bill, I should make it clear that the British Railways Board recognises the need for efficiency and for making the service as acceptable to its customers and passengers as possible. However, the board can boast a great achievement and a first-class record.

In the 1980 corporate plan it was decided that there should be a slimming down of the work force by about 38,300. About two thirds of the target has been achieved this year, and 24,000 employees have left the railways. The external finance limits that were established in 1982 will be the guidelines for the industry.

However, not everything is perfect and many areas must be improved. A disturbing factor in the future profitability of the railways is ticket evasion. The latest figures for ticket evasion in London and the south-east show that it costs British Rail about £12 million a year. There is a long way to go before we cure all the ills of the system.

This Bill sets out to continue the modernisation that has been part and parcel of previous legislation. It is a slow and relentless attempt by the board to make the system more competitive. That means, inevitably, that occasionally action is required that will provoke local controversy.

One of the most significant parts of the Bill is the decision to establish a rail link with Manchester Ringway airport. It takes into account the argument about the third London airport and of general airport policy. Other parts of the Bill deal with more mundane matters such as the closing of level crossings and footways, the extension of facilities and the improvement of some facilities to make them more efficient. If I am fortunate enough to catch your eye, Mr. Deputy Speaker, and with the permission of the House, I shall deal with those matters in more detail later in the debate.

Clause 3 deals with the incorporation of the general Act and is a standard clause in such Bills. Clause 4 relates to the Compulsory Purchase Act 1965 and is again a standard clause in such Bills. Clause 5 is the first area of contention. It gives power to undertake certain works, the first three of which relate to the construction of the new railway to connect Manchester International airport at Ringway with the Manchester to Wilmslow line via Styal. That work is part and parcel of the airport authority's general plan from 1985 to 1990. It will have far-reaching consequences, because for the first time it will provide access to the airport for rail passengers from many parts of the north of England and from as far away as the east coast. If the Stansted airport expansion ever take place, or if it is delayed, all those factors will affect the decision. However, there can be no doubt that the airport at Manchester is now of international significance and it is right that such a proposal should go ahead as quickly as possible. I hope that the House will approve the proposal.

The fourth work relates to the constituency of the hon. Member for Stockport, North (Mr. Bennett) and to his constituents in the Woodmoor residents association. It deals with the construction of a short length of railway at Hazel Grove to enable a through week day passenger service to be introduced between Liverpool and Sheffield. As someone with business interests in Sheffield, I know how badly needed that link is. The link will enable passengers to travel that journey without changing. The board is prepared to admit the problems currently faced by passengers in Manchester who have long walks between trains. This construction will solve the problem and will enable the Liverpool, Warrington, Manchester and the Manchester, Sheffield and east coast railways to be combined in a single service through Stockport. That will mean a direct service from Stockport to the Mersey, across the Pennines, to Scotland, the east coast and Europe.

That short line will have a significant effect on the economic and industrial infrastructure of the area. However, I recognise that it will be necessary to acquire a small portion of land that is not owned by the British Railways Board, and that adjoins Norbury churchyard. Discussions have taken place and every possible provision has been made to ensure that there is no interference with graves or memorials in the churchyard.

Clause 6 deals with the infilling of a disused canal in Leeds. I mention it only because it is an example of how a comparatively small amount of work can be used to get round the problem of maintenance that is currently besetting this piece of line, where the bridge can be supported in a different way and money saved as a result.

Clauses 7 to 18 deal with the closures and extensions to which I referred earlier. As I said, I shall be happy to deal with hon. Members' specific points later. Clauses 19 to 27 deal with land acquisitions and related provisions. Clause 19, with which schedule 4 should be read, relates to a section of line that is liable to flooding in heavy rain. My hon. Friend the Member for Derbyshire, South-East (Mr. Rost) is concerned with this matter. In the Draycott area of the Derby to Trent railway there is a dip in the track which tends to flood. The board proposes to remove the dip in the track and to construct a new drainage system. I recognise that the constituents of my hon. Friend the Member for Derbyshire, South-East and especially Erewash borough council and the Breaston parish council are concerned that any plans to do that may be detrimental to other flood prevention plans. I assure my hon. Friend that the board's intention is to work out with the local authorities and others a scheme that will not interfere with flood prevention in any way.

The board is determined to cure this serious problem affecting the railway system. I trust that it will be possible to work out a comprehensive scheme for flood prevention in the area, and that my hon. Friend and the two local authorities to which I have referred will accept the board's proposals.

Clause 28 in part V of the Bill deals with the problems faced by my hon. Friend the Member for Portsmouth, North (Mr. Griffiths). Sealink UK Limited, which is a subsidiary of the British Railways Board, has a plan to overcome the serious problem that affects the Portsmouth area. The new powers sought in clause 28 are that Sealink should be able to levy charges on the users of the floating landing stage and pontoon in Portsmouth harbour beside the railway station. The British Railways Act 1963 enabled the Portsmouth Harbour Ferry Company Limited

Prime Minister

2 LCCJV

15

MCS 15/3

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

The Rt Hon Norman Fowler, MP
The Secretary of State for
Social Services

15 March 1983

Dear Norman

1983 BUDGET AND SOCIAL SECURITY UPRATING

Thank you for your letter of 14 March.

The formula you suggest would amount to repeating the present pledge for the next Parliament - which would be contrary to our general policy of avoiding new pledges. It would prejudice our consideration of the long-term prospects for public expenditure, on which the Prime Minister has commissioned reports from Ministers. I should therefore much prefer you not to use this formula.

I hope it is not necessary to decide now on the formula that should be used. We shall probably need to discuss this further. But if something has to be said soon, the third of the forms of words in the list attached to your letter seems much the best.

Copies of this letter go to the Prime Minister, the Chief Secretary and Sir Robert Armstrong.

GEOFFREY HOWE

Social Services: Uprating of Benefits: Pt 3

15 MAR 1983

BUDGET SECRET

14A

CH/EX REF NO B(83)27

COPY NO 1 OF 10 COPIES

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

14 March 1983

Michael Scholar Esq
10 Downing Street
Whitehall
SW1

Dear Michael,

BUDGET SPEECH: UPRATING OF PENSIONS AND
OTHER SOCIAL SECURITY BENEFITS

... I attach a copy of the Budget speech passage on pensions and other social security benefits on which the Chancellor and the Secretary of State for Social Services have now agreed. You will note that it is slightly different from the previous versions which you already have.

Yours ever,

John Kerr

J O KERR

cc - PS/Secretary of State for
Social Services

PS/Sir Robert Armstrong

BUDGET SECRET

SOCIAL SECURITY AND CHARITIES

I now turn to social security. This is much the biggest single element in public expenditure - more than one quarter of the total.

About half of social security expenditure is on benefits for pensioners. The costs are borne mainly by contributors; and we had in November to announce further increases in National Insurance contribution payments, which take effect from next month.

The House will remember that, because prices have been falling faster than expected, last November's uprating of social security benefits, which was meant to be in line with the rate of inflation, in fact exceeded it by 2.7 per cent.

The forecast method of uprating, which gave rise to this situation, has never worked well. For a forecast made at Budget-time of what the rate of inflation will be at the time the uprating takes place in the following November is necessarily uncertain. Increases can therefore be larger or smaller than intended. There have been years when prices have been under-estimated, as in 1981 - when a 2 per cent under-provision was made good the following year - and others, such

/as 1980

as 1980 and 1982, when the error has gone the other way. In each case there has necessarily been a year's delay before the error of the previous year could be corrected.

The system of trying to forecast inflation, introduced in 1976 is a fragile basis for calculations of such importance to millions of our fellow citizens. Given the experience of the past seven years, the Government believes that it would now be right to restore the more certain system that prevailed before 1976. This is the system by which benefit upratings are calculated on what has actually happened to prices, rather than on what might happen in future - if we got our forecast right.

From this November, therefore, we shall return to the historic, or actual, method. The necessary legislation will be introduced immediately.

The uprating this November will be based on the rise in prices in the twelve months to May of this year. That figure will be announced by the Department of Employment in the usual way, and will be the basis for the uprating statement as soon as possible after that. We have chosen the May figure because it is the latest month we can use as the basis of the calculation and still make sure that all recipients get their increase in November.

/The

The uprating will be based on whatever the May figure turns out to be. At this stage, of course, I cannot say exactly what that figure will be.

It seems likely, however, to be in the region of 4 per cent. Of course, in November, as I have already told the House, the annual rate of inflation may temporarily be running at about 6 per cent. But if we had retained the old system, and taken full account of last year's 2.7 per cent overpayment, the increase in benefits would have been significantly smaller.

There will of course be no question of asking pensioners to return any of the pension money they have already received; no question of any so-called "clawback". Beneficiaries will retain the full benefit of the extra payment they are now receiving. And part of it is likely to continue into 1984.

Linked public service pensions will be raised in November by the same percentage as benefits. For unemployment benefit, the increase will be in addition to the restoration of the 5 per cent abatement which I have already mentioned.

On the basis I have described, the position for pensioners over the life-time of this Government is this. Between the November upratings of 1978 and 1983 prices are likely to have risen by some 70 per cent, and pensions by some 75 per cent.

/Our pledge to

Our pledge to maintain the value of the pension over the life-time of this Parliament will thus have been more than fulfilled.

There is of course one other social security benefit to which we attach no less significance. It plays a major part in easing the unemployment trap, and so in our strategy of improving incentives for everyone. It is important for families, and particularly for the low-paid. Indeed, it is the benefit which provides the greatest help to many of the poorest families in the country. I refer, of course, to child benefit.

I am glad to be able to tell the House that from November 1983 the rate of child benefit will be increased from £5.85 to £6.50. One-parent benefit will be correspondingly increased to £4.05. On the basis of our inflation forecast, both benefits will then be worth more than ever before. I know that the House, and the country, will welcome this news very warmly.

/This

1̶4̶ 14

Prime Minister 2

MCS 14/3

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

14 March 1983

Dear Geoffrey.

1983 BUDGET AND SOCIAL SECURITY UPRATING

Last week we discussed possible long-term pledges on the uprating of social security benefits.

I enclose possible variations on this theme which we have been considering. These are in addition to those set out in my second letter of 3 March. All these show how difficult it would be to hold the position if we give less than a whole-hearted pledge. I expect that we shall be pressed on our future intentions from the moment you sit down. In all the circumstances, I believe we should follow one of the lines suggested in my letter of 3 March:

> "We stand by what we said in this Parliament - that we shall maintain the value of pensions and related long-term benefits."

In advocating this, I have in mind the savings we are already making - and will continue to make - from uprating by prices only instead of the better of prices or earnings. We are already saving £500 million a year. By the end of the decade, on the assumptions on prices and earnings in the review of longer term expenditure, the annual saving will have gone up to at least £2 billion to £3 billion a year. This seems to me to be substantial by any standards - and I very much doubt if we can realistically expect to do more.

I am copying this to the Prime Minister, the Chief Secretary and Sir Robert Armstrong.

Yours ever
Norman

NORMAN FOWLER

ANNEX

CONFIDENTIAL

Possible Pledges

Approach A: price protection subject to escape clause

1. During this Parliament - as we pledged - we have fully protected the value of pensions and other related long-term benefits against rising prices. We have also brought inflation down very considerably. As a result, benefits, earnings and savings are keeping their value for longer than in many years past. During the next Parliament we intend to keep inflation under control, and we look forward to better pensions as new pensioners benefit under the new pensions scheme.

2. During the next Parliament we shall continue to protect the value of pensions and other related long-term benefits subject only to over-riding economic circumstances - a qualification which any responsible Government must give.

3. The pledge we gave in the last Parliament to protect the value of pensions was very important because of the hight levels of inflation which so quickly eroded their value. Although there may be less need for a similar pledge, now that we have the lowest level of inflation for over 10 years, we shall continue to give a high priority to protecting the living standards of pensioners.

4. During the next five years, new pensioners will retire on better pensions, thanks to the growing maturity of the new pensions scheme and the growth of good occupational pension schemes. We shall moreover, continue to give a high priority to the interests of pensioners, especially existing pensioners.

5. During the next five years, we can look forward to new pensioners retiring on better pensions as the new pension scheme begins to mature. But it will still be important to protect the value of pensions and the supplementary pension safety net on which many existing pensioners depend for extra help. [We shall give this a high priority]. [Helping pensioners and other vulnerable members of our society is central to our priorities in Government].

6. Inflation is now at the lowest level for over 10 years and it will be one of our primary objectives to ensure that it remains under control. So long as it does not again get out of hand, we shall again protect the value of pensions and other relation long-term benefits during the next Parliament. [The basis of our policy has always been to protect the most vulnerable in society].

Approach B: committed on pledged but not unpledged benefits

Our [firm] [expectation] [intention] is that we will again be able to maintain the value of pensions and other related long-term benefits during the next Parliament.

8. We shall continue to put pensioners and pensions high on our list of priorities for Government spending.

9. We remain committed to protecting the value of retirement pensions and other related long-term benefits. The extent to which we are able to maintain the value of other benefits will depend on economic and other circumstances.

13B

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

David Clark, Esq
Private Secretary to the
Secretary of State for
Social Services

11 March 1983

Dear David,

SOCIAL SECURITY: ADJUSTMENT

The Chancellor told your Secretary of State yesterday that he was considering three rival drafts of the section in the Budget Speech which will deal with the "adjustment". The three have now been boiled down into one, as in the attached copy - and the Chancellor would be most grateful for your Secretary of State's comments on it.

I am sorry to seem pressing, but the exigencies of the Budget timetable are such that I fear I must ask that such comments reach us this afternoon.

I know that you will ensure that the text is handled with maximum discretion.

Yours ever,

John Kerr.

J O KERR

BLOCK I: Social Security

I now turn to social security. This is much the biggest single element in public expenditure - more than one quarter of the total. About half of social security expenditure is on benefits for pensioners.

why

2. The House will remember that the effect of last year's uprating of social security benefits was an over-provision of 2.7 per cent. This happened because inflation fell faster than expected. In effect, therefore, beneficiaries received an advance payment of part of the increase due this year, and I announced last autumn that there would accordingly be an adjustment of this year's uprating. The effect of the proposal I am about to make is that part of last year's over-provision will be allowed for in this year's uprating, and that part will be left with th beneficiaries.

3. To leave the whole of this over-provision in place would mean very substantial costs in future years. These costs would have to be borne very largely by contributors. Ever since the Beveridge report our system has been based on the contributory principle. And rightly so. For that principle

/requires

requires us all to take account of the effect of benefit increases on the working population, who pay the contributions, and who have seen them increase substantially over the years: indeed, only last November we had to announce further increases in National Insurance contribution payments which take place from next month.

4. As the House knows, since 1976 upratings have been based on what is known as the forecast method of uprating. That is, they are based on a forecast made at Budget time of what the annual rate of inflation will be at the time the uprating takes place in the following November.

5. But this method has not worked well. A forecast is necessarily uncertain. Increases can therefore be larger or smaller than intended. There have been years when prices have been under-estimated, as in 1981 - when a 2 per cent under-provision was made good the following year - and others such as 1980 and 1982 when there has been over-provision. (The 1980 over-provision was of course corrected in full.) And in every case there has necessarily been a year's delay before the error of the previous year could be put right.

/The

6. The system of trying to forecast inflation is a fragile basis for calculations of such importance to millions of our fellow citizens. There have therefore been suggestions from pensioners' organisations that we should restore the more certain system that prevailed until the party opposite withdrew it, in order to make savings, in 1976. This is the system by which benefit upratings are calculated on what has actually happened to prices rather than on what might happen in future if we got our forecasts right. ~~I have decided to accede to this advice.~~

7. From this November, therefore, we shall return to the historic, or actual, method. The necessary legislation will be introduced immediately.

8. The uprating this November will be based on the rise in prices in twelve months to May of this year. That figure will be announced on 17 June. We have chosen May because it is the latest month we can use as the basis of the calculation and still make sure that all recipients get their increase in November.

9. The uprating will be based on whatever the May figure turns out to be. At this stage, of course, I cannot say exactly what that figure will be.

/But it seems

But it seems likely to be in the region of 4 per cent. It is therefore likely that benefits will be increased by significantly more than would have been the case had the old system been retained - with an adjustment made to take full account of the amount of last year's over-provision. Linked public service pensions will be raised in November by the same percentage. For unemployment benefit the increase will be in addition to the restoration of the 5 per cent abatement which I have already mentioned.

10. Between the November upratings of 1978 and 1983 prices are likely to have risen by some [67 per cent] and pensions by some [72 per cent]. Our pledge to maintain the value of the pension over the lifetime of this Parliament will thus have been more than fulfilled.

COPY 2 OF FOUR COPIES

13ª

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

11 March 1983

Dear Geoffrey.

Thank you for sending me the draft of what you intend to say on the return to the historic method for the uprating of pensions and other social security benefits. My concern is with paragraphs 2 and 3 which seem to me to give the wrong signal about what is to come. I would have thought that it was better in presentational terms to argue the case of principle for change - which is strong - while at the same time being entirely frank about its effect on pensions. I have, therefore (rather rapidly), sought to redraft that part of your speech and I think the effect of this would be to greatly improve the presentation of the case. If I may suggest, this is a crucial point because the tone of the debate which will undoubtedly follow will be set by your initial announcement. I very much hope that you can agree to the lines of this redraft as I think it will substantially help when we come to present the legislation. I am, incidentally, copying this to the Prime Minister in accordance with the Cabinet remit that all three of us should discuss how best the Government's decisions can be presented.

I am available virtually at any time on Sunday to talk to you about this if this would be helpful.

A copy also goes to Sir Robert Armstrong.

Yours ever,
Norman

NORMAN FOWLER

ECON POL.

Prime Minister

Much on the lines of the – more specific, of course – points we have already made to the Chancellor. He was grateful for them and is making ~~minor~~ changes to reflect them. Otherwise he will not change the speech much. MCS 11/3

MR [illegible]ALL

cc Mr Butler

BUDGET SPEECH

I wonder whether I could make a few presentational points on the Budget speech.

The fact is that this is broadcast as it is delivered and dissected as it is going on. There is every opportunity in these circumstances to damn it before even it has been uttered in full - or even in part. Certainly, before the Chancellor has had an opportunity to set out in his own terms his specific measures.

I am chronically against doing things for purely presentational reasons. But, the fact is that the Budget is in part a presentational exercise - and especially so in 1983 with a by-election to follow the week after.

It is therefore important that the Chancellor should exercise the maximum amount of control over the presentation of his Budget.

I suggest the following is required:

- first, a watchword: what word does the Chancellor want to appear in the headlines on Tuesday evening and Wednesday morning which sets the tone: prudent, sensible, practical; budget for recovery, building for the future?;

- second, what do we wish to avoid - opportunist, vote catching, reckless (all of which are unlikely), or over-cautious, too little too late, irrelevant, nothing for jobs etc. The truth is that some of these epithets will be voiced regardless of justice; the point is to avoid a general condemnation;

- third, how will he condition the view taken by commentators as he delivers his speech?: this requires 2 or 3 paragraphs early on - ie. in the first 5 pages given evening newspaper deadlines, and not least those of the Evening Standard.

mb

I suggest a few paragraphs which summarise the purpose, size and broad content of the Budget against which newspapers, radio and tv will have to comment.

Further, it is absolutely essential that the Chancellor throws a particularly juicy bone to his side of the House, and also a particularly frustrating one for the Opposition at an early stage in his presentation; and that his colleagues and PPS orchestrate vocal support at that point. All too often the Government benches have been limp in the face of good news.

I hope this is helpful.

B. INGHAM
11 March 1983

BUDGET CONFIDENTIAL

Prime Minister

MES 9/3

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

9 March 1983

Michael Scholar Esq
10 Downing Street

Dear Michael,

HOUSE OF LORDS DECISION - WICKS v FIRTH,
JOHNSTON v FIRTH
EMPLOYER SCHOLARSHIPS

In the light of the Prime Minister's comments, the Chancellor has decided to proceed with legislation on the following, altered, basis.

There will be a provision to tax parents on the benefit of scholarships which come to students because of their parents' employment. But parents will not be taxed on any existing award for as long as that award is available at the school or university the student is currently attending. This transitional exemption will apply to all those awards made before Budget Day.

Yours ever,

J O Kerr.

J O KERR

BUDGET CONFIDENTIAL

10 DOWNING STREET

Prime Minister

Budget Speech

The attached draft is incomplete and will be extensively revised tonight. But I think it will be worthwhile for you to look at it tonight (since you won't be able to tomorrow night).

Robin and I have made a few suggestions. It is very long.

MCS 9/3

13

MORTGAGES AND THE BUDGET

1. Effects of the Budget

		per month
(i)	married man, 1½ x average earnings, contracted-in	gains 53p
(ii)	married man, 1½ x average earnings, contracted-out	loses £1.28p
(iii)	single, £12,000 a year, contracted-in	loses £1.10p
(iv)	single, £12,000 a year, contracted-out	loses £3.30p

NIC increases affect April payslip. Tax reductions affect May.

2. Mortgage effects on payslip

Assuming each of the above has £15,000 mortgage the effects of the following are the same for each on the April pay packet.

A. Coding change

Loses £5.82 per month
But this offsets the interest free loan enjoyed in 1982-83 when codes were not changed following interest fall.
"Loan" recovered over 12 months.

B. MIRAS

(a) With loan of 10% - £37.50 per month loss in pay packet.
But for endowment mortgages and for those exercising statutory right to maintain old profile of payments this is offset in reduced payments to building society

for those choosing to go to constant net repayment method payment to building society is £29.65 less.

C. There is a loss of tax relief in 1983-84 of £13.12 per month frompaying 10% rather than 13½% (i.e. from benefit of reduced payments).

There will be a letter to all MPs post Budget explaining these changes.

FP Group
HM Treasury
9 March 1983

MCS

10 DOWNING STREET

Please copy to Michael Scholar.

PM has top copy.

FERB

Personal Income Taxation

Main rates - including basic rate of 30 per cent - remain unchanged. Allowances and thresholds increased by about 14 per cent as follows:

	1983-84 (proposed)	1982-83
	£	£
Married	2,795	2,445
Single (and wife's earned income)	1,785	1,565
Basic rate limit (starting point for higher rates)	14,601	12,801

Higher rate thresholds and bands increased correspondingly

Social Security and Other Benefits, Aged, Children, Widows and Charities

Uprating of social security benefits will be based on the outturn figure of inflation to May 1983. Next November's uprating will therefore be announced in June. May's inflation figure expected to be in the region of 4 per cent. Linked public service pensions to be increased by same amount.

Income tax age allowance up from £3,295 to £3,755 (married) and from £2,070 to £2,360 (single); and age allowance income limit raised from £6,700 to £7,600.

for

Threshold/investment income surcharge raised from £6,250 to £7,100.

Child Benefit increased by 65p to £6.50 from November 1983; one parent benefit up 40p to £4.05. (Gross cost £122 million in 1983-84 as compared with no increase at all £340 million in 1984-5).

Additional personal allowance for one parent families and widows' bereavement allowance raised from £880 to £1,010.

Five per cent abatement of unemployment benefit to be restored from November 1983 (cost £22 million in 1983-4, £60 m. in a full year).

A number of measures to provide substantial help to the sick, disabled, war pensioners and the less well off. Main changes:

/a.

a. Amount the severely disabled can earn before benefit is up from £20.00 to £22.50.

b. "Invalidity trap" to be ended - people under 60 on incapacity benefit for a year will qualify for long term rate of Supplementary Benefit. Over 60s will qualify immediately.

c. Capital disregard for entitlement to Supplementary Benefit increased from £2,500 to £3,000. Additional disregard of £1,500 for life assurance policies.

Entitlement to widow's bereavement allowance extended to cover year after husband's death. (Cost £30 million in a full year.)

£250,000 ceiling for CTT exemption on bequests to charities abolished: outright bequests to charities will not be taxed.

Annual ceiling for tax relief at higher income tax rates for payments under deeds of covenant to charities raised by £2,000 to £5,000.

Companies to be able to deduct for tax purposes costs of staff seconded to charities.

Help to construction, other forms of industry and employment (including North Sea)

The NIS is to be cut by another ½ per cent to 1 per cent from 1 August. Benefit to be confined to private sector. (Cost £215 million in 1983-84, £390 in full year).

Ceiling for mortgage interest relief up from £25,000 to £30,000 (cost £50 million in 1983-84). Relief extended to self-employed in tied accommodation buying houses elsewhere.

Limit on expenditure eligible for home repair grants increased by 20 per cent. Additional resources to "enveloping" schemes - external repairs to whole streets or terraces in inner city areas. (Cost of these 2 measures -\ £60 million in 1983-84.)

Stock relief available on houses accepted by builders in part exchange.

Industrial buildings allowance - permitted proportion of office space up from 10 per cent to 25 per cent (full year cost £25 million).

Development Land Tax deferment scheme on developments for owners' own use extended from April 1984 to April 1986.

Total North Sea revenues expected to be about £8 billion in 1983-84 similar to 1982-83 estimated outturn. A package of reliefs totalling £800 million over four years for existing fields, together with a substantially more favourable regime for future fields. Total cost of Budget tax reductions estimated at £115 million in 1983-84:-

Advance petroleum revenue tax (APRT), 20 per cent rate from 1 July 1983 cut to 15 per cent; to be phased out completely by the end of 1986.

PRT relief for expenditure incurred in searches or appraisal of discovered reserves, other than in existing oil fields or developments.

/ New

New fields (consent given after 1 April 1982) will get double existing oil allowance of ½ million tonnes each six months (total limit 10 million tonnes) and will not pay royalties. (Does not apply to onshore and Southern Basin oil fields).

Abolition of restriction on PRT relief for expenditure on shared assets (e.g. pipelines).

90,000 men between 60 and 65 no longer required to register solely in order to protect pension rights.

42,000 unemployed men on Supplementary Benefit will no longer need to wait a year (or to reach 65) to qualify for long term rate of SB.

New scheme for part-time job release.

Small Firms, Enterprise, Technology and Wider Share Ownership

Measures to foster growth of small and medium sized enterprises and improve their competitive environment. The new VAT registration limit and the changes in capital taxation will also help small firms.

Enterprise allowances to help unemployed people set up their own businesses extended to the whole country.

Business Expansion Scheme extends and improves the Business Start-up Scheme. The life of the scheme is extended to April 1987, it will now be applied to new and established unquoted trading companies and the maximum yearly investment limit will be raised from £20,000 to £40,000.

Corporation Tax - small companies rate cut from 40 per cent to 38 per cent; profits limits raised - lower limit up £10,000 to £100,000 - upper limit up £275,000 to £500,000. (Cost £40 million 1983-84; £70 million in full year.)

/ Interest

Interest relief extended to share purchases in employee buy-outs.

Deep-discounted stock - borrowers to get relief for accrued discount; investors to pay tax only on redemption and sale.

Profit Sharing and share options:-

a. profit share limit - £1,250 annual limit plus alternative of 10 per cent of salary to maximum of £5,000;

b. save-as-you-earn monthly limits raised by £25 to £75;

c. for other share options, 3 year instalment period over which income tax can be spread extended to 5 years.

Loan guarantee scheme - ceiling for total lending raised from £300 million to £600 million.

Small Industrial Workshop Scheme - averaging of size requirement for conversions of old buildings.

Freeports - legislation to be introduced; a few experimental locations to be authorised.

Small Engineering Firms Investment Scheme re-opened.

First year allowances for rented teletext receivers extended to June 1984, and for British films until March 1987.

Also includes help with information technology, innovation linked investment and extension of science parks. (Total costs of technology and innovation measures package - £240 million over three years).

BUDGET CONFIDENTIAL
until after Budget Speech on 15.3.83
then UNCLASSIFIED

C3 MEDIUM TERM FINANCIAL STRATEGY

Factual

Fourth MTFS, updated and extended to 1985-86 provides:-

(i) Statement of Government's objectives:- "to continue reducing inflation and to secure a lasting improvement in the performance of the UK economy, so providing the foundations for sustainable growth in output and employment."

(ii) Description of financial framework Control of money supply is central part of the strategy, but in judging appropriate rate of monetary growth, Government will continue to take account of all the available evidence, including the exchange rate.

Ranges for monetary growth apply to narrow (M1) and broad (£M3 and PSL2) aggregates, though more rapid growth in M1 could be appropriate for a time (as interest rates come down).

% Change	1983-84	1984-85	1985-86
1983 MTFS	7-11	6-10	5-9
1982 MTFS	7-11	6-10	n.a.
1981 MTFS	4-8	n.a.	n.a.

Target for 1983 applies to 14 months between mid February 1983 and mid April 1984, at an annual rate. Ranges for later years are illustrative.

As last year, ranges are constructed on the assumption of "no major change in the exchange rate from year to year".

(iii) Fiscal projections illustrating how fiscal policy can be made consistent with financial framework, given public expenditure plans.

PSBR		1982-83	1983-84	1984-85	1985-86
		Estimate	MTFS Projections		
1983 MTFS*					
	£ bn	7½	8	8(½)	7(4)
as %	GDP	2¾	2¾	2½	2
Autumn Statement					
	£bn	9	8	n.a.	n.a.
as %	GDP	3¼	2¾	n.a.	n.a.
1982 MTFS					
	£bn	9½	8½	6½	n.a.
as %	GDP	3½	2¾	2	n.a.

*Figures in brackets show implied fiscal adjustment.

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until after Budget Speech on 15.3.83
then UNCLASSIFIED

C3 Cont

Detailed revenue and expenditure assumptions based on following assumptions:-

% Change	1983-84	1984-85	1985-86
Real GDP	←	2½% p.a.	→
GDP deflator	5½	5½	5
Money GDP	←	8% p.a.	→

Positive

(i) Continuity of stable financial framework. Monetary guidelines and PSBR projections virtually the same as in the 1982 MTFS.

(ii) MTFS has made important contribution to reducing inflation well into single figures.

(iii) Continued decline in monetary ranges consistent with keeping inflation on a downward trend.

(iv) Lower inflation means monetary ranges leave plenty of room for recovery in real activity.

(v) Success in reducing PSBR has contributed to reduction in interest rates, while keeping within 1982-83 target for monetary growth. PSBR fallen from 5 per cent GDP in 1979-80 to less than 3 per cent in 1982-83 (estimated).

(vi) Tax cuts in Budget possible without raising PSBR above figure suggested in last year's MTFS.

(vii) Declining path of PSBR over medium term should leave room for lower interest rates, as monetary growth comes down.

Defensive

(i) Monetary targets too high? Raised monetary targets last year to reflect apparent shift between broad monetary aggregates and inflation, caused by structural changes to financial markets and effect of high real interest rates on saving behaviour. Nothing has happened to change that view. Inflation has come down fast, and monetary growth within higher target range was consistent with appropriately restrictive monetary conditions last year. (Money GDP grew more slowly than expected.)

(ii) Has there been a change of view on velocity? Not for M1. Last year's MTFS warned that M1 velocity could fall as inflation and interest rates come down. This year's MTFS says fall could go further. £M3 is a bit different. Velocity of £M3 fell last year (whereas MTFS projections last year implied velocity would be stable with growth in the middle of the range); but change is relatively small. Forces that led us to revise targets up have continued, and seem likely to continue a little longer. New MTFS projections assume restoration of broad money velocity after recent fall starts in 1984-85 instead of 1983-84. Uncertainty about velocity is key reason why other indicators are used to interpret monetary conditions, and why ranges for later years are provisional. No intention of allowing velocity to return to trend via a rise in inflation.

(iii) Why not set a separate target for M1? Could be a lasting fall in M1 velocity as we move to lower inflation and interest rates (was a shift in the opposite direction when inflation rose in early '70s); if so, faster M1 growth, for a time, would not damage inflation prospects. But scale and timing very uncertain. Faster growth in M1 only appropriate if other indicators suggest this is consistent with maintaining moderately restrictive conditions.

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C3 Cont

(iv) Why has inflation prospect improved (despite unchanged monetary ranges)?

	1982-83	1983-84	1984-85
GDP deflator (% change)			
1982 MTFS	7 ½	7	6½
1983 MTFS	7	5½	5½
Money GDP (% change)			
1982 MTFS	←	9½	→
1983 MTFS	←	8	→

- Changes are fairly small, especially relative to width of target ranges. Never claimed a very precise relationship between inflation, money GDP and monetary growth over 2-3 years.

- Prospects for inflation have improved because world prices (especially oil) and domestic costs may grow more slowly. Fall in exchange rate will affect RPI path (as noted in FSBR) but, providing monetary conditions are kept moderately restrictive, effect on inflation should be temporary (and may be less pronounced on GDP deflator).

- Outside forecasts of inflation have come down a lot since last year too.

(v) Lower money GDP (actual and forecast) suggests policy is unduly restrictive. Money GDP is not a target. Slower growth not primarily due to domestic pressures but depth of world recession. Monetary ranges leave room for recovery.

(vi) Role of exchange rate? Response to exchange rate movements depends on overall assessment of domestic monetary conditions. Recent fall not interpreted as symptom of policy laxity. But exchange rate will continue to be one of the financial indicators taken into account in interpreting monetary conditions.

(vii) MTFS says that "monetary ranges are constructed on the assumption of no major change in the exchange rate." What does this mean?

- difficult to define a major change precisely. But assumption applies to year to year movements in the effective exchange rate

- even if there is a major change (as last year) correct response depends on overall assessment of domestic monetary conditions

- as Chancellor has made clear, no reason to expect domestic policy stance to cause large change in the exchange rate in foreseeable future. (Short term forecast in FSBR assumes rate will remain at around present levels over the period of forecast.)

(viii) Shift of emphasis from monetary targets to PSBR? No. MTFS always emphasised the need for consistent fiscal and monetary policies.

(ix) Fiscal policy far too restrictive (eg OECD etc) Lower PSBR makes room for lower interest rates; PSBR alone not a measure of overall stance of policy. Lower inflation eases fiscal stance, for any given nominal PSBR (ie raises inflation adjusted or 'real' PSBR).

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(x) Cyclically adjusted PSBR?

- no single correct way of calculating cyclical adjustment (not enough just to take out direct "cost of unemployment" - cyclical effects on PSBR depend on why employment and output are low)

- acid test is pressure on interest rates. Actual not hypothetical PSBR that has to be financed (and affects spending)

- objective is to secure trend reduction in PSBR relative to GDP

- PSBR was adjusted in 1981 to take account of recession though principle that path should be on declining trend was adhered to. Estimated PSBR outturn in 1982-83 likely to be about ½ per cent of GDP higher than envisaged in 1980 FSBR.

(xi) Real PSBR?

- may be a useful indicator of stance of policy. But not sensible to fine-tune nominal PSBR to achieve targets for real PSBR, (could involve raising nominal PSBR when inflation rises, effectively accommodating higher inflation).

- lower inflation has meant some easing in fiscal stance in 1982-83, despite low outturn for nominal PSBR; real PSBR has risen slightly, compared with 1981-82, (one way in which lower inflation helps to raise real demand, within given nominal framework).

(xii) PSBR interest rate link discredited? PSBR not only influence on interest rates. But we cannot do much about world interest rates. Responsible fiscal policy has helped to keep our interest rates towards bottom of the international range.

(xiii) Fiscal adjustment in 1984-85 depends on undershooting PEWP planning total?

[Table 2.3 shows underspending £1½ billion - described as differences due to economic assumptions; table 2.5 shows fiscal adjustment of only £½ billion.]

Fiscal adjustment subject to very large margin of error (same as PSBR). But scope for tax cuts always depends critically on success in controlling public expenditure. Planning total for 1984-85 will be reviewed nearer the time, in the normal way.

(xiv) Balanced Budget? Government aims to reduce PSBR as share of money GDP over medium term. Illustrative profile in 1982 MTFS shows figure of 2 per cent in 1984-85. Nothing has been said about later years.

(xv) Why is the 1984-85 PSBR higher than in 1982 MTFS?

PSBR projections are illustrative and are reviewed every year. Current level of PSBR (ie 2¾ per cent of GDP) close to averages in 1950s and 1960s, and not surprising that progress from now on is slower than that in recent years. But we are looking for some further trend decline. [Not for use: oil prices are not a good excuse: oil revenues in 1984-85 are unchanged from last year's MTFS.]

Contact point: Mrs R Lomax (MP1) 233-7901

SOME COMMENTS ON THE PROPOSED MEASURES

Personal Allowances

1. The proposal is to increase all thresholds and allowances (including the higher rate and IS thresholds) by 14 per cent, or 8½ per cent above the statutory minimum. This follows the increase of 2 per cent above the statutory minimum of last year. This year's increase will for the great majority, but not all, people more than outweigh the increased National Insurance Contributions which come into effect next April.

Social Security etc

2. The main proposal is to increase child benefit to £6.50 per week, taking its value well above the level inherited in 1979. There will be a parallel increase in one-parent benefit. Other proposals are to restore the 5 per cent abatement in unemployment benefit effected in 1980, to extend the widows bereavement allowance to make it more effective, and to remove the so-called invalidity trap. These measures comprise an attractive package which should go some way to offset the criticism likely to arise over the question of the social security upratings generally.

Corporation Tax

3. The proposal is to reduce the small companies rate from 40 per cent to 38 per cent, and to alter the limits so as to reduce the transitional marginal rate.

Oil

4. Comprised here is a package of proposals designed in particular to encourage the development of the next generation of North Sea oil fields.

National Insurance Surcharge

5. The Government inherited a 3½ per cent NIS rate, and has already brought this down by steps to 1½ per cent from 1983-84. Complete abolition of the Surcharge is the one single measure most frequently and forcefully pressed in industrial representations. It is proposed to meet these pressures, in part for political and presentational reasons, by a further ½ per cent for the private sector only, to take effect from next August.

Small Firms, Enterprise and Wider Share Ownership

6. The main proposal here is a major extension of the Business Start-Up Scheme, to be called the Business Expansion Scheme. The principal change is the extension of the present scheme so that there will be tax relief for equity investment not just in new companies but in all qualifying established unquoted trading companies. Other changes are being made to make the scheme less restrictive. Other proposals under this head include further measures to encourage wider share ownership, some real improvements in the Capital Transfer Tax regime, an extension of the Loan Guarantee Scheme, and an increase in the VAT registration threshold.

Technology and Innovation

7. The principal proposal here is a re-opening, at a cost of £100 million over the next three years, of the Small Engineering Firms Investment Scheme (SEFIS). Also included in the total technology package of £240 million over three years is to help with Information Technology, Innovation Linked Investment and a provision for extension of Science Parks. It is hoped that this package will particularly benefit the West Midlands.

Construction

8. The principal proposal here is the increase in the Mortgage Interest Relief ceiling from £25,000 to £30,000. Also included are proposals to provide more for Home Improvement Grants, and also to provide money for so-called "enveloping" schemes, under which local authorities repair the external fabrics of complete streets or terraces, as part of helping counter the problems of housing decay.

Unemployment

9. The measures here include the proposals in respect of early retirement, a nationwide extension of the Enterprise Allowance Scheme, and making the Job Release Scheme available to part-timers from the age of 62.

Specific Duties

10. These will be increased generally in line with inflation, though with some small real decreases in cigarettes, petrol and derv, and, largely due to rounding, some small real increases in beer, cider and VED. The Chancellor's minute to the Prime Minister of 24 February set out details of the proposals for petrol, derv and VED.

Other

11. The measures here comprise mainly action on personal fringe benefits and corporate anti-avoidance. On fringe benefits :-

- proposals in respect of employers scholarships were explained in the Chancellor's letter of 23 February to the Secretary of State for Education and Science.

- car and car fuel scales for company cars used privately by higher paid employees will be increased from 1984-85 by 14 per cent on average. These scales will still be less than justified by a realistic estimate of the costs of running a car.

- on Directors PAYE tax it is necessary to deal with cases in which close companies pay directors or higher paid employees a sum without deduction of tax from him and so account for insufficient tax to the Revenue. To do this, tax accounted for by the company will be deemed to be a benefit in kind of the director.

- where companies provide expensive accommodation(the "Marks & Spencer" device)to employees it will be taxed as a benefit.

Two other proposals will give help :-

- removal of special "deemed domicile" CTT rule applying to those emigrating to the Channel Islands and the Isle of Man.

- allowing the tenant self-employed (publicans and farmers) to have interest relief on second home mortgages.

12. The main anti-avoidance proposals are :-

- countering the "British Leyland" device for avoidance through groups relief; on this Treasury Ministers are satisfied that the proposals will not hamper genuine business transactions.

- legislation on tax havens <u>but</u> with the measures to take effect from 1984 and to provide for Double Taxation Relief to be allowed from the same date against the full corporation liability <u>before</u> ACT is deducted. Taken together these two changes do not represent an increase in the burden of tax on international business but a switch in the burden away from those who remit profits to the UK towards those who accumulate surplus cash balances in tax havens overseas.

Michael

233 5842

10 DOWNING STREET

From John Kerr:

1. IF threshold is uprated by 10% each of 4 blokes would be 50P better off.

2. 75% of mortgages are less than £15.000. 60% less than £10.000.

∴ examples quoted are a typical.

Peter

Michael

Econ Pol

(2)

10 DOWNING STREET

Prime Minister

Budget: Tax avoidance measures

Alan Walters thought you should see John Chown's views on the tax avoidance measures in the Budget as amended by John Wakeham.

MCS 9/3

M T

bc AW

JP

10 DOWNING STREET

From the Private Secretary

8 March 1983

HOUSE OF LORDS DECISION - WICKS v FIRTH, JOHNSON v FIRTH
EMPLOYER SCHOLARSHIPS

The Prime Minister has seen the Chancellor's minute of 4 March, together with a copy of Sir Keith Joseph's letter to the Chancellor of 3 March about the Wicks v Firth case.

The Prime Minister does not agree to the modified proposal contained in the Chancellor's minute. She believes that, if there has to be a provision (and she herself remains opposed to this) to tax parents on the benefit of scholarships which come to students because of their parents' employment, it should not apply to scholarships which have already been granted. The Prime Minister considers that such a provision, with the period of grace envisaged by the Chancellor, would lead to indefensible cases where children were removed from independent schools mid-way through their education.

M. C. SCHOLAR

Miss Jill Rutter,
HM Treasury.

PERSONAL AND BUDGET SECRET

11

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

Prime Minister

MCS 8/3

PRIME MINISTER

INCOME TAX THRESHOLDS

You asked me to think about the possibility of increasing the thresholds by 10 per cent.

2. In recent weeks I have, as you know, been planning a 8½ per cent increase, largely because:-

a. we need to demonstrate our determination to go on reducing borrowing, even if only at a moderate rate; this means a 1983-84 PSBR which can be shown (after some "rounding down") as no more than £8 billion;

b. which in turn means that our scope for total net tax reductions (after indexation and valorisation) is, on the latest forecast, limited - in terms of PSBR impact - to some £1.5 billion (and even that is pushing it a bit); and

c. to target more than three quarters of these reductions on individuals, rather than business and industry - and more than two thirds on the single area of income tax thresholds - would be open to sharp criticism. (Frankly, I think we would be accused of electioneering.)

3. There is no particular magic about the 8½ per cent figure: the £1 billion relief (in PSBR terms) which it represents, on top of indexation, is more important. But 8½ per cent does meet, or

/beat

beat, a number of important targets, viz:-

a. taking the Government Actuary's assumption of earnings growth of 6½ per cent between 1982-83 and 1983-84, it reduces or matches average rates of tax and NIC for 1982-83 for all people who are contracted-in;

but not tax+NIC

b. it reduces average rates of tax compared to 1978-79 for married men on at least three quarters of average earnings - ie two thirds of married men; and

c. because I have rounded up the married man's allowance, it gives all married men a tax reduction of just over £2 a week.

4. As I told you, there is a huge choice of figures on which to base alternative calculations. They are all complicated by two things: the increases in NIC which we have had to make (including this year's special addition to the contracted out rate): a total of 2.5 per cent for those contracted in, and of 2.85 per cent for those contracted out; and the very large increase in average earnings that has taken place.

5. With this in mind one can make a variety of comparisons with 1978/79, Labour's last year. A reduction in the average percentage rate of tax and NIC combined to the levels in that year would require an increase of more than 30 per cent over indexation. On average rates of tax alone, indexation plus 8½ per cent improves the position for most married men, but indexation plus 15 per cent would be needed to match 1978/79 for a majority of the single (and earning wives).

6. The figure of indexation plus 10 per cent (which I mentioned) would, as it happens, restore allowances to their 1978/79 level as

/a percentage

a percentage of earnings. But it would take no particular tricks, since that milestone is seldom mentioned. Reference is more often made to the real value of the allowances expressed (as "Rooker-Wise" requires) in terms of prices; and by that yardstick indexation plus 3 per cent is sufficient to restore the 1978/79 level. (I see that the ITN Budget Factbook, for example, suggests that to "provide complete indexation during [his] time as Chancellor" would require me to make an overall increase this year of 12 per cent and we shall be doing better than that.) Average earnings, of course, have increased more than prices - which means that all the options, including bare indexation, show real net earnings in 1983/84 after tax and NIC as higher than in 1978/79.

7. There is one other thing which may have been obscured by the way in which we are obliged to do our initial arithmetic in terms of the first year net PSBR cost of any measure. The income tax cuts which I now propose cost, on that basis, "only" £1 billion. But the full year revenue cost of such income tax cuts, including indexation, is about £2.5 billion, and that is the figure which will hit the headlines.

8. I believe it would be unwise to go beyond that, not least because it would make the PSBR up to £8.5 billion. To announce an intention of borrowing much more, in nominal terms and as a proportion of GDP, next year than in the current year would cause considerable surprise, since it would be inconsistent with the strategy we have been following over the years. And it would reduce still further our very limited room for manoeuvre in face of a sharp fall in oil prices.

9. So I really do think that 8½ per cent makes sense, and that more would be a mistake.

GH

(G.H.)
8 March 1983

10

BUDGET SECRET

PRIME MINISTER

I had better see the Chancellor this morning (Wed). Would you also ask his office to take into account the effect on the pay-slips of the new system of mortgage relief which takes effect in June e.g. let us look at the total tax effect on pay of (i) a married man on 1½ av. earnings with a £15,000 mortgage and (ii) a single person on say £12,000 with a £15,000 mortgage taking in both cases contracted in and contracted out.

1. You looked quickly at the Chancellor's and Alan's notes (attached) earlier this evening. They are worth studying carefully now, because decisions are needed very soon.

The PSBR: £8b or £8½b

2. I believe Alan makes a strong case for sticking to an £8 billion PSBR. If, as he believes, we have an average oil price in 1983-84 of $26 a barrel £8 billion becomes up to £8.9 billion: that would be just tolerable against the estimated PSBR we had for 1982-83 of £9½ billion.

3. The argument is even stronger if we compare estimate with outturn - as one should not do, but as some will do. The 1982-83 outturn will be shown on Budget day as £8 billion. In reality it may be lower. Is there not merit in publishing a 1983-84 PSBR lower than this figure: or, at any rate, no higher?

4. Doing the sums in GDP percentages points to the same conclusion. An outturn of £8 billion this year will be shown as 3% of GDP. An estimate of £8 billion for 1983-84 will be shown as 2.75% of GDP. We would (just) keep up the downward pressure.

Thresholds up from 8½% to 10%; or a NIS reduction?

5. If you accept the foregoing you then have a straight choice between pushing the thresholds up by an additional 1½% above indexation; or dropping a further ½% from NIS.

6. What does each of these options buy you?

7. Reducing NIS

(a) Buys support for the Budget from the industry lobby, the CBI, etc. Useful.

/(b)

(b) Reduces the risk of the Budget being described as lopsidedly directed to persons and therefore electioneering (although, with an £8 billion PSBR this would be a scarcely credible line of attack anyway).

(c) Is, arguably, unnecessary since industry is already enjoying the two reductions announced in the Autumn, one of which comes into effect in April; as well as the benefits of a lower exchange rate and lower interest rates. There must be some risk, too, of the NIS reduction leaking into pay.

8. 10% rather than 8½% threshold increases

(a) Will help to achieve many important economic objectives - e.g. reducing the why work syndrome?, taxing fewer people below the SB threshold, reducing the higher taxpayer's bill, and so on. The more we can increase our absurdly low thresholds the better.

(b) On the other hand, indexation + 10% buys little more immunity from criticism than 8½% would. At 10% there will still be people paying more tax + NIC in 1983-4 than they did in 1982-83 (whether on the static or the dynamic comparison). At 10% all those with less than twice average earnings will be bearing a heavier burden of tax + NIC than they did in April 1979.

(c) On both 8½% and 10% we can say that

(i) average rates of tax + NIC will be lower than, or equal to, those in 1982-83 for all people who are contracted in;

/(ii)

(ii) average rates of tax (NB not tax + NIC) will be lower than in 1978-79 for all married men on $^3/_4$ average earnings or more;

(iii) thresholds would be above their 1978-79 levels in real (i.e. RPI) terms.

9. I find these arguments finely balanced. For what it is worth, my personal preference would be to increase thresholds by 10%, because I rate highly the arguments at 8(a) above. But I can see the force of the Chancellor's view (7(a) and (b) above) that the Budget will be more likely to succeed if he further reduces "Labour's tax on jobs".

10. Are you ready to come to a decision tonight?

11. If not, you should see the Chancellor as soon as possible tomorrow morning - instead of Dr. Nicholson at 11 a.m.? The Treasury need to print their tables and so on very soon.

MCS

8 March 1983

BUDGET CONFIDENTIAL

PA

Econ Pol

cc D/N

bc AW

JS

10 DOWNING STREET

From the Private Secretary

8 March 1983

NORTH SEA FISCAL REGIME

The Prime Minister has noted without comment the Chancellor's minute of 4 March about the changes he has in mind for the North Sea fiscal regime in the Budget.

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

M. C. SCHOLAR

Miss Margaret O'Mara,
HM Treasury.

Secret & Personal

Prime Minister
MCS 8/3

9

8 March

Prime Minister

The Budget

This morning we reviewed the oil price possibilities and the effect on the budget and PSBR etc. The PSBR results are as follows:–

World Oil Price	Increase of PSBR (£bn) 1983/4	1984/5
$27 a barrel	0.5	0.7
$26	0.9	1.2
$25	1.3	1.8

[These allow for a depreciation of sterling by 2% for every 10% reduction in oil price.]

Oil is trading now on the Rotterdam spot market at about $26 - 27 a barrel and there are many transactions below those values.

Oil price reductions are very similar to reductions in specific excise taxes – except that we do not control them but must make guesses about their magnitude. [My personal guess has, since end 1981, been that the oil price would go below $25 before the end of 1983 – but it may well be sensible to envisage an average value of $26 in 1983/4 with contingency plans for a fall to the low 20's]

The certainty of a substantial fall in the oil price reinforces the Chancellors view that we hold the PSBR (assuming oil prices at about \$29 a barrel) to £8 Bn. If the oil price falls to \$26, then the PSBR will rise to £9 Bn.

I think it would be prudent to plan to absorb about half the increase in PSBR. Thus we should plan for a £7½ Bn PSBR (assumed oil price \$29). The effect would be roughly the same as an £8½ Bn PSBR if the oil price falls as expected to \$26. The extra billion is the indirect-tax-reduction-equivalent to the fall in the oil price.

The Chancellor has a good case for holding the thresholds to inflation + 8½%. There ~~are~~ also compelling reasons for dropping the NIS reduction but he may well want to keep that card up his sleeve for the time being.

I would urge you to think about the consequences of any substantial reductions in tax when there is such a high likelihood of substantial reductions in the oil price.

This year above all we do not want to have to introduce July-measures to increase taxes to offset falls in oil revenue and to calm fevered markets.

I doubt if you will find this at all palatable but there it is!

Alan Walters

8

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

PRIME MINISTER

THE BUDGET

In this minute I set out the Budget plans, which remain along the lines we have previously discussed. I envisage no major changes - except in the event of a very substantial further fall in the oil price in the next few days.

2. I plan to hold to the figuresfor monetary growth set out in the 1982 Medium Term Financial Strategy - ie ranges of 7-11 per cent for next year, 6-10 per cent for 1984-85 and 5-9 per cent for 1985-86. As before these paths apply to both the narrow and broad measures of money. I hope that we shall hit the middle of the ranges. I have given a good deal of thought to the possibility of reducing at least the top of these ranges by one point. But there is some disadvantage in revising medium term objectives in two successive years. And it is clear that the announcement of a downward move could make it significantly more difficult for us to go on getting interest rates down. In present circumstances, I regard that as decisive.

3. At the time of the last Budget, and again last Autumn, I proposed a figure for the 1983-84 PSBR of 2¾ per cent of GDP, and I plan to hold to this too. For this year (1982-83) we shall publish a forecast out-turn figure of some 3 per cent. The 1984-85 figure, after taking account of the Budget measures and allowing for a future "fiscal adjustment" of £0.5 billion, is forecast at 2½ per cent. Although the nominal figures will coincidentally be £8 billion in all three years, we shall thus continue to show a downward trend as a percentage of GDP.

4. On the basis of the present forecast, an £8 billion PSBR next year gives scope for tax reductions with a PSBR cost of some £1½ billion,

over and above revalorisation of thresholds and excise duties. This figure, however, understates the total reductions we shall have effected for the year 1983-84 because it does not take account of the measures I announced in the Autumn. I shall, of course, ensure (with due discretion) that these are not overlooked.

5. The Annexes below provide a summary of the detailed proposals. Where they have a public expenditure cost it will be accommodated within the Contingency Reserve, and will not lead to any increase in plan totals.

6. As you see, the lion's share of the initial benefit goes to individuals rather than to industry. We both think this is right, given the need to tackle the poverty and unemployment traps, and the way we have favoured industry in previous years, (eg by not increasing thresholds in 1981). Industry is, of course, the main beneficiary of the measures which we announced in the Autumn - and is also helped by the lower exchange rate.

7. The main line of attack on our plans will I think be that we are proposing a "Budget for the Better Off". As you know, I plan to raise all the income tax thresholds and allowances by 8½ per cent over indexation. Using the Government Actuary's earnings assumption of 6½ per cent, this will reduce or match average rates of tax and NIC for 1982-83 for all those contracted-in. But the perceived effect of course is to confer the greatest benefit on the better off and critics will seize on the point that the immediate effect of the Budget changes will be that at fixed levels of income (the so-called static comparison) taking the changes in tax with the NIC increases, married men on salaries of less than £16,000 a year will gain only up to £100 in 1983-84 (and some single people or a few on contracted-out schemes will actually lose.) Yet a married man on £30,000 a year will gain some £600.

8. The increase in the mortgage interest relief ceiling will also give most benefit to the better off. And no doubt our critics will add our plans for social security upratings to their indictment.

9. But there is no sensible way of preventing the perceived effect of increases in the income tax thresholds. One could in theory increase the higher rate bands less than the basic rate thresholds - or even freeze them, as happened over many years in our political youth. But that allows inflation to make the rate structure even more steeply progressive than it already is, and would be wholly wrong. Even if we were to do no more than index the higher rate bands, our £30,000 a year married man would still gain by about £450, and we should scarcely have blunted our opponents' attack. The truth is that all the thresholds and bands suffered similarly from the absence of indexation in 1981; and that all should be corrected now if we are to restore the rate structure - though not yet the levels - set in my 1979 Budget.

10. All this increases the political importance of a number of - not very costly - other measures, viz the increase in child benefit to £6.50, which is above the April 1979 level; the unemployment package we have discussed, together with action on unemployment benefit; extension of the widow's bereavement allowance; removal of the invalidity trap, and so on - the full list is in table 2 of Annex B below. Another useful counter-weight to criticism is the group of minor measures against corporate tax avoidance and fringe benefits listed in table 6 at Annex B.

11. On the positive side, for business and enterprise I am proposing packages of measures to help small and new businesses - including a major simplification and extension of the Business Start-up Scheme, now extended to all existing unquoted companies; new technology - including a £100 million re-introduction of the SEFIS scheme; the construction industry; and wider share ownership. This is all in addition to the further ½ per cent cut in NIS which we discussed some weeks ago: I am sure that it is politically necessary to cope with the "pure" industrial lobby, which has significant backbench support, not least in the West Midlands.

... 12. I attach at Annex A a summary of the costs of the main proposals. Annex B lists the minor items. You may also wish to glance at the commentary by officials at Annex C.

13. I am sending you a separate note on the oil taxation proposals which I have agreed with Nigel Lawson.

(G.H.)

4 March 1983

 ANNEX A

£ million

	1983-84		1984-85	
	PSBR	REVENUE	PSBR	REVENUE
Individuals				
Personal Allowances	1010	1170	1060	1490
Housing and Home Ownership (Table B1)	80	115	65	105
Social Security (Table B2)	75	125	190	320
Unemployment (Table B3)	25	55	40	75
	1190	1465	1355	1990
Businesses and Industry				
Corporation Tax	35	40	60	70
National Insurance Surcharge	200	220	300	400
Small Firms and Enterprise (Table B4)	25	35	130	165
Technology and Innovation (Table B5)	30	40	50	80
	290	335	540	715
North Sea Oil	105	120	85	100
Specific Duties	(10)	(10)	(10)	(10)
Miscellaneous (Table B6)	-	-	(30)	(45)
GRAND TOTAL	1575	1910	1940	2750

Note 1: The measures include both tax and public expenditure elements. For tax the costs shown are the excess over indexation; for public expenditure the excess over what is already provided in the PEWP.

2: The figures shown are rounded and may still vary marginally. The specific PSBR costs shown for each group of measures is necessarily approximate.

ANNEX B

TABLE 1

HOUSING AND HOME OWNERSHIP

£ million

		1983-84	1984-85	Full Year
1.	Enveloping*	50	nil	-
2.	Mortgage Interest Relief ceiling - increase to £30,000	50	85	60 *
3.	Improvement grants*	10	10	-
4.	Stock relief: householders part exchange simple scheme	under 1	5	5
5.	Self-employed second home mortgage interest relief	2	5	5
	Revenue costs	52	95	70
	Public expenditure costs	60	10	-
	GRAND TOTAL	112	105	70
	Taken as	115	105	

Note: Items marked * are public expenditure

* Interesting! We were given £50-75m for 1983-84, £75m-100m for 1984-5 and £100-200m "eventual" cost in the Chancellor's paper.

MLJ.

ANNEX B

TABLE 2

SOCIAL SECURITY

		1983-84	1984-85
			£ million
1.	Abolition of £25,000 limit for CTT exemption on gifts to Charities	under 1	under 1
2.	Deeds of Covenant - increase in ceiling for higher rate		3
3.	Tax relief for staff seconded by companies to voluntary bodies	under 1	under 1
4.	Extension of widow's bereavement allowance	25	30
5.	Raise cut-off for SB resources to £3,000 *	2	7
6.	Raise cut-off for SB single payments to £500 *	1	3
7.	Real increase in therapeutic earnings limit *		
8.	New mobility supplement for War Pensioners *		
	Less housing benefit savings	(2)	(6)
9.	Restoration of 5 per cent abatement in UB *	22	59
10.	Increase child benefit to £6.50 per week, plus corresponding rise in one parent benefit *	74	212
11.	Removal of invalidity trap *	4	14
	Revenue costs	25	34
	Public expenditure costs	101	290
	GRAND TOTAL	126	324
	Taken as	125	320

Note: not abated by 2.7% MLS

* Public expenditure items. Costs are those over and above amounts provided for in the White Paper

ANNEX B

TABLE 3

UNEMPLOYMENT

£ million

	1983-84	1984-85
DHSS early retirement (automatic credits 2, long-term SB 22)*	24	24
Enterprise allowance: cash limited nationwide scheme, plus spill over (gross)*	25	25
Part-time JRS from 62* (subject to the Chief Secretary's agreement)	5	25 ≠
GRAND TOTAL	54	74
Taken as	55	75

Note: Items marked * are public expenditure

≠ £25 million is provisional estimate

SMALL FIRMS, ENTERPRISE AND WIDER SHARE OWNERSHIP

£ million

		1983-84	1984-85	Full Year
1.	Business Expansion Scheme	nil	75	75
2.	Loan Guarantee Scheme*	nil	nil	-
3.	Wider share ownership	20	30	40
4.	Capital Gains Tax (see note 1)			
	a. monetary limits	nil	1	1
	b. retirement relief	nil	1	4
5.	VAT registration thresholds	5	10	10
6.	De minimis limit for assessment of apportioned income	under 1	under 1	under 1
7.	Acceptance credits	1	1	1
8.	Capital Transfer Tax (see note 2)	8	18	20
9.	Zero/deep-discounted stock	neg	15	15
10.	Relief for interest, employee buy-outs	1	1	2
11.	Tax treatment of interest paid by companies to non-residents	under 1	under 1	10
12.	Increase in proportion of office space qualifying for industrial building allowance	nil	10	25
13.	DLT - extension of own-use deferment	nil	under 1	4
14.	Small Workshop Scheme - averaging for converted premises	under 1	under 1	under 1
	GRAND TOTAL	36	163	208
	Taken as	35	165	

Note: Items marked * are public expenditure

1. The cost of these CGT measures when statutory indexation is added is nil, 5 and 15 million.

2. Indexation of CTT costs 15, 30 and 45 respectively. The additional costs shown for item 8 are for rounding up the indexed thresholds, for extending the instalment period from 8 to 10 years, and for increasing reliefs on let land and unquoted companies to 30 per cent.

TECHNOLOGY AND INNOVATION

£ million

		1983-84	1984-85	1985-86
1.	Extension of transitional period for capital allowances - films	nil	nil	30
2.	Extension of transitional period for capital allowances - teletext TVs	nil	10	15
3.	SEFIS*	20	40	40
4.	Information technology*	5	8	11
5.	Innovation linked investment*	5	15	20
6.	Advisory services*	9	6	6
7.	Science Parks* (included above)			
	Revenue costs	nil	10	45
	Public expenditure costs	39	69	77
	GRAND TOTAL	39	79	122
	Taken as	40	80	

Note: Items marked * are public expenditure

The cost of the whole package over three years is £240 million

ANNEX B

TABLE 6

MISCELLANEOUS

£ million (yields)

		1983-84	1984-85	Full Year
1.	Car and car fuel scales - 15 per cent average increase	nil	(25)	(30)
2.	Cheap housing for directors	nil	nil	(1)
3.	Life assurance: chargeable events: secondhand bonds	under (1)	under (1)	under (1)
4.	CGT: non-resident trusts	under (1)	under (1)	under (1)
5.	CTT: remove special deemed domicile rule for Isle of Man etc	1	2	2
6.	Group relief: avoidance (BL)	nil	(10)	(10)
7.	DLT: disposals by non-residents	(1)	(2)	(2)
8.	Taxation of international business. Offset by Double Taxation Relief against Corporation Tax	nil	nil	nil
9.	Beneficial mortgage loans from employers	nil	under (1)	under (1)
10.	Directors PAYE tax	nil	(10)	(10)
11.	TSBs to be treated as bodies corporate	3	10	10
	GRAND TOTAL	2	(47)	(52)
	Taken as	-	(45)	

Annex C.

INDIVIDUAL MEASURES

Personal Allowances

1. All thresholds and allowances (including the higher rate and IS thresholds) to increase by 14 per cent, or 8½ per cent above the statutory minimum. This will for the great majority of people (but not quite all) more than outweigh the increased National Insurance Contributions which come into effect in April.

Social Security etc.

2. Child benefit to increase to £6.50 per week, taking its value above the level inherited in 1979. There will be a parallel increase in one-parent benefit. The 5 per cent abatement in unemployment benefit, effected in 1980, to be restored; widows bereavement allowance to be extended to a second year; the invalidity trap to be eliminated. Should go some way to offset the criticism on general social security upratings.

Housing and Home Ownership

3. This group includes the increase in the Mortgage Interest Relief ceiling from £25,000 to £30,000. Also included are proposals to provide more for Home Improvement Grants, and also to provide money for so-called "enveloping" schemes, under which local authorities repair the external fabrics of complete streets or terraces, as part of helping counter the problems of housing decay.

Unemployment

4. The measures here include proposals in respect of early retirement, a nationwide extension of the Enterprise Allowance Scheme, and making the Job Release Scheme available to part-timers from the age of 62.

Corporation Tax

5. Reduce the small companies rate from 40 per cent to 38 per cent, and alter the limits so as to reduce the transitional marginal rate.

National Insurance Surcharge

6. Cut NIS by ½ per cent for the private sector only, from next August. Complete abolition of the Surcharge is the single measure most frequently and forcefully pressed in industrial representations.

Small Firms, Enterprise and Wider Share Ownership

7. A major extension and simplification of the Business Start-Up Scheme, to be called the Business Expansion Scheme. The principal change is the extension of the present scheme to provide tax relief for equity investment not just in new companies but in all qualifying established unquoted trading companies. (Following a review, other changes are being made to make the scheme less restrictive.) Also further measures to encourage wider share ownership, improvements in the Capital Transfer Tax regime, an extension of the Loan Guarantee Scheme, and an increase in the VAT registration threshold.

Technology and Innovation

8. The major measure is the re-opening, at a cost of £100 million over the next three years, of the Small Engineering Firms Investment Scheme (SEFIS). Also included in the total technology package of £240 million over three years is help with Information Technology, Innovation Linked Investment and a provision for extension of Science Parks. It is hoped that this package will particularly benefit the West Midlands.

Other

9. The measures here comprise mainly action on corporate anti-avoidance and personal fringe benefits.

10. On anti-avoidance, the intention is:-

(i) to counter the "British Leyland" device for avoidance through group relief. Treasury Ministers are satisfied that the proposals will not hamper genuine business transactions.

(ii) to legislate on tax havens but not implement the new measures before 1984, and to provide for Double Taxation Relief to be allowed from the same date against the full corporation tax liability before ACT is deducted. This is one of the changes most widely requested in representations on our corporation tax green paper. Taken together the two changes do not involve any net increase in the burden of tax on international business, but a switch in the burden away from those who remit profits to the UK towards those who accumulate surplus cash balances in tax havens overseas. The tax havens element in the package has been the subject of extensive consultation by Mr Wakeham: he and the Chancellor are satisfied that the proposals in their latest form meet every reasonable representation that has been made during the consultative process.

I understand that Alan Walters is content

MCS

11. On fringe benefits, the intention is:-

(i) from 1984/85, to increase car and car fuel scales for company cars used privately by higher paid employees by 15 per cent on average. (But the scales will still be well below any realistic estimate of the costs of running a car.)

(ii) on Directors PAYE tax, to deal with cases in which close companies pay directors or higher paid employees a sum without deduction of tax from him and so account for insufficient tax to the Revenue. To do this, tax accounted for by the company will be deemed to be a benefit in kind to the director.

(iii) to tax as a benefit expensive accommodation provided by companies to employees.

(iv) a deficiency in the present rules will be remedied to prevent employees getting both tax relief up to the limit on a commercial mortgage and the benefit of a commensurate interest free loan from the employer for house purchase.

Several other proposals go in the opposite direction:-

(i) the extension from 20 per cent to 30 per cent of the CTT reliefs for minority holdings in unquoted companies, and for let land.

(ii) the removal of the special "deemed domicile" CTT rule applying to those emigrating to the Channel Islands and the Isle of Man. (The Home Secretary has pursued this case for some time.)

(iii) allowing the tenant self-employed (publicans and farmers) to have interest relief on "second" home mortgages.

Specific Duties

12. These will be increased generally in line with inflation, thought with some small real decreases in cigarettes, petrol and derv, and, largely due to rounding, some small real increases in beer, cider and VED. The Chancellor's minute to the Prime Minister of 24 February set out details of the proposals for petrol, derv and VED.

Oil

13. The Chancellor's minute of 4 March reports on the package of measures agreed with the Secretary of State for Energy.

DRAFT MINUTE FOR THE CHANCELLOR OF THE EXCHEQUER TO SEND TO :

PRIME MINISTER

THE BUDGET

In this minute I set out the ~~I have now completed my~~ Budget plans, which remain along the lines we have previously discussed. I envisage no major changes ~~They may have to be amended if there is any substantial change in the oil market~~ ~~unless of course there were a very substantial further fall~~ ~~over the next few days, but subject to that this note sets out my thinking.~~ though a very substantial further fall in the oil price would necessitate a further review.

[2. Overall I shall continue with the monetary and fiscal policies we have adopted hitherto, with a view to sustaining and encouraging the recovery.

? omit

3. [There are some hopeful signs, but there are also some serious risks, most notably on oil, as already mentioned. Thus I shall need to lean on the cautious side, not only from this point of view but also for fear of adverse reaction in the present very sensitive markets. I also have well in mind the domestic political situation; there is no need for a Budget which is over severe but on the other hand we want so far as possible to avoid charges of electioneering - though of course these will be levelled whatever we do.]]

? omit

2. I plan to hold to ~~shall abide by~~ the figures for monetary growth set out in the 1982 Medium Term Financial Strategy ~~(MTFS) published at the time of my last Budget — that is,~~ ie ranges of 7-11 per cent for next year, 6-10 per cent for 1984-85 and 5-9 per cent for 1985-86. As before these paths apply to both the narrow and broad measures of money. ~~Stated policy in respect of the exchange rate will remain unaltered.~~

~~2.~~ 3. At the time of ~~my~~ The last Budget, and ~~in the~~ last Autumn, ~~Statement,~~ I proposed a figure of $2\frac{3}{4}$ per cent of GDP for the ~~Public Sector Borrowing Requirement~~ ~~(~~PSBR~~)~~ for 1983-84, and I plan to hold to this ~~I intend to abide~~ too. We shall publish a forecast out-turn figure of 3% for this year, ~~by this, and to continue the downward trend by going for a $2\frac{1}{2}$~~ ~~and~~ The 1984-85 figure, taking account of the Budget measures and allowing for a future fiscal adjustment of £0.5 billion, will be $2\frac{1}{2}$%. ~~per cent of GDP for 1984-85. In nominal terms this leads to~~ We shall thus continue to show a downward trend, though the nominal figures will be £8 billion in all 3 years ~~showing £8 billion for each of the two years. [This is likely to be a little bigger than the latest estimate for the current year 1982-83 which we shall disclose at Budget time].~~

~~3.~~ 4. On the basis of the present forecast ~~on~~ a £8 billion PSBR next year ~~this~~ gives scope for tax reductions ~~next year~~ with a PSBR cost of ~~around~~ some £$1\frac{1}{2}$ billion, over and above revalorisation of thresholds and excise duties. This figure however understates the total reductions we shall have effected for the year 1983-84 because it does not include the costs of the measures I announced in the Autumn. ~~[By way of comparison, the total reductions effected last year had a PSBR cost of around £1.3 billion]~~.

~~4.~~ 5. I attach a ~~note which summarises~~ summary of ~~my~~ the detailed proposals ~~and comments briefly on them~~. Where they have a public expenditure cost ~~they~~ it will be accommodated within the Contingency Reserve, and will not lead to any increase in plan~~ned~~ totals. ~~Most of them affect 1984-85 also, but taken with the PSBR I propose I shall be able to show at the time of the Budget a small positive "fiscal adjustment" for that year.~~

~~5.~~ 6. As you see, ~~this will be a Budget where~~ the greater part of the initial benefit goes to individuals rather than to industry. ~~In my view this is~~ We both think this right, ~~having regard~~ given to the need to ~~do something about~~ tackle the ~~problems of the~~ poverty and unemployment traps, and ~~to~~ the way we have favoured industry in previous years, (eg by not increasing thresholds in 1981) ~~I have also borne in mind the help for industry for 1983-84~~ industry is of course benefiting substantially from the measures which we announced in the Autumn. ~~and the way the lower pound helps industry as against individuals.~~

~~7. It seems~~

7. I ought to alert you to what will probably be the main line of attack on our proposals ~~Beta~~

~~7.~~ ~~Nevertheless, these proposals will lead to some attack.~~ ~~be attack~~

I plan to raise all the income tax thresholds and allowances by $5\frac{1}{2}$% (lower indexation ~~?~~: ~~The bands are further~~ to compress the bands would be a mistake. Yet the effect is of course to ~~?~~ confer the greatest benefit on the better off.

For example, if one takes account of ~~Taking the changes in tax with~~ the NIC increases, a married man on £12,500 a year will gain £6 in 1983-84. A single man, ~~on~~ ~~(and lose if~~

~~he is single or in~~ or one on a contracted-out NIC scheme ~~whereas~~ ~~would~~ will lose at that salary level). Yet a married man on £30,000 will gain ~~nearly £350~~ some £600. (The increase in the Mortgage Interest Relief ceiling will also help the better off - ~~a~~ the gain to the married man earning £30,000 ~~and with a~~ rises to £750 if he has a £30,000 mortgage) ~~will benefit by about £750. There is risk therefore that the Opposition will call this a "Budget for the better off", and~~ So it is no And No doubt ~~what we propose in respect of~~ our critics will add our plans for social security upratings ~~will be added~~ to their indictment. ~~In order to minimise the effect of this charge, therefore, I attach importance to the various measures which I propose in respect of tax avoidance, fringe benefits, and the like. We must have these in order to help give the total picture a balanced political appeal.~~

8. I don't think we need lose much sleep over this, ~~but I reckon we can point out~~ but it increases the political importance of the major increase in child benefit which I envisage, ~~and then~~ together with action on unemployment benefit, widows bereavement allowance, and the invalidity trap. ~~Also~~ Another useful ~~though minor~~ counter-weight is the ~~various~~ a group of minor measures against fringe benefits and corporate tax avoidance. ~~as [illegible]~~

~~10. This is not an easy Budget, for a number of reasons. But overall and to a great extent in detail what I propose will not be out of line with what most commentators expect. Although the detailed measures will be attacked on the grounds I describe, I am convinced that overall this is the right approach in both economic and political terms.~~

9. I attach ~~[illegible]~~ a summary of the costs of all the individual proposals, together with a commentary by officials.

~~[illegible]~~

10. I shall send you a separate note on the Oil Taxation proposals ~~by which Nigel Lawson~~ which I have agreed with Nigel Lawson

4 March 1983
ALAN WALTERS

BUDGET - SECRET

7

PRIME MINISTER

THE BUDGET

Personal Taxes

The Chancellor's proposals for Rooker-Wise plus 8½% on all thresholds together with the increase from April 1983 in the upper earnings level for NIC (from £220 to £235 a week) creates some opportunities for opponents to attack the Budget.

Raising of the upper earnings level and NIC means that tax plus NIC will be greater in cash terms in 1983/84 than in 1982/83 for many of those who fall in the earnings range from the UEL (upper earnings limit) to the top of the 1982/83 basic rate band. The increase of Rooker-Wise plus 8½% reduces the cash loss but does not eliminate it. ~~(See Annex 1 attached.)~~ Furthermore, even if we increase the thresholds by Rooker-Wise plus 10% it will only reduce the loss slightly. Indeed to make sure no-one loses requires more than Rooker-Wise plus some 20+%.

This comparison, however, is on stable earnings from 1982/83 to 1983/84. If we allow an average increase in the rate of earnings of, say, 6½%, then the number who lose and the amount of loss falls very considerably. But it is not entirely eliminated even under the Rooker-Wise plus 10%, although in that case on my calculation the loss will be less than 20 pence per week for Rooker-Wise plus 10% and about 40 pence for Rooker-Wise plus 8½%.

The lesson is that with our present UEL arrangements combined with the standard rate band, we cannot produce a threshold adjustment in the system which will ensure that no-one can lose. Certainly this is true on static money incomes (that is to say reduced real incomes) and even under conditions where money earnings increase by 6½% per annum, there are some losers.

NIS

The Chancellor is proposing another ½% reduction on the usual grounds that industry put it first and that we are committed to abolition. I suggest that in view of the reductions in interest rates and sterling, we might now regard the NIS as the "optional extra". If, therefore, there is a sudden fall in the oil price, or

/some similar

some similar revenue reducing event, we could eliminate the NIS reduction from the package. This will give a revenue saving of £220m in 1983/4 and £400m in 1984/5.

Corporation Tax, etc

The changes here are small, in revenue terms, but they do hang together with the small firms and enterprise package. I think it would not be wise to try cheeseparing here. All the other changes are quite small in terms of revenue, except for construction, and there is a good case for the building and contracting industry.

Summary

I think that the budget is broadly along the lines which you wanted. I wish we could have done more on thresholds, but RW + 8½% is as far as we can prudently go.

AW

ALAN WALTERS
4 March 1983

6

PRIME MINISTER

So am I. Must see the Chancellor - on Monday. MT

1. Please see a number of minutes from the Chancellor; and one from Alan Walters.

2. I am shocked at the extent to which the NIC increases announced in the Autumn Statement offset the generous threshold increases the Chancellor is proposing. In spite of the threshold increases many (single) people will be paying more in tax - plus - NIC next year than they did this year. An earlier draft of the Chancellor's minute (not intended for No. 10) had the following example: "a married man on £12,000 a year will gain £6 in 1983-84; a single man or one on a contracted-out NIC scheme will lose at that salary level [By contrast, a married man on £30,000 will gain some £600 (or £750 if he has a mortgage of £30,000 plus)]".

3. I have enquired about the threshold increases which would be required in order to reduce the burden of taxation plus NIC (i.e. income tax + NIC as a proportion of gross earnings) below the level before May, 1979. At indexation plus 8½ per cent the burden of tax will be higher than in May, 1979 after the Budget for single and married people at half-average earnings, average earnings and twice average earnings. I have not enquired above this level. Indexation plus 10 per cent would just maintain the burden unchanged from 1979 for those on twice average earnings but the burden would be increased for all those less well off.

4. If you cut out the ½ per cent NIS reduction (after all, there will be a NIS reduction anyway in April, as announced in the Autumn Statement) you would have £200 million to apply to threshold increases - it would enable you to go up from indexation + 8½ per cent to indexation + 10 per cent. Still not enough, I fear, to enable you to demonstrate that you had reduced the burden of taxation since the Election. And you may need the NIS £200 million yet to repair the hole in the Budget which would be caused by a reduction in the oil price to, say, $28 a barrel.

MCS

4 March, 1983

Prime Minister

Agree to this modified proposal?

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

PRIME MINISTER

No - it would have to extend to the end of the child's education. Otherwise you will have hundreds of children being removed from independent schools. Your proposals are a harsh and thoroughly inhumane provision.

MW 4/3

HOUSE OF LORDS DECISION - WICKS v FIRTH,
JOHNSON v FIRTH
EMPLOYER SCHOLARSHIPS

I sent you a copy of my letter of 23 February to Keith Joseph in which I explained why I thought it right to introduce a provision to tax parents on the benefit of scholarships which come to students because of their parents' employment. You will have seen from his reply of 3 March that Keith acquiesces.

(attached)

2. Michael Scholar has reported your concern, and I do of course accept that action on this point will be disappointing to the people directly concerned. But I really don't think it can be represented as action against middle income groups. We are here concerned with a highly selective benefit available only to the lucky and relatively few whose employers are in a position to arrange their remuneration in a particular way to help with education costs. What is more, as I explained in my longer minute to you today, the Budget as a whole will be criticized as very favourable to those on larger incomes. Against this background, we would be open to severe criticism if we did not act now to deal with this well publicised tax advantage - which is, quite frankly, unfair.

3. As you know,

3. As you know, to avoid causing hardship to those parents currently benefitting from these scholarships, I had it in mind to provide for a period of grace to the end of the present academic year. On reflection, I think that this period might be rather too short, and I am prepared to extend it for existing beneficiaries to the end of the next academic year, 1 August 1984. But I think I must proceed with legislation in the Finance Bill on that, more generous, basis.

John Kerr p.p.

G.H.

4 March, 1983

written by the Chancellor, signed in his absence.

Prime Minister

MES 4/3

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

PRIME MINISTER

NORTH SEA FISCAL REGIME

You will wish to know what changes I have in mind for the North Sea fiscal regime in the Budget. They have been fully discussed, and agreed, with Nigel Lawson.

2. My proposals reflect the changed prospects for oil prices. They also benefit from detailed consultations with the industry.

3. Nigel and I have concluded that it is important to concentrate on most cost-effective ways to encourage new development. Existing fields are still, by and large, earning good profits. New fields, by contrast, are likely to be smaller and more complex and therefore generally less profitable.

4. My main proposals are as follows:-

a. First, I intend to help current oil company cash flow, and so give some modest assistance to financing new activity, by phasing out Advance Petroleum Revenue Tax (which advances PRT into the early years of field life) between now and the end of 1986. This has been a major bone of contention with the industry.

b. Second, to encourage exploration and appraisal of new projects, I propose to enable companies to claim immediate PRT relief against any existing field for expenditure after Budget Day on exploration and appraisal.

This would give immediate tax relief worth up to 75p in the £ for such expenditure.

c. Third, and most importantly, for new fields, (which will be defined to include the two N Alwyn and Clyde field, approved within the last year), I propose to double the PRT oil allowance and Nigel Lawson proposes to use his powers to waive royalties. These measures will mean that future fields will pay no special taxes before they have recovered their costs; all taxes will be based on profits; and only corporation tax will be payable on production below 1 million tonnes a year. On the future fields we looked at, this brings the average rate of tax down from over 70 per cent to around 60 per cent.

At this stage we are not extending these reliefs to future onshore or Southern Basin fields because the present evidence suggests that they are likely to be pretty profitable. But I have agreed with Nigel that, so far as Southern Basin fields are concerned, we will be ready to review the position with the industry since the evidence we currently have on their economics is very sparse. If we are convinced that there is a case for extending these concessions to the Southern Basin, we would do so for fields approved for development after Budget Day 1983.

d. Fourth, following last May's consultative document, we would introduce new PRT rules giving full and immediate relief on assets shared between fields (such as pipelines). As a corollary we would bring any related receipts such as pipeline tariffs into charge for PRT. In order to prevent the charge on tariffs discouraging sensible and desirable sharing arrangements for linking in new smaller fields to existing facilities, I am proposing an exemption for the first ½ million tonnes throughput a year for each different user field. This would be increased on a transitional basis to ¾ million tonnes a year for five years for receipts under tariff agreements made before May 1982.

5. These proposals will cost £115 million in 1983/84 and represent a total package of reliefs of over £800 million over the next four years (subject to last minute changes in the forecast). They go a long way to meet the industry's pre-Budget representations, particularly those which they appeared to regard as particularly important.

6. Clearly no tax measures can be guaranteed of themselves to keep up the level of development, particularly at a time when the future of oil prices is so uncertain. And the industry itself recognises that it needs to work on new technological advances to reduce the costs of development of small deep water fields. But I believe these should provide effective, well targeted, fiscal incentives. They go as far as we should - within the overall Budgetary constraints - to meet the industry's concerns.

7. I am copying this to Nigel Lawson.

(G.H.)
4 March 1983

COPY No 1
5

Prime Minister
To note
MCS 4/3

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

3 March 1983

Dear Geoffrey.

1983 BUDGET AND SOCIAL SECURITY UPRATING: OTHER ITEMS

I have written separately about the outstanding issues on the 1983 uprating. This leaves a number of awkward or unresolved items: it may be helpful if I list these, since you may well be tackled on them.

The first is the pensioners earnings rule. As I said in my Budget letter of 4 February, this seems likely to be a Manifesto promise on which we shall not have made progress in this Parliament; and it is one to which Opposition parties are drawing attention. During previous discussions last autumn in the public expenditure context we had hoped to be able to make a further move on this by raising the earnings limit significantly at the November 1983 uprating from £57 to £97 a week at a cost of £18.5 million in 1983/84 and £44.5 million in 1984/85. That has now fallen by the wayside, and there is no provision to do anything in November 1983 beyond the normal uprating of the earnings limit.

The normal uprating arrangements will not get us very far. The public expenditure provision is for the earnings rule to go up in line with prices. (Arguably, the comparison should be with earnings but this could not in any event be allowed for in the public expenditure figures because we do not have earnings assumptions in the same way as we have price assumptions.) If we have an uprating of 4 1/4 per cent, it would produce an increase of £2.40 from £57 to £59.40.

You and I (and the Prime Minister) may well be pressed hard on this. There is provision in the forward public expenditure figures for 1984/85 and 1985/86 for abolishing the rule in two annual stages, starting at November 1984. I believe that the least we can do, if

COPY No 1.

E.R.

nothing extra is possible in November 1983, is to make an announcement that it remains our intention to move on this at the beginning of the next Parliament and that we have made the necessary provision in the social security programme. Indeed, you may like to say this yourself in the Budget speech.

Second, there is the question of tax relief on national insurance contributions paid by the self-employed. I set this out fully in my letter of 4 February. In the absence of some concession here we shall have nothing to offer as a result of the review we have conducted following a promise in the last Manifesto. Is there anything else we could do for self-employed people? We shall be in a very exposed position without anything to show for our Manifesto promise to review the position.

Last, but most important, we are bound to come under pressure for a statement of our longer term policy on protecting the interests of pensioners and other beneficiaries in the next Parliament. As you know, a number of voluntary organisations wrote to the Prime Minister on this very point last month. (I attach a copy of the letter for convenience.) So it seems almost certain to be raised during the Budget debate - possibly immediately after your statement.

(not attached)

There seem to me to be two possibilities:

- We say that we stand by what we said in this Parliament - that we will maintain the value of pensions and related long term benefits.

- Alternatively, we reply to the effect:

  "With the backing of a satisfactory method of uprating we shall continue during the next Parliament to protect the value of pensions and other benefits subject only to overriding economic circumstances - a qualification which must apply to any Government policy in any area."

We shall need to consider carefully whether we could sustain this second approach. Any qualification (however worded) presents problems. I think it is important that we give this consideration both in the light of the letter to the Prime Minister and the Budget debate.

I am copying this to the Prime Minister.

Yours ever
Norman

NORMAN FOWLER

1

DEPARTMENT OF EDUCATION AND SCIENCE

ELIZABETH HOUSE, YORK ROAD, LONDON SE1 7PH

TELEPHONE 01-928 9222

FROM THE SECRETARY OF STATE

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

3 March 1983

Dear Geoffrey,

I did not earlier answer your letter of February 23rd because I had the day before it reached me in fact spoken to you of the Wicks v Firth case and asked you to let the outcome of the House of Lords decision stand - to help private schools and those who use them. You had explained to me the factors set out in your letter and I had - so far as education is concerned - accepted that the decision is one that can best be made in the light of all the other interacting decisions involved in the Budget. I have now seen the Prime Minister's reaction.

Naturally I regret the disappointment that reversal of the Lords' decision will mean to those people concerned and to private schools. But I accept that they can fairly be asked to judge the effect of the total package upon them.

I am sending a copy of this letter to the Prime Minister.

Ever,

Keith.

BUDGET SECRET 3 March 1983

£ million indexed costs

	1983-84 PSBR	1983-84 REVENUE	1984-85 PSBR	1984-85 REVENUE
Individuals				
Personal Allowances	1010	1170	1060	1490
Social Security	75	125	190	320
Industry				
Corporation Tax	35	40	60	70
Oil	105	120	85	100
National Insurance Surcharge	200	220	300	400
Small firms	30	35	130	155
Technology	25	40	50	80
Construction	75	110	65	110
Unemployment	25	55	40	75
Specific Duties				
Various changes, net	(10)	(10)	(10)	(10)
Other				
Miscellaneous measures	5	5	(30)	(40)
	1575	1910	1940	2750

Note 1: The measures include both tax and public expenditure elements. For tax the costs shown are the excess over indexation; for public expenditure the excess over what is already provided in the Public Expenditure White Paper.

2: The figures shown are rounded and may still vary marginally. The specific PSBR costs shown for each group of measures is necessarily approximate.

Treasury Chambers, Parliament Street, SW1P 3AG

TO ALL MEMBERS OF THE HOUSE OF COMMONS

Dear Colleague

I am writing to you to explain some events in relation to personal tax reliefs and allowances which by coincidence are all happening at about the same time. I am doing this in order to help you in replying to your constituents if they find events confusing and write to you. There are really four separate things happening coincidentally.

First, the PAYE code numbers for 1983-84 include an adjustment to recover the excess of mortgage interest relief given during 1982-83. The allowances for mortgage interest relief included in PAYE codes for 1982-83 were calculated on the basis of the building society interest rates in force at the time. But during the course of the year these interest rates fell twice. Corresponding adjustments were not made in the PAYE codes. This means that the original estimates of relief in PAYE codes were too high, and insufficient tax has been deducted during 1982-83. The adjustment to 1983-84 codes is necessary to recover the excess relief given in 1982-83. Nonetheless the reduction in interest payments still leaves everybody better off.

Second, from April this year the new system of giving mortgage interest tax relief at source starts. The change is entirely an administrative one. Until now, borrowers have been getting their tax relief for mortgage interest either through PAYE or their tax assessments. From April, most borrowers will get their tax relief instead by making lower mortgage payments to their lender. At the same time, they will find their tax payments going up because the relief is no longer given through PAYE or tax assessments. The net effect will be to leave borrowers in broadly the same position as before; and I emphasise that there is no change in the entitlement to mortgage interest relief for taxpayers. Indeed, one benefit of the new system of giving relief is that for most borrowers the kind of adjustment to collect excess relief mentioned above will not be necessary in future years, because the relief will be given in the calculation of the mortgage payments and not through PAYE.

Third, under the new scheme, some mortgage lenders will propose to borrowers with repayment mortgages a switch from their present repayment basis - constant gross payments - to a constant net repayment basis. The constant net repayment basis costs a little more in the earlier years but a little less in total over the life of the mortgage. Borrowers do not have to accept the proposal and may choose to make lower payments.

I have had some notes prepared on these three topics which I hope will help you to answer most of the questions raised by your
... constituents. I enclose some copies which you may find helpful at surgeries or with correspondence. If you would like more copies the Vote Office have a supply.

Fourth, the Chancellor announced in his Budget that personal allowances will be increased by 14 per cent. This will result in a reduction of taxation for your constituents, from May 1983.

All of these factors may produce some fairly major changes in your constituent's PAYE codings over the next two or three months. Equally they must be seen alongside the fact that their mortgage payments declined three times - on the two occasions of the two falls in interest rates in August and November last year, and in April when the switch to giving tax relief at source is made.

Overall everyone should be better off as a result of all these changes, (although some more than others depending on whether they switch to the constant net repayment basis). I append a diagram in pictorial form showing the precise sequence of events from the first interest rate fall for which no general coding adjustment was made until the benefit of the Budget changes comes through in May. The figures given are illustrative only and are for a taxpayer with around average gross earnings of £750 per month on the basic rate of tax with a mortgage of £16,000 (the average new mortgage at the beginning of 1982-83). For mortgages greater or lesser the figures will vary accordingly.

Sometimes taxpayers will wish to raise more particular questions about their own circumstances. In that case, I am sure that either the taxpayer's own tax office or his lender (depending on the nature of the question) will be happy to try and clear the points up. And of course do write to me in cases of difficulty.

Yours sincerely

Nicholas Ridley

NICHOLAS RIDLEY

A. MORTGAGE INTEREST AND TAX RELIEF : THE NEW ARRANGEMENTS

From April 1983 most borrowers will be getting their tax relief on their mortgages in a new and simpler way. Instead of getting that relief in their PAYE codings or tax assessments, as they do at present, most borrowers will get tax relief at the basic rate by making lower mortgage payments to their lender. The borrower's payments will go down because tax relief at the basic rate of 30 per cent will be taken off the interest part of the mortgage payment. But because the borrower will no longer be given an allowance for the interest in PAYE codings or assessments, the amount of tax he/she pays will go up. The change is administrative. It does not affect the tax relief rules or the amount of the relief, only the way in which it is given. Borrowers entitled to relief will still get all the relief which is due on their interest payments.

Why is the change being made?

The main reasons are to make the system simpler and more efficient. Frequent changes in interest rates have made it difficult to give the correct relief through PAYE, and taxpayers often overpay or underpay tax. With the new system, the right amount of relief can be given at once, even if interest or tax rates change, without involving the tax office. This is better for the borrower and has the added benefit of enabling administrative savings in the Inland Revenue - about 1,000 staff by April 1984 - from which taxpayers generally should also benefit.

Is everyone affected by the change?

Although most borrowers will be affected, some will be outside the scheme. For example, some borrowers whose loans are above the tax relief limit will find that their relief will still be given by their tax office. This is because their lender has exercised its option to keep loans above the tax relief limit outside the scheme. And although the major lenders are within the scheme, some lenders - mainly those bodies for whom mortgages form a small part of their business, and private lenders - will remain outside. Borrowers with those lenders will, of course, continue to get their tax relief through their PAYE codings or assessments as they do now.

Will borrowers still get the higher rate tax relief to which they are entitled?

Yes. Because only basic rate relief can be given under the new system, those entitled to relief at the higher rates will continue to get that relief through their PAYE codings or tax assessments. The mortgage interest paid will, of course, still be taken into account in determining whether a taxpayer is in fact liable to tax at the higher rate.

Does the scheme only affect mortgages?

No. Some improvement loans which qualify for tax relief will also come within the scheme. The scheme can also apply to certain loans used to purchase an annuity by a borrower who is over the age of 65.

Will borrowers be obliged to pay more?

No. At present, except for endowment mortgages, the net cost of a mortgage gradually increases, because as the capital debt is paid off, the interest element in the monthly payments goes down and so the tax relief also goes down. Under the new scheme, some lenders, notably the building societies and local authorities, may propose a change in the way borrowers pay back their loans, so that future net payments remain constant, except when interest or tax rates change. Compared with the present pattern, the borrower's payments would be slightly higher in the early years and slightly lower in later years. The legislation permits the lender to propose this change, but it also gives existing borrowers the right, if they wish, to keep their payments at a lower level (the amount they would have had to pay at the beginning of 1983/84 if the lender had not proposed the change).

Lenders who wish to propose this change have to notify individual borrowers, and the borrower will then be able to see what his options are and decide.

Are option mortgages affected by the change?

Yes. The option mortgage scheme comes to an end on 31 March 1983. For those with an option mortgage, the subsidy will normally be replaced by the benefit of tax relief, whether or not they pay tax. After March, an option borrower will become like, and have the same rights as, any other borrower. In general, option borrowers are likely to find that their payments will be little, if any, different under the new scheme. The individual borrower will hear from his lender how he is affected and what choices he may have.

How will people know whether they are affected?

Borrowers should hear from their lenders, who will tell them whether and exactly how their payments are affected.

B. THE 1982 FALLS IN MORTGAGE INTEREST RATES

Why are PAYE codes for 1983/84 being reduced to recover mortgage interest relief for 1982/83?

Allowance for mortgage interest relief in PAYE codes for 1982/83 were originally calculated on the basis of building society interest rates in force at the time. But during the course of 1982, mortgage interest rates were reduced. This means that the original estimates of relief in PAYE codes were too high, and insufficient tax was deducted during 1982/83. The purpose of the adjustments to 1983/84 codes is to recover the excess relief. An important benefit of the new system of giving relief is that for most borrowers this kind of adjustment will not be necessary in future years because the relief will be given in the calculation of the mortgage payments and not through PAYE.

Why were PAYE codes for 1982/83 not adjusted when interest rates changed?

When PAYE codes are adjusted, they operate to correct the tax position from 6 April to the date of their operation. Where, as in the case of the fall in interest rates, allowances are reduced, the results can be heavy deductions of tax on the first pay day the new code is applied. To avoid heavy deductions, reduced codes are usually applied only from the date they are received; arrears are not collected during the year but in a later tax year. If codes had been adjusted in August/September, they would have been applied only from the date of receipt. There would still have been arrears to recover in 1983/84.

But it was clear in August 1982 that there would be a second reduction in interest rates (this was announced on 12 November 1982). Any recoding in August/September would have been incorrect by December. All the calculations of arrears would have had to be revised and would have been confusing to the taxpayer.

Because only part of the arrears could have been recovered in 1982/83 and this at the cost of confusion for the taxpayer, it was decided to make one comprehensive adjustment in 1983/84.

Borrowers should remember that the reductions in their mortgage interest in August and November 1982 were, of course, larger than the resulting reductions in tax relief.

CHANGES IN MONTHLY INCOME AFTER INCOME TAX AND MORTGAGE PAYMENT

NOTES

1. The diagram overleaf is illustrative only. The timing and size of changes will depend on the precise details of an individual's mortgage and income tax position.

2. The diagram illustrates the position of a married PAYE taxpayer with gross monthly income[a] of £750 (a little over average earnings), with a 25-year term repayment mortgage of £16,000 taken out at the beginning of 1982/83. (£16,000 is around the level of the average new building society loan at that time; the average <u>outstanding</u> mortgage is lower, about £10,000.) The solid black line on the diagram represents the amount of monthly income after income tax and mortgage payment. From April 1983 it applies to the borrower who stays on the gross payment profile. The broken line (-.-.-.) represents the same amount for the borrower who in April changes to a 'constant net' payment profile.

3. The shaded areas labelled 'Excess Relief' represent that part of the increase in net income which would not have occurred had it been possible to change tax codes in 1982/83 to reflect fully and immediately the reduction in interest rates leading to a fall in the amount of interest actually paid.

4. Two offsetting changes in net income are shown for April 1983. (The timing of these two events will vary from individual to individual, according to the date of their mortgage payment and pay day.) —

(i) An increase associated with the fall in mortgage payments resulting from the new tax relief arrangements (MIRAS). These will amount to £40 for a borrower who maintains the former 'constant gross' repayment profile and £32 for a borrower who changes to a 'constant net' profile; and

(ii) a decrease (of £60) due to the larger tax deductions from the pay packet.

5. The £60 reduction in tax relief consists of three components:

(i) £40 arising from the removal of mortgage relief from tax codings (at the new 10 per cent rate). This is counter-balanced by the reduction in mortgage payments.

(ii) £14 reduction in the relief due on interest payments from April (reflecting the fact that the current 10 per cent rate of interest will apply).

(iii) £6 recovery of the excess relief given in 1982/83 (corresponding to the shaded areas) when relief was given on 13½ per cent interest rate, although the actual rates had fallen successively to 12 per cent and 10 per cent.

6. Amounts are shown to the nearest whole £.

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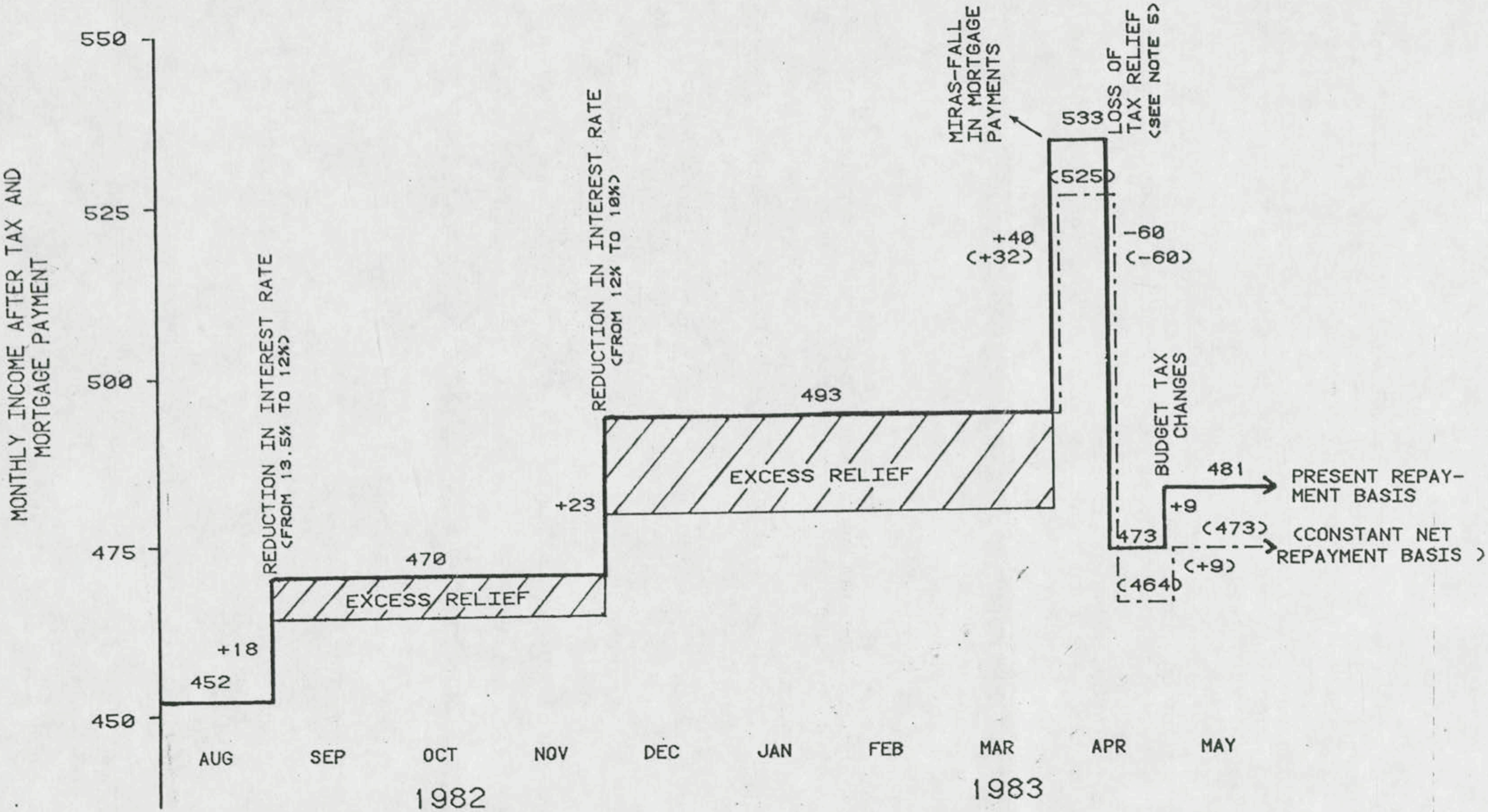
[a] The changes in (but not the levels of) net income would be the same for any married man with a mortgage of the specified amount paying tax through PAYE and liable to tax only at the basic rate.

CHANGES IN MONTHLY INCOME AFTER TAX AND MORTGAGE PAYMENT (SEE NOTES OVERLEAF)



J F Chown and Company Limited

Capital House
42 Weston Street
London SE1 3QD

Directors
J F Chown
J F Staddon
J R Dewhurst

Telephone 01 403 0787
Telex 883571
Cables Intertax London SE1

Professor Alan Walters,
10 Downing Street,
LONDON, SW1.

3rd March, 1983.

JFC/PJP

Dear Alan,

For information as requested. Everything seems under control.

I shall be in your old stamping ground, Washington, most of next week catching up on their problems by way of light relief from ours.

With best wishes,

Yours sincerely,

John F Chown

Enclosure

J F Chown and Company Limited

ADVANCE COPY

1st March 1983

"TAXATION OF INTERNATIONAL BUSINESS"

JOHN CHOWN, JOHN DEWHURST, STEPHEN RUMBALL

After two years of discussion, this year's UK Finance Bill will include provisions to tax the income of certain foreign subsidiaries of UK companies. This analysis of the latest draft Clauses is for the guidance of clients of J F Chown and Company Limited.

I INTRODUCTION

A new set of draft Clauses has now been published. They provide for the current taxation of UK corporations in respect of the undistributed profits of certain 'controlled foreign companies' in 'low tax jurisdictions'. No immediate proposals are made on 'company residence' and 'upstream loans' but there are important comments (discussed in Parts IV and V) which need to be watched by the business community. It is no longer proposed to abolish Section 482 (not to be confused with the US Code section of that number).

MS

The new proposals are a great improvement on earlier versions and are now published with a preface by Mr John Wakeham, Minister of State at the Treasury. It is thanks to his personal, energetic and intelligent intervention that we may now have, at least, a firm base for detailed consultation.

Although further representations were invited there was little chance for further consultation before the 15th March Budget. The Clauses, are expected to be introduced in the 1983 Finance Bill with an effective date of possibly 6th April 1983 but more probably 6th April 1984. This paper is an analysis of the proposals mainly for the benefit of clients and correspondents. We draw attention to some technical points - readers can assume that these will be taken seriously and may be reflected in the version which emerges from the Parliamentary scrutiny of the Bill.

We indicate where the new proposals differ significantly from the original. This should bring home to new readers (rather more forcibly than the bland prose of the document itself) the full horror of the unlamented original. The business community should remember that its authors are still at large: 1983 may be an election year and a new government could well 'buy' the original package. Meanwhile, foreign financial institutions looking forward to the emasculation of UK based competition may not have all their hopes fulfilled.

There have for many years been provisions (now sections 478 - 481, Taxes Act 1970) by which UK resident individuals can be subject to tax on income arising to companies, trusts and other entities abroad for their benefit. Following the 'Vestey' case the law was changed (both to close a loophole and to limit the Revenue's overkill powers) by the Finance Act 1981.

Another consultative paper is promised on the tax treatment of non-residents operating in the UK. We do not discuss either topic here.

Part II below sets out the history and background leading up to this paper. Part III is a detailed analysis of the actual proposals, while Parts IV and V draw attention to some serious threats still contained in the comments on company residence and upstream loans.

II BACKGROUND

In our 'Finance Act 1982' memorandum last year (copies still available) we drew attention to two conflicting aspects of recent tax legislation. The 'positive thread' was represented by the elected government's determination to restore the economic conditions necessary for prosperity, stability and growth. The 'negative thread' was represented by the preoccupation of the Inland Revenue with so-called tax avoidance and with highly technical measures drafted by civil servants with a less than whole-hearted commitment to the free enterprise system.

We are delighted that policy on 'International Tax Avoidance' (to use the provocative title of the earlier papers) now appears to be under Ministerial control.

UK companies expanding abroad had until recently to contend with two sets of administrative restrictions: exchange control (now happily abolished) and Section 482 ICTA 1970. The latter prohibits a wide range of normal international transactions by UK companies without prior Treasury consent. Originally enacted as an emergency measure, it is unusual in tax legislation in imposing specific criminal penalties. The end of exchange control strengthened the case for also getting rid of this archaic provision. Although it had been fairly liberally administered in recent years, it gives an unacceptable degree of administrative discretion over the normal and proper affairs of international business.

It was generally recognised that the abolition of Section 482 might facilitate certain types of international tax avoidance and ministers authorised the Revenue to make recommendations. Both the original proposals themselves and the Revenue attitude in putting them forward were widely criticized by a remarkably broad section of the business community.

International tax is a small profession: the specialist independent advisers and the heads of tax of the major multinationals tend to know each other pretty well, and to know what is going on amongst reputable companies world wide. We were frankly puzzled by the Revenue attitude: we were genuinely not aware of the type of abuse of which they complained. Recent events, though, suggest that the Revenue may have seen (and misinterpreted) transactions with tax havens which constituted not tax avoidance (or even evasion) but simple old fashioned fraud. This conjecture certainly makes their attitude more explicable.

On 26th January 1981 the Revenue published a consultative document. The Institute for Fiscal Studies organised a seminar to discuss this on 3rd March, 1981, and various representative bodies made critical submissions. (See 'Taxes International' July and August 1981.

In November, 1981 the Inland Revenue produced draft Clauses for the 1982 Finance Bill. This document known as the "Yellow Peril" dealt with three subjects: company residence, tax-haven subsidiaries and upstream loans. It took little account of the representations submitted and there was a storm of protest. Again the Institute for Fiscal Studies played a substantial role, organising a seminar on 3rd March, 1982 a year after the previous one, and with the same three speakers: John Chown, Alun Davies and Kenneth Evans.

Following these pressures, the Chancellor announced in his 1982 Budget that the proposals would be deferred for a year. The Institute for Fiscal Studies then set up its Working Party under the chairmanship of Mr Edmund Dell. Meanwhile an Inland Revenue letter of 4th June 1982, apparently intended to be conciliatory, did little to cool tempers. It also hinted at an attempt (since withdrawn) to extend the "tax haven" concepts to capital gains as well as to income.

The Dell Report was regarded, even by those who had commissioned it, as 'wet'. The IFS held another seminar at which the 'opposition' to Dell was represented by Margaret Erskine and John Chown. (FN: See 'Taxes International' November 1982).

There are in fact substantial changes and, specifically, Ministerial influence has ensured that the new paper gives proper regard to the effect on international competitiveness and the position of London.

The new paper argues (paragraphs 19-21) against the case some of us had made, 'that it was inappropriate to seek to take action on company residence, tax havens, and upstream loans separately. Instead the issues should be considered as part of the wider debate on the corporation tax green paper or double taxation matters generally'. The Revenue arguments, sound enough in context, miss the point. There are anomalies favouring business and adversely affecting the Revenue. There are also those, involving very large sums of money, which adversely and inequitably affect international business. The same priority should be given to dealing with both: it is simply not acceptable to push forward with closing loopholes while postponing indefinitely relief for serious tax traps remaining in present legislation.

There is a practical point here. Tax traps recruit tax avoiders. Many reputable companies have refused to be a party to anything even approaching 'tax avoidance' (never mind 'evasion') and have been reluctant to take specialist international tax advice, even at an elementary 'check up' level. Having been caught in the 'foreign loan' or 'ACT prejudice' trap they tend to become enthusiastic tax planners, determined to get 'some of their own back'. The unfortunate tone of the earlier Revenue papers did nothing to deter the flow of recruits. We hope that the Revenue will now succeed in re-establishing the traditinal good relationship with corporate taxpayers.

III TAX HAVEN COMPANIES

The draft clauses cover only one of the three topics dealt with in the November 1981 draft. (There are generalised threats on 'company residence' and 'upstream loans', and we deal with these briefly in Sections IV and V.) Further representations have been sought but the real (and possible final) opportunity for scrutiny and amendment will be during the Finance Bill debates.

SUMMARY

Briefly, where an overseas company is under UK control (a 'controlled foreign company' - 'CFC') and is subject to a 'lower level of taxation' in its country of residence, the Inland Revenue may direct that 'notional UK tax' be apportioned to any UK company which, with 'persons who are connected or associated' with it has at least a 10 per cent stake in the overseas company. No direction may be made if the tax paid by the overseas company in its country of residence is at least half the amount that would have been payable in the UK had it been resident here (ie, it does not enjoy 'a lower level of taxation') or if the overseas company is engaged in 'exempt activities' or makes an 'acceptable distribution' to the UK parent of a proportion (generally half) of its profits or if it satisfies a 'motive test'.

The precise meaning of all these technical terms is, of course, vital. We discuss each of them below.

The Revenue paper (paragraph 23) draws attention to five ways in which UK companies are said to be using low tax countries to minimise tax.

i) 'Money box' companies
ii) 'Dividend trap' companies
iii) Offshore captive insurance companies
iv) Sales, distribution or service companies
v) Patent holding companies

DEFINITIONS

The legislation only comes into play at all if there exists a UK company which has an assessable 'interest' in a 'controlled foreign corporation'.

There are no material changes in the definition. A CFC will be a company under the control of one or more UK residents. "Control" follows the broader Section 302 definition (Clause 9(3)). This gives a variety of alternative tests and includes the words 'is entitled to acquire' which can catch option or trust arrangements. The profits (but not chargeable gains - the threats in the 4th June letter have lapsed) of such a company may be computed in accordance with UK principles and apportioned to any UK resident company (or other person) having an 'interest' in the company. Apportionment will be made only to any UK person entitled (with 'associates') to at least 10% of the profits. In contrast with the US practice all shareholders however small their holding will be taken into account, with no "de minimis' provision, in determining whether UK residents have control.

'Notional UK tax' (NUT) can be apportioned not only among shareholders as such but also among those who at any time during the relevant accounting period have 'interests' (broadly defined) in the CFC (Clause 2(5)).

LET-OUTS

Even if a company is 'prima facie' a CFC, it is still possible to invoke a number of let-outs. Two are closely related. No direction is to be made if the company is not subject to a 'lower level of taxation' (previously referred to as a 'privileged tax regime') or if it pursues an 'acceptable distribution policy'. These two tests in concept could mean that a UK parent can postpone about half its potential tax charge. It can either divert profits to a zero tax jurisdiction and pay half these profits as dividend or it can set up in a jurisdiction where the effective tax burden exceeds, by as small a margin as possible, half the UK burden. In practice we have to examine the precise rules, which turn out to be less favourable.

'Lower level of taxation'

A CFC is regarded (Clause 3) as enjoying a 'lower level of taxation' if the 'local tax' paid in its jurisdiction of residence (defined in Clause 2(1) and (2)) is 'less than one half of the corresponding United Kingdom tax on those profits'.

The original version made the comparison with a wholly artificial base from which many normal UK adjustments, such as capital allowances, were specifically excluded. The comparison is now in principle to be made on a consistent basis but there are still problems. (The concept of a notional UK tax (NUT) is again relevant - see below.)

List of countries

As a practical matter the Inland Revenue says it intends to

> "publish a list of countries which would not be regarded as low tax countries ..... Some of these countries will in no circumstances trigger a charge ..... For other countries it would be necessary to distinguish those companies which benefit from particular reliefs or allowances, which would be specified on the list." (page 20)

The business community is pressing for the list to be incorporated in the statute - or at least to be published as part of the consultative process. This may prove difficult in practice. Will the Revenue put EEC partners (such as the Netherlands) on a black list, even under the proviso?

The United States does not specifically designate territories although one let-out from the provisions is granted by reference to the tax regime of the country to which the profits arise.

Canada has an exclusion for countries with which there is a double tax agreement even though the current form of the agreement may have no specific provision governing it.

Germany excludes from the provision companies in jurisdictions where there is at least a 30% tax rate. It is not clear whether this is actual or potential tax. The wording of this provision is complex: there is an attempt to prevent "mixing in" of losses and tax credits from other sources.

Japan has a list of designated tax havens. France appears to have the same concept, but it is not yet clear whether the "list noire" under Article 238(A) is the one which will apply. (Article 238(A) applies a more than usually stringent "arm's length" test to interest, royalty and managerial fee payments to suspect territories.)

'Acceptable distribution' (Schedule 1 Part I)

A UK shareholding company can avoid a charge if the controlled foreign company distributed by way of dividend at least 50% (if it is a trading company) or 90% (if it is not) of its profits to UK residents within a reasonable time. The percentage is of the total profits regardless of the proportion attributable to UK residents. This would produce perverse and unacceptable results for companies with foreign minority shareholders. (See Schedule 1 Para 2(1)(c).) This anomaly is defended (unconvincingly) on page 47 of the preamble, and will doubtless be changed.

For the purposes of the 'acceptable distribution' test, the definition of 'available profits' specifically excludes chargeable gains (see Schedule 1 Para 2(4)(b)).

The test will not be satisfied to the extent that dividends are paid out of specified profits, (Part I Clause 2(1)(b)). This prevents a UK resident company from circumventing the UK's source by source double tax relief limitation rules. This will most commonly apply to a CFC which is a holding company. It might otherwise attempt to avoid an assessment by specifying that a dividend paid on to the UK is paid out of distributions from a high tax subsidiary rather than a low tax subsidiary. It would then be possible to satisfy the 90% test by remitting dividends which would not be liable to UK tax because of double tax relief and leaving unremitted dividends from low tax subsidiaries in the CFC.

The new draft clauses still do not contain a 'de minimis' or 'consent dividend' provision to cover the situation where there is a marginal failure to satisfy the acceptable distribution test. The result will be that the unwary will incur an assessment on a CFC, even when a substantial part of the profits of the CFC have been remitted to the UK in the form of dividends. In addition, no account will be taken of funds retained in the CFC to meet the needs of the business. In both cases, the 'motive' test is not an acceptable substitute for the omission of specific provisions.

In deciding whether a dividend was paid within a reasonable time, regard must be had to the length of time it normally takes for the foreign company's accounts to be prepared and for payment of a dividend to be agreed. It is stated in the text, (but not in the draft clause, which is all the courts could look at) that where a dividend is paid within eighteen months after the end of the period to which it related, the condition would be regarded as satisfied.

Exempt activities (Schedule 1 Part II)

The most complicated of the let-outs relates to the carrying on by the CFC of 'exempt activities' (clause 1(6)(b) and Schedule 1 part II). The premises, business establishment and management provisions are predictable and straight-forward. We need to watch the provision that "any services provided by the company for persons resident outside that territory are not in fact performed in the United Kingdom". (Schedule 1 paragraph 7 (b)). This, as worded, could adversely affect contracts entered into by the CFC part of the performance of which is sub-contracted to firms or individuals in the UK at proper arm's length prices. It would be clearer if the words 'by the CFC' were inserted after the word 'performed'.

'Exempt activities' cannot include leasing, dealing in securities (otherwise than as a broker) or receipt of passive income such as dividends, interest or royalties. Nor can the phrase include dealing in goods for delivery to or from the UK (unless the goods are actually delivered to the territory where the CFC is resident) or to or from connected or associated persons. There is no 'export trade corporation' let-out as in the United States.

'Exempt activities' also do not include the activities of a CFC engaged in 'wholesale, distributive or financial business' if 50% or more of the CFC's gross trading receipts is derived directly or indirectly from connected or associated persons. 'Wholesale, distributive or financial business' means wholesale dealing in goods, shipping or air transport, banking, trust administration, dealing in securities as a broker, dealing in commodities or financial futures and long-term insurance. There are specific provisions which deem banks and insurance to fall outside this exemption in certain circumstances.

Paragraph 4(2) of Schedule I purports to allow a CFC to satisfy the 'exempt activities' test where it has no country of residence for the purposes of the legislation. However, it uses 'effective control and management' rather than 'central management and control'. This new concept will have to be defined by the courts and it adds an undesirable degree of uncertainty.

Motive

Even if a CFC fails the 'acceptable distribution policy' and 'exempt activities' tests, the parent may escape a direction if it satisfies the 'motive' test. This is really a long-stop and it is perhaps unfair to expect the test to be both satisfactory and precise.

Under Clause 1(8), supplemented by Schedule 1 Part III the test is met if it appears to the Board that, having regard to the reasons why it did fail those tests, the transactions giving rise to the CFC's profits were:

a) carried out for bona fide commercial reasons and -

b) ....it was not the main purpose or one of the main purposes of the transaction to achieve a reduction in income tax, corporation tax or capital gains tax, and,

c) in so far as the existence of the CFC resulted in a diversion of profits from the UK, the diversion was not the underlying reason, nor one of the underlying reasons for the existence of the CFC.

The 'motive test' is extremely subjective and it appears that if one transaction fails, then the whole 'motive test' is failed. The third limb of the test (c) is a new obstacle which did not appear in previous versions. Rational business decisions must be taken in after-tax terms, and it is unlikely that (c) can ever strictly be satisfied. UK companies will seldom, if ever, be able to rely on the 'motive test' alone.

There is no reference here to the distinction between UK taxes and foreign taxes and the test does not recognise that the minimisation of the tax bill by legitimate means is part of commercial operations and indeed, a duty owed to corporate shareholders. Many CFC's are established to avoid or reduce foreign taxes, to avoid foreign exchange control rules or to avoid being forced into a UK or foreign tax trap because of the need to accept a foreign joint venture partner for local political or other reasons.

Paragraph 42 of the commentary explains that '... the charge would not apply where the objects and activities of the company were not directed towards achieving a significant reduction in UK tax.' The reference needs to be made explicitly in the legislation.

POWERS OF THE BOARD

The Board is given powers to obtain certain information relating to 'controlled foreign companies'. They may require a CFC's 'controlling company' to supply specified information within a prescribed period. In addition, they may inspect the relevant books and accounts of the 'controlling company' and any company under its control.

It is objectionable that tax should be levied at the discretion of the Revenue rather than in accordance with statutory rules. The 'motive test' proposed is at the discretion of the Revenue as is the legislation in general (Clause 1(1)). Prior experience with Section 460 ICTA 1970 indicates that discretionary powers do little or nothing to narrow the scope of legislation.

'NOTIONAL UK TAX' (NUT) AND CONSEQUENCES OF APPORTIONMENT

Where a company is 'prima facie' within the mischief of the provisions NUT must be calculated both to ascertain whether or not the CFC 'enjoys' a 'lower level of taxation', and to provide a basis for assessment. In principle the new proposals (unlike the old) broadly make a fair comparison of the local tax and the tax the CFC would have paid if it had actually been resident in the UK. There are still serious anomalies.

Clause 3(1) excludes from the calculation of local tax, any taxes which are computed on some basis other than profits. This is in line with the provisions on double taxation relief. Clause 3(2)(b) also excludes third country taxes, which, would be taken into account in computing double taxation relief. Since the CFC is assumed to be resident in the UK for the purposes of computing NUT, such third country taxes would be taken into account under the normal double taxation relief rules in computing the corresponding UK tax with which the local tax is being compared.

There is no provision for companies which pay little or no tax in their territory of residence because of losses brought forward from accounting periods prior to that in which the new charge first applies. Schedule 2 paragraph 2(2) does appear to allow any losses sustained by the CFC, after the first direction has been made by the Revenue, to be carried forward and set against a notional UK tax charge in the future. This is so even if no directions have been made in intervening years.

There are also potential problems (see page 35) on the timing of overseas reliefs in that an overseas territory may allow reliefs, such as capital allowances, in different years from those in which they would be allowed in the UK. This anomaly is dismissed in the consultative document on the grounds that in practice cases of this kind should be excluded from the charge, because the country in question would probably fall within the list of countries excluded from the new legislation. This is unsatisfactory.

An assessment may be made on a person who held an interest at any time during the accounting period (Section 1(3)(b)). There is no explicit provision by which an apportionment would take account of the fact that the interest was not held for the whole period.

Clause 5 deals with the rules for apportioning tax. The basis is to apportion tax rather than profits. This is justified in paragraph 48 but we would still argue that the provision is an attempt by the Revenue to 'evade' (or to be charitable to 'avoid') the provision of double tax agreements.

A UK company which is assessed on its apportioned share of a CFC's notional tax liability may claim to set certain reliefs against that assessment. Since only tax, and not profit is being assessed on the UK company, to the extent that it has an excess of relevant allowances over taxable profits for the appropriate accounting period, it may claim that tax at the appropriate rate on that excess be set against its liability to notional UK tax, (Schedule 3 Para 1(1)).

The relevant allowances which may be utilised in this manner are:

1. Trading losses (incurred in the relevant accounting period or carried back from a subsequent period).

2. Charges on income.

3. Management expenses.

4. Excess capital allowances, of the type given by discharge or repayment under the Capital Allowances Act 1968 S 74.

5. Group relief.

6. Surplus Advance Corporation Tax.

The normal six year time limit applies in accordance with Section 43 of the Taxes Management Act. In the case of group relief, the limit is extended beyond the normal two years to the end of the accounting period following that in which the assessment is made, if that is later.

Relief from a double tax charge is given by Schedule 3, Para 3(1) and (2). Therefore, when the NUT has been apportioned for a particular period to a UK resident company and the CFC pays a dividend wholly or partly out of its profits for that period, the NUT is treated as underlying tax paid in respect of the dividend and eligible for foreign tax relief. This relief is not confined to shareholders to whom notional tax has been apportioned and the normal rule that a shareholder must have a minimum holding of 10% to qualify for relief for underlying tax is suspended for this purpose.

Holding companies

In contrast with the original proposals, a holding company which derives at least ninety per cent of its gross income during the relevant accounting period from companies which it controls and which are throughout the relevant period engaged in exempt activities and resident in the same territory as the holding company will be covered by the 'exempt activities' test. (Part II, Para 5(3)).

This amendment is a result of criticism of the fact that holding companies could never satisfy the 'genuine trading' (now 'exempt activities') test. It has been recognised that many overseas holding companies are set up for policy reasons or to save foreign rather than UK taxes. An illustration of this principle is where a company has two subsidiaries, A and B in another country. Because there is no common parent in the country, A and B are not a 'group' for tax purposes. If A were to make a profit and B were to make a loss, they could not generally be offset. Clearly, a holding company would be essential in such circumstances and its function would be to reduce foreign, not UK taxes.

The present draft proposals exempt certain holding companies specifically under Para 5(3) or more generally under the 'motive' test. In the preamble to the clauses, it is provided that the 'motive' test will be regarded as satisfied where the main purpose of the holding company is:

(a) receiving dividends and interest from overseas subsidiaries as a mere 'staging post' in the course of reinvestment into the trading operations of the overseas subsidiaries concerned; or

(b) the holding of funds outside the source country for the purpoe of reinvestment into that country because of exchange controls, inflation, exchange fluctuations, political instability or the risk of expropriation.

These extra-statutory guidelines should be given statutory recognition and the reinvestment should not be confined to the subsidiary which has paid the income to the holding company. If the 'motive' test is applied in this manner, a limited amount of flexibility will remain. However, the extent to which 'money-box' activities will be exempted is now minimal and the reasons for the retention of funds will be closely scrutinised.

The constraints on holding companies are still far too restrictive. It is not acceptable that to satisfy the test, a holding company must derive at least 90% of its gross income from companies resident in the same territory as the holding company. In addition, the holding company, a passive creature by nature, must have a business establishment and be effectively controlled and managed in the territory concerned.

Interaction with Section 485

One of the justifications given for the draft clauses is that they will counter sales, distribution and service companies in low-tax areas. It is stated that '... companies may make little or no real contribution towards the business of the multinational. But by enabling selling, distribution or service profits to be attributed to the entity in the low tax area, such companies serve to reduce the amount of UK tax paid by the multinational.'

The Revenue already have the means to deal with any artificial diversion of profits in this way by using Section 485, ICTA 1970, the 'transfer pricing' section. This additional weapon in their armoury is justified on the grounds that:

1. S 485 does not apply to transactions between a low tax company and an unrelated company and,

2. S 485 does not apply to transations between two non-resident companies, whether related or not.

The Revenue have given no reasons to justify extending their powers to cover transactions between non-resident companies and unrelated companies.

BANKS AND FINANCIAL INSTITUTIONS

After many representations criticised the November 1981 draft proposals, the provisions relating to banks have been substantially modified. As a result, diverse and large scale banking activities will generally be outside the scope of the prospective draft legislation. However, it is clear that 'captive banks' and possibly finance subsidiaries remain a target.

The 'exempt activities' let-out is denied by Schedule 1 Para 5(2)(b) to

> '... a company which is mainly engaged in wholesale, distributive or financial business where less than 50 per cent of its gross trading receipts from that business is derived directly or indirectly from connected or associated persons.'

An additional requirement is contained in Schedule 1 Para 10(3). A company engaged in banking activities will be presumed not to satisfy the 50% rule if at any time in the accounting period, the persons in control of the company and/or persons connected with them have an aggregate 'capital interest' in the company such that the amount by which that interest exceeds the company's fixed assets is 15% or more of the amount by which the company's outstanding capital exceeds the fixed assets.

Loan Creditors

The Board may treat a loan creditor as having an 'interest' in a controlled foreign company if they think it appropriate - Clause 2(7). Such a direction is subject to a right of appeal under Clause 6(4)(c). The problem is further compounded by Clause 5(3) which gives the Revenue power 'if it seems to them just and reasonable to do so' to treat a loan creditor as having an interest in a CFC if the CFC is not a trading company. Clause 5(3) appears to conflict with Clause 2(7).

The main purpose of this provision appears to be to prevent those persons in 'control' of a CFC circumventing an assessment by becoming substantial loan creditors. It would otherwise be possible to set up a CFC with an artificial capital structure including a high debt/equity ratio. The loan creditor would then be able to divert profits in the form of interest repayments without ever suffering an assessment on the profits of the CFC.

By virtue of Clause 9(3)(b), a banker acting in the ordinary course of his business will not be regarded as a loan creditor. The preamble states that any arm's length loan creditor of a CFC will not be deemed to have an 'interest' in that CFC where either, the creditor was acting in the ordinary course of his business, or, neither the creditor, nor persons associated with him, had an interest (direct or indirect) in the company, other than the amount of the debt together with any interest payments. A greater degree of certainty is necessary here and these informal guidelines must be given statutory authority.

Captive Insurance Companies

The draft clauses on insurance companies have also been modified. However, they are still directed against captive insurance companies and against reinsurance or pooling arrangements for conventional insurance companies.

To satisfy the 'exempt activities' test, the insurance company must show that fifty per cent of its gross trading receipts are derived from independent sources. This rule is applied as follows, (Schedule 1 Para 10(b)):

1. Only receipts relating to commissions and premiums received under insurance and reinsurance contracts are to be taken into account.

2. Any return commission or premium is not to be taken into account.

3. Where a liability under an insurance or reinsurance contract is reinsured, in whole or in part, the premium attributable to that liability shall be treated as reduced by the appropriate proportion of the reinsurance premium.

IV COMPANY RESIDENCE

The original proposals to produce a statutory definition of 'dual residence' were widely criticised on the grounds that they would produce uncertainty and that, in the absence of proper transitional provisions, could have serious and inadvertent adverse effects. These have been dropped. However, Section 482 '(which amongst other things makes company migrations unlawful without Treasury consent)' is now to remain. 'The Inland Revenue will issue a statement of practice which will clarify the application of the present test of company residence' (paragraph 7).

A statement in the paper contains a lightly veiled threat for the future:-

> 'Section 482 does not apply where companies move to or are set up in the UK. There is evidence that UK multinationals are increasingly taking advantage of this to 'import' the losses or lowly-taxed profits of overseas subsidiaries. Thus a company making losses overseas may arrange to be treated as UK resident although its business activities are elsewhere. Under the group relief provisions the losses are now available to be shifted amongst other members of the group and so reduce the group tax bill as a whole. Similarly a company resident overseas which has accumulated profits and which may previously have transferred its business to a non-resident foreign subsidiary may transfer its residence to the UK and then, provided there is a group election in force, these accumulated profits can be distributed to the UK group members without any tax becoming payable' (paragraph 8).

Legislation is threatened to deal with these 'abuses'. The paper does not include any draft clauses dealing with these points. There is thus a generalised threat on which the process of consultation cannot properly be said to have begun. It would be quite unacceptable for the government to legislate on this without initiating such a consultative process.

We have already suggested a more appropriate approach to this problem. There should be no change in the definition of company residence and Section 482(1)(a) should be abolished. What is needed is legislation to modify the fiscal consequences of a change of company residence. We can draft detailed proposals.

In general the new provisions should ensure that a change of residence should neither give a once and for all tax advantage nor should it force a company which (maybe inadvertently or by the consequences of law) changes its residence into a tax trap.

Dell, in our view, missed the point on this one. See our comments in 'Taxes International' November 1982.

Section 482 requires administrative consent for far more than the change of residence of a UK company: prohibitions include the setting up of a new company overseas, the transfer of shares in and the issue of shares by such company and the transfer of a trade or business overseas. Since these provisions were designed to prevent what the proposed legislation on tax haven companies may now deal with in a more appropriate way, these other provisions (Section 482(1)(b), (c) and (d)) must also go.

V UPSTREAM LOANS

The upstream loans provisions of the previous draft would have seriously affected the ability of companies to manage their foreign exchange exposure rationally and would have inhibited their efforts to deal effectively with tax and exchange control problems in other countries. In our view they should have been dropped completely. Instead, we are told that the government have decided:

> 'to give further consideration to this problem bearing in mind the need to protect loans made in the ordinary course of business. In due course the government will consult further but it is not their intention to bring forward proposals for the 1983 Finance Bill'.

The matter is not, therefore, dead and it is therefore vital that those affected should keep up the pressure to ensure there is no back door introduction of technical 'negative thread' legislation while Ministers have their attention distracted elsewhere.

The Inland Revenue paper of the 4th June 1982 referred to '50 cases involving loans worth a total of £300 million'. A reader might have assumed, and was probably intended to assume, that the figure referred to the amount of tax at stake. In the latest paper the figure has been increased to £400 million but it is now admitted that:

> 'the annual tax loss involved is of course' (their words - now)
> 'much less than the £400 million of the loans themselves'.

In our contribution to the critique of Dell we pointed out that business enterprises exist to maximise profits and a rational business will seek to maximise after tax profits. Any decision taken by a business must be affected, and can be distorted, by tax factors. We cannot accept a subjective definition of "tax avoidance" as being any circumstance where the tax actually paid is less than the Inland Revenue feel they would like to be able to collect.

An old story is worth repeating in this context. It involves what many practitioners believe to have constituted a serious miscarriage of fiscal justice.

The 1960 Finance Bill introduced legislation (now ss 460-468 ICTA 1970) directed at a family of hard core tax avoidance devices, including 'dividend stripping' and 'bond washing'. It was absolutely right to legislate and the broadly drafted provisions were, for the purpose, appropriate.

The trouble began with some additional provisions (s 461 D and E) tabled at Report Stage which dealt with matters outside the original problem. (This, as so often, produces highly unsatisfactory results. Parliamentary procedure should be amended to require that clauses with substantial new material adverse to the citizen are recommitted for further detailed examination in Standing Committee.) It has been argued that Parliament was misled as to the nature and intention of these additional provisions.

The outline facts in an early case under these provisions (Cleary v IRC) are as follows:-

Two individuals owned two companies, company A and company B. Company A had over the years earned profits on which tax had been paid but which had not been distributed. During those past periods the Revenue had power, by imposing a 'surtax direction' to treat those profits as distributed to shareholders. They had not in fact used those powers but had given clearances. There is an analogy with an overseas subsidiary of a UK company which has earned profits not been subject to a direction under the 'tax haven company' rules.

Company A had cash surplus to its trading requirement and which could be more fruitfully employed in the pockets of its shareholders. It was accepted that the company could have been sold to a third party for a (then) tax free capital gain with the benefit of its accumulated assets. There were also several ways in which the company could have been reconstructed and slimmed down to extract the cash without falling foul of the provisions on which it was to become a test case. The course in fact adopted was the simple, obvious and (it was thought) innocuous method of selling the share capital of company B to company A at a proper arm's length value for the greater part of Company A's surplus cash.

This was held to be 'a transaction in securities' giving rise to 'a tax advantage' which the Revenue were entitled to 'counteract'. Given the available alternatives, it might be thought that the advantage was minimal. Not so: the company was taxed as if it had adopted the very worst of the options open to it - ie that it had distributed the whole of its accumulated profits to high bracket tax payers in a single year! The effect was confiscatory.

Pursuing our analogy, the making of an upstream loan might result in a company being deemed to have fallen over a trip-wire which immediately gives the Revenue the right to recompute the company's tax affairs as if its affairs had been conducted in such a way as to maximise the take of the Revenue and to have paid a dividend in circumstances where this was overwhelmingly the least attractive alternative.

A Conservative government was (unwittingly) responsible for this legislation although the case was decided after they had lost office. Their more fiscally sophisticated successors must not let history repeat itself.

3

CH/EX REF NO B(83)14

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RECORD OF THE SIXTH BUDGET OVERVIEW MEETING AT 4PM ON 2 MARCH

Present:

Chancellor	Mr Burns	Mr Cassell	
Chief Secretary	Sir Lawrence Airey (IR)	Mr Ridley	
Financial Secretary	Mr Fraser (C&E)	Mr Kerr	
Economic Secretary	Professor Walters (No 10)	Mr Hall	
Minister of State (C)	Mr Bailey	Mr Green (IR))	
Minister of State (R)	Mr Middleton	Mr Monger)	Item 2
Sir Douglas Wass	Mr Moore	Mr Mountfield)	only
Sir Anthony Rawlinson	Mr Kemp	Mr Pestell)	

Papers:

i. PSBR Forecast (Mr Burns' minute of 2 March)

ii. Progress Report (Mr Kemp's minute of 1 March)

ITEM 1: PSBR Forecast

Mr Burns recommended that, in the absence of further changes in oil prices, the PSBR for 1983-84 should be shown as 2¾ per cent of GDP (£8.2 billion), which would be consistent with Budget measures along the lines of those in Annex A to Mr Kemp's minute. For 1984-85, a PSBR of £8 billion, with a fiscal adjustment of £0.5 billion, could be shown. The latest estimate for the 1982-83 outturn was between £7.5 and £8 billion: to show £8 billion for each of the 3 years would produce a GDP percentage path of 3 per cent, 2¾ per cent, and 2½ per cent.

2. It was suggested that the 1983-84 PSBR could be raised to £8.5 billion (or £8.7 billion, rounded to £9 billion). It was however noted that a 1984-85 figure of £8 billion would be unattainable if additional Budget measures, whose impact would carry forward, were allowed for 1983-84. It was also noted that a 1983-84 PSBR of £8 billion had been suggested in the Autumn Forecast, and that developments on the exchange rate and the oil price since the autumn could point to greater caution. The 1982 MTFS had suggested a 1984-85 PSBR of 2 per cent of GDP: to go up to 2½ per cent of GDP for that year might be seen as

a significant relaxation, even if the 1983-84 PSBR remained at 2¾ per cent of GDP, as indicated in the 1982 MTFS. To compound this by going above 2¾ per cent in 1983-84 would give the wrong signal.

3. It was agreed that, in the absence of any further dramatic oil price fall before Budget Day, the MTFS would show PSBR figures of £8 billion for the 3 years 1982-83 to 1984-85. A further meeting would be held - on 4 March - to consider what action would be appropriate in the event of a major fall in the oil price before 15 March, and how the risk of such a fall after 15 March should be handled in the Budget Speech.

ITEM 2: Progress Report

Specific Duties

4. It was noted that decisions had been taken on all the specific duties. Those on petrol and derv might however be at risk in the event of an early and major oil price fall: they could be reopened without undue difficulty up to 7 March, though changes thereafter would create difficulty.

Oil Taxation

5. It was agreed that the Secretary of State for Energy should be offered the additional concessions noted in paragraphs 6 and 8(c) of the Minister of State (R)'s minute of 28 February, but not that in its paragraph 5. The Revenue cost of the total oil package would then be £120 million in 1983-84 and £100 million in 1984-85, the PSBR costs some £105 and £85 million. The Chancellor would write immediately to the Energy Secretary: if a further meeting with him proved necessary, it would take place on 3 March.

Budget Core

6. It was agreed that the NIS ½ point reduction from August, the Rooker-Wise plus 8½ per cent increase in income tax allowances, and

the additional rounding of the married man's allowance, and package 6(b) on corporation tax should remain the core of the Budget.

Child Benefit

7. The Chief Secretary proposed that the increase in child benefit should be to £6.50 a week. The extra costs above those already allowed for would be £20 million in 1983-84 and £50 million in 1984-85. To cover the 1983-84 costs he proposed to drop the proposed extension of the home improvement scheme to inter-war houses, and to deduct £5 million from the innovation package. How to handle the additional costs in 1984-85 would need further study.

8. The Chancellor agreed. Child benefit should be raised to £6.50. The handling of the 1984-85 extra costs would be discussed at a separate meeting on 3 March, which would also consider the public expenditure implications of the decisions taken at the Prime Minister's meeting on unemployment measures on 2 March.

Capital Transfer Tax

9. It was agreed that no major CTT relaxation, on top of indexation, could be afforded, but that it would be in order to round up the indexed scale at a cost not exceeding £5 million in 1983-84. [The Chancellor subsequently agreed to the rounded scale proposed in Mr Beighton's minute of 3 March.] Three minor CTT reliefs were also agreed, viz a 2 year increase in the period for payment by instalments (1983-84 cost £2.5 million), the removal of the £0.25 million limit on gifts to charities (1983-84 cost negligible), and the removal of the special deemed domicile rule for the offshore islands (1983-84 cost £0.5 million). [The Chancellor subsequently agreed to the inclusion of the two further reliefs - the extension of the business relief for minority holdings in unquoted companies, and of the agricultural relief for let land, from 20 per cent to 30 per cent, mentioned in Mr Beighton's minute of 3 March (1983-84 cost £0.5 million)].

Tourism Package

10. The meeting discussed the Chief Secretary's minute of 24 February, and subsequent comments from the Financial and Economic Secretaries. It was agreed to drop both the proposed increase in the hotel allowance and its extension to self-catering.

Caring Package

11. It was agreed that the proposed increase in the mobility allowance should be dropped. The proposed extension of the widows' bereavement allowance, and the possible removal of the invalidity trap, would be discussed further on 3 March, when the public expenditure implications of the child benefit and unemployment measures decisions were clear.

Taxation of International Business/Advance Corporation Tax

12. The Minister of State (R) proposed legislation in 1983, for implementation from 1984, on tax havens and the reversal of the ACT/DTR set-off. As explained in his minute of 2 March, the package would be Revenue-neutral throughout.

13. It was suggested that, if implementation were to be deferred, legislation this year on tax havens might court unpopularity to no good purpose. The Minister of State, and Professor Walters, disagreed: the Minister of State thought that every reasonable objection to the tax havens proposals had now been met, and Professor Walters thought that the package, including the reversal of ACT/DTR set-off, was well worth while, and would be well received.

14. It was agreed that the package, as proposed in paragraph 5 of the Minister of State's minute, should be included in the Budget.

15. On the separate issue of the extension to six years of ACT carry back, a decision was deferred. It would be taken in the light of

the decision reached on the mortgage interest relief ceiling.

JOK

J O KERR

Distribution:

Those present
Mr Littler
Mr Battishill - Inland Revenue
Mr Crawley - Inland Revenue
Mr Evans
Mr Robson
Mr French
Mr Harris
Mr Norgrove

for Budget file

10 DOWNING STREET

Prime Minister

Mortgage interest relief ceiling

I attach

(1) Flag A : The Building Societies Budget Representations. See Sir G Howe's 1979 remark.

(2) Flag B Budget Memorandum of Joint Taxation Committee of Building and Engineering Contractors

(3) Flag C House Builders' Federation Budget Representation

(4) Flag D DoE assessment of the number of mortgages above

£25,000.

(5) Flag E (less interesting)

Bank of England paper on mortgage lending, which argues that the connection between raising the limit and increased house prices is not as simple as the Treasury paper suggests.

MCS 1/3

INSTITUTE OF DIRECTORS

PA   Econ. Pol   1

Director General
Walter Goldsmith

BY HAND

Told them no

Prime Minister

I am told they also want to press you to increase the £25,000 mortgage interest relief ceiling.*

Agree to see them?

No - they must go to the Chancellor, not

MCS 2/3

* perhaps now there is no point!

MCS 2/3

Michael Scholar Esq
Private Secretary to the Prime Minister
10 Downing Street
London SW1

2nd March 1983

116 Pall Mall
London
SW1Y 5ED
Telephone
01-839 1233
Telegrams
Boardrooms
London SW1
Telex 21614

Dear Michael,

As we discussed on the telephone this morning, the Institute of Directors and The Retail Consortium would very much welcome the opportunity to see the Prime Minister in advance of this year's Budget.

The case which they would hope to have the opportunity to present is for significant increases in personal tax thresholds and allowences, which in the view of both organisations would help both industry and the retail sector. Industrialists are eager to see tax cuts of this type both to strengthen the UK home market and ease pressure on wage demands. Retailers are concerned that tax cuts are vital to boost retail demand which had fallen significantly after the encouraging rise resulting from lower interest rates and the abolition of higher purchase controls.

The proposed members of the delegation are Lord Taylor of Hadfield, Ronald Halstead and Sir Lawrence Barratt from the Institute's side, and Colin Patterson, Chairman of the Retail Consortium, Michael Sacher of Marks & Spencer and Leslie Porter of Tesco from the retailers together with Walter Goldsmith from this institute and Bob Lloyd-Jones, Director General of the The Retail Consortium.

We very much hope that the Prime Minister's diary might allow her to see this delegation, with its message which we hope she would find helpful. I should be very glad to hear from you whether this might be possible.

Yours sincerely,

Graham Mather

Graham Mather
Head of Policy Unit

10. The Labour Government accepted the need to review regularly the £25,000 limit. When the limit was introduced, the Financial Secretary to the Treasury said: "The Government accept that there may be a need from time to time to revise it", and he went on to say: "I accept on behalf of the Government that there is a need to protect people against the problems of inflation." The Minister concluded that "any responsible Government will review a limit of this sort regularly". In a debate on the Finance Bill in the House of Commons on 24 May 1978 the Financial Secretary, Mr Robert Sheldon MP, said: "Of course there will come a time when the increase in house prices will be large enough if inflation continues even at a modest rate, to justify raising the limit."

11. The Conservative party has been equally committed to owner-occupation and to tax relief. In 1978 a Conservative Front Bench spokesman, Mr Nicholas Ridley MP, put down an amendment to the Finance Bill to increase the loan ceiling to £40,000 and he suggested that this was the figure suggested by the change in house prices since 1974. More directly, on 1 March 1979 the then Conservative housing spokesman, Mr Hugh Rossi MP, said: "We must, for example, raise the £25,000 tax relief ceiling on mortgage borrowing, because inflation has overtaken that figure." When asked at a pre-election conference in April 1979, whether a Conservative Government would raise the mortgage relief tax limit, Sir Geoffrey Howe said: "Yes, we are committed to that. The present £25,000 figure should be more like £40,000 at today's prices, but I do not want to commit myself to a figure."

12. Since the £25,000 limit was originally set the retail prices index has increased by 200% and the house price indices by 144%. The limit has, therefore, been more than halved in real terms. The Association considers that it is appropriate for the limit to be restored to nearer its real value in 1974 and suggests a figure of £50,000. However, it is recognised that in taking any such decision the Government must have regard to its other fiscal and social priorities.

13. When it was introduced, the tax relief ceiling affected only a small number of purchasers of very expensive houses. The majority of people who were affected were probably higher rate tax payers and were certainly people at the upper end of the income scale. This is no longer the case. The average house price in London and in the South East is now in excess of £30,000 and indeed the latest figure for the average price throughout the country is in excess of £26,000. In London the average price paid by first-time buyers is above £25,000. Following their normal cyclical pattern, house prices have begun to move upwards again and, although no explosion is expected, a steady increase over the next year or two is probable and this will mean that the £25,000 limit will bite harder and harder on those least able to bear it, that is, young first-time buyers in London and the South East of England, people who need high percentage mortgages and are already adversely affected by the discriminatory effects of stamp duty. In a speech to the HBF on 30 April 1982, the Chief Secretary to the Treasury seemingly justified the £25,000 limit by referring to average loan figures but it is those borrowers who need loans higher than the average who are most adversely affected.

THE BUILDING SOCIETIES ASSOCIATION

December 1982

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER ON THE 1983 BUDGET BY THE BUILDING SOCIETIES ASSOCIATION

1. Since 1978 the Association has requested Chancellors of the Exchequer to act in respect of two fiscal measures which are not in harmony with the policy of encouraging owner-occupation and which also can have adverse effects on the mobility of labour -

(a) Stamp duty on the purchase of owner-occupied dwellings.
(b) The £25,000 ceiling on loans qualifying for tax relief.

2. The Association was encouraged by the measures contained in the Finance Act 1982 to reduce the impact of stamp duty. In these Budget Representations, the Association renews these requests. The state of the housing market and the general economic recession mean that action in respect of these two points is particularly appropriate. House prices have begun to move upwards, albeit slowly, thus increasing the burden of stamp duty and meaning that the £25,000 ceiling for loans qualifying for tax relief is being further reduced in real terms. Stamp duty and the tax relief ceiling hit hardest at those buying in London and the South East where house prices are considerably higher than the national average. They can also have a particularly adverse effect on first-time buyers and those forced to move house for job reasons.

Stamp Duty

3. The costs of buying a house are considerable. They may include valuation, survey and legal fees and Land Registry charges and, first-time buyers apart, there are the expenses of selling the present house. They will include stamp duty where the price of the house exceeds £25,000. The duty is levied on the whole of the price (not just the excess over £25,000) and is at the rate of ½% where the price is over £25,000 and up to £30,000, 1% where the price is over £30,000 and up to £35,000, 1½% where the price is over £35,000 and up to £40,000 and 2% where the price exceeds £40,000. In many cases, the largest single item of expense will be the stamp duty.

4. The latest figure (October 1982) for the average price of houses mortgaged to building societies is £26,502. The purchaser of this average house would therefore pay £130 in stamp duty. In the third quarter of 1982

about 38% of houses mortgaged to building societies cost in excess of £25,000 and therefore attracted stamp duty. Successive governments have allowed the real value of the stamp duty threshold to fall considerably. In 1974 only 16% of building society borrowers bought houses which were above the stamp duty threshold; now the proportion has reached 38% (If comparative figures for bank lending were available the proportion of all buyers could well be much higher.)

5. National figures tend to mask considerable regional variations. In the third quarter of 1982 the average price of houses mortgaged to building societies in the Greater London area was £30,800 and in the rest of the South East it was £31,000. Thus in these areas the buyer of this average house has to pay over £300 for what is effectively a tax payment when he purchases his home. In the third quarter of 1982 nearly 65% of the houses mortgaged in London to building societies cost in excess of £25,000 and therefore attracted stamp duty.

6. The regional bias in the incidence of stamp duty accentuates the inherent unfairness of this tax on house-buyers. The tax runs counter to the Government's policy of encouraging owner-occupation and, indeed, conflicts with other policy instruments. For example, through the Homeloan scheme the Government offers a bonus to first-time buyers of up to £110 which, in many cases, is immediately returned to the Government in a very modest part payment of stamp duty.

7. The Association again make a strong plea that stamp duty on house purchase be abolished. It is estimated that in 1982/83 this would have cost £290 million. If this is too much to consider, then as an earnest of the Government's commitment to owner-occupation, the Association suggests that the various thresholds be increased substantially.

Tax Relief on Mortgage Interest

8. The Finance Act 1974 set a limit of £25,000 for a house purchase loan for which interest payments were fully eligible for tax relief. No relief is due for interest on the excess of any mortgage loan over £25,000. The legislation specifically provides for the limit to be reviewed annually.

9. The major political parties are agreed that the promotion of owner-occupation is a desirable policy and that tax relief is an essential means to this end. Paragraph 5.30 of the Labour Government's Housing Policy Green Paper, published in 1977, commented -

> "The Government consider that tax relief on mortgage interest - which has a long history as part of the tax structure - and the option mortgage subsidy must form an integral part of their housing policy. The continuance of mortgage tax relief and option mortgage subsidy is vital to the growth of home-ownership."

The evidence is that the £25,000 limit deters potential house-buyers in that there is a bunching of mortgage loans just below that figure. Presumably this means that some purchasers are able to find the additional resources themselves, but others are probably excluded from the market. The number excluded will rise as house prices increase.

14. There is the further point that next April, as a result of the Finance Act 1982, the method by which house purchasers obtain tax relief on their mortgage interest will change. Instead of making a gross payment to the building society and recovering tax relief through the PAYE system, borrowers will pay a net rate to their society. Societies have made a substantial investment in this change of system and are enabling the Government to save some 1,000 civil servants. If the £25,000 limit is not increased this work will be wasted as an increasing proportion of new loans will be outside the new arrangements and will have to be treated as special cases by building societies and will be subject to tax relief through PAYE as at present, thereby necessitating an increase in the number of civil servants. The Association and building societies have worked to bring in the new mortgage tax relief system, believing it to be in the interests of the great majority of their borrowers. The value of this work, and the new system as a whole, will be nullified if it is not the Government's intention to increase the £25,000 limit.

15. If the Government feels unable to restore the limit to nearer its real value in 1974 then the Association urges that the limit should be increased modestly to £35,000 so as to continue to embrace the vast majority of first-time buyers and not to undermine the changes in the tax relief system. The limit should then be further increased to take account of inflation year by year.

MORTGAGE TAX RELIEF

2.1 We most strongly urge that the existing £25,000 limit for tax relief on mortgage interest should be raised to at least £35,000 in the 1983 Budget, and that it should be indexed for future years.

2.2 This Government has always given high priority to the expansion of home ownership, and we were naturally heartened by the Prime Minister's recent assurance that the Government has no intention of abolishing mortgage interest relief. Certainly MIR has been an essential factor in enabling over 50% of households in the UK to become owner-occupiers, and it is vital that the real value of this assistance be protected against the constant erosion of inflation.

2.3 We must emphasise that the construction of new houses, which creates new jobs and adds to the nation's housing stock, is being hampered by the present £25,000 limit. During the 8 year period since it was first introduced by a Labour Government, there has been a 130% rise in average house prices, while the average mortgage loan (as recorded in Building Society Association figures) has risen from around £7,000 to approximately £17,000.

2.4 We wish to point out that in those parts of the UK where economic recovery is likely to begin most strongly - namely London and the South East, which together constitute almost a third of the housing market - house prices are higher than elsewhere, and increasing numbers of first-purchasers and existing owner-occupiers are finding that their mortgage exceeds the £25,000 limit. In London the average loan on new houses is now over £23,000 for first-purchasers and £26,000 for owner-occupiers; in the rest of the South East, the comparable figures are £20,000 and £21,000.

2.5 In short, the problem is already acute, and action must be taken by the Chancellor to raise the MIR limit, so as to enable the private housebuilding industry to respond to the more favourable demand conditions expected in 1983 and increase its output, with minimum adverse consequences for inflation and imports. We would add that in our view, failure to raise the limit would also seriously jeopardise the Government's welcome plan to achieve a reduction of 1,000 tax officials' jobs through the proposed change next April in the administrative arrangements for giving mortgage tax relief.

3. STAMP DUTY ON HOUSE-PURCHASE

3.1 While we applaud the action which the Chancellor took in the 1982 Budget to ease the Stamp Duty burden, we should nevertheless like to see still further progress towards taking most house-purchase transactions out of the Stamp Duty net.

3.2 The present Government has raised the stamp duty thresholds twice since 1979. This has undoubtedly removed a very damaging impediment across a substantial part of the housing market, especially for first-purchasers. However, just as the £25,000 mortgage tax relief limit imposes an increasingly harmful distortion on the housing market in London and the South East, so also the present £25,000 stamp duty lower limit places a substantial burden on first-purchasers and owner-occupiers in those areas where average house prices are above £25,000. In London and the South East, average prices are over £30,000. In the South West, the average is over £25,000. For the United Kingdom as a whole, the average is now over £26,000. This means that more than half of all house purchasers must still pay stamp duty, as against a very small percentage as recently as the mid-1970's.

JOINT TAXATION COMMITTEE

of

National Federation of Building Trades Employers
Federation of Civil Engineering Contractors
Committee of Associations of Specialist Engineering Contractors
Export Group for the Constructional Industries

Please reply to : 82 New Cavendish Street, London W1M 8AD Telephone 01-580 5588

DWT/JRS/FK

20th December 1982

The Rt.Hon.Sir Geoffrey Howe M.P., P.C.,
Chancellor of the Exchequer,
H.M.Treasury,
Treasury Chambers,
Whitehall, London S.W.1.

Dear Chancellor,

I am pleased to submit our 1983 Budget Memorandum on behalf of the four major construction organisations who are represented on the Joint Taxation Committee. Our Committee brings together all the major interests on the employers' side of the construction industry, covering building and civil engineering and the various ranges of specialist contract work both at home and overseas.

These recommendations have a direct relevance to your Government's economic policy objectives and do not call for a reversal of the Government's overall strategy. Our proposals will encourage both increased public investment in essential national infrastructure and a major contribution next year from the private sector. Our aim has been to concentrate upon measures to promote greater domestic output and to avoid stimulating any further import penetration.

We deal in this Memorandum with both public expenditure and tax recommendations. Some restoration of public capital investment to proper levels is now widely accepted as an over-riding pre-requisite for the regeneration of the productive economy. This objective holds a high priority in our overall representations.

The civil engineering sector in particular wished me to stress that they would not wish tax reductions to be pursued at the expense of proper capital investment. They further feel that recent examples of under-spending on budgets in this respect demonstrates the inefficiency of trying to operate these long-term investments on an annual basis. Accordingly, we hope that you will find means to fund the infrastructure programme on a longer term rolling basis with provision for adequate carry-over from one year to the next.

The Rt.Hon. Sir Geoffrey Howe M.P., P.C. 20th December 1982

Our tax recommendations are also closely geared to your own specific economic priorities, and I do think that it would be most opportune for either yourself or one of your Ministers to meet with myself and senior members of the Committee to discuss these proposals and the benefits which they would create, not simply for our industry, but for the economy.

We would greatly appreciate the opportunity of explaining to you personally the importance of the recommendations we are making in the attached Memorandum, and why we regard them as particularly crucial in the forthcoming financial year.

Yours sincerely,

Denis Turner

D.W.Turner
Chairman

DWT/FK

JOINT TAXATION COMMITTEE

of

National Federation of Building Trades Employers
Federation of Civil Engineering Contractors
Committee of Associations of Specialist Engineering Contractors
Export Group for the Constructional Industries

MEMORANDUM TO THE

CHANCELLOR OF THE EXCHEQUER

BUDGET 1983

PART I - ECONOMIC INTRODUCTION

1. The economic introduction to our Budget Memorandum this year starts from the new climate which has been created by the **Prime Minister's initiative** this autumn to give greater priority and political momentum to the construction investment programme. Notwithstanding our specific comments below on the Government's recent **"capital underspend"** announcements, we welcome the clear, explicit recognition now being given by the Government to the **exceptionally depressed** state of our industry and to its overwhelming **economic importance.**

2. This memorandum will therefore move on from an analysis of the likely impact of these latest Government construction measures to highlight the dangers next year of **import penetration** and to set out why and how further encouragement to construction is critical to forestall this threat to the Government's economic strategy.

3. Before specifying in Part II the individual taxation recommendations which the Federations believe would help the industry and the economy, this economic introduction will close with a review of how **cost-effective** the implementation of a construction tax and expenditure package in the Budget would be to achieving sustained, non-inflationary growth.

PRIME MINISTER'S INITIATIVE

4. The Prime Minister's response to the representations made at her meeting in mid-October with the combined construction industry "Group of Eight" was prompt and welcome. She has now written to the local authority associations to encourage them to ensure that much more of their available resources are used for construction investment. Her strong public commitment to reducing the scale of capital underspend has been followed by several announcements during October and November, from the Chancellor of the Exchequer, the Secretary of State for the Environment and the Minister for Housing and Construction, of measures aimed both at easing the path towards extra construction expenditure in this financial year 1982/83 and at boosting the capital allocations for the next financial year 1983/84.

5. The substantial political weight and publicity given to these announcements demonstrate beyond doubt not only how serious has the construction industry's depressed workload become but also how important is the role now allocated to construction investment in promoting any kind of sustainable economic recovery. In our Budget Memorandum last year we drew attention to the precipitate decline in construction output and to the lack of any convincing evidence, despite Government optimism, that a significant recovery was in prospect. That analysis has been fully justified by developments in the past year and the Government's latest initiatives only emphasise how stagnant is the present outlook for construction. Down 20% on the position three years ago and with a virtually flat trend in overall new orders for the past eighteen months, the industry must now be accepted by all sides to be lodged in its deepest and longest post-war recession.

TIMING

These construction initiatives are particularly welcome for their emphasis upon the benefits of public investment in construction and for their clear recognition of the distinction between curbing current public expenditure and improving the amount of resources devoted to the capital account. Capital investment as a proportion of total public expenditure has been halved in the past seven years to less than 10%. This damaging trend has been followed by successive Governments and must be reversed. The Federations themselves have been highlighting the urgent need for such action in our last three Budget Memoranda and it is regretted that these sensible moves were not made by the Government at a considerably earlier stage. Nevertheless, the Federations have responded positively to the Government's latest measures in the hopes that they will help to get some extra construction work moving. We have also identified a number of financial and procedural obstacles which may make it more difficult than originally envisaged to obtain a substantial take-up of the capital underspend in this financial year.

7. These latest measures may therefore be less favourable for firms' prospects this side of the Budget itself than the Government had hoped. The reductions in National Insurance Surcharge will, by contrast, have an early, beneficial impact upon construction companies and this has been widely welcomed throughout all industries. Yet this alone will not be sufficient to alleviate the industry's very high unemployment problem and to reverse the exceptional decline in building recruitment and apprentice intakes which has occurred during the past year and which holds such damaging consequences for the nation's future building performance. More substantive measures both before and in the Budget to encourage greater construction investment will be required.

IMPORT PENETRATION

8. The Chancellor's Autumn Economic Statement also contained the alarming forecast that whilst Gross Domestic Product would only rise by 1½% in 1983, consumers expenditure would rise by 2½% and imports by 5%. These figures illustrate the dangerous tendency for marginal changes in personal post-tax incomes to leak disproportionately into imports, especially of finished manufactured goods. This remains probably the single most serious threat to the success of the Government's economic strategy in 1983 and it must pay the Government to encourage any sector whose growth can encourage domestic supply rather than imports.

9. Thus it is not only for the strength of the construction industry itself but also for the health of the domestic economy that the Federations put forward more strongly than ever the priority claims of construction investment to the benefits from any room for manoeuvre which the Chancellor may have in the next Budget judgement. For whilst imports account for around one-fifth of the materials used in construction, this is a far lower proportion than is the case for most of the goods on which people tend to spend their post-tax income increases. If one calculates the import content out of the whole construction process (ie. including labour, plant and materials), its proportion falls to below 10%. Furthermore, some of the more urgently and obviously required areas for increased investment, such as sewer renewal and replacement, not only are highly labour-intensive but also have a substantially lower import usage than even the average figure of just under 10% for the construction industry as a whole.

10. In addition, the Chancellor's Economic Forecast referred to the key role that would be played in next year's recovery by the response of private investment, especially in housing, to the fall in interest rates. The Government's rightful concern with stemming the rise in unemployment must also reinforce this importance of construction investment, since repeated studies have demonstrated - and the Chancellor himself recognised in last Budget statement - that this industry is the most effective generator of real new jobs in the economy. With so much expected from this sector and with so little clear evidence so far that interest rates alone are sufficient to generate a significant investment response, it is all the more important that the Chancellor should use the opportunity of the Budget to smooth the path wherever possible for increased construction investment. This means not only extra direct capital expenditure but also an approach towards the encouragement of privately funded construction initiatives which will be additional to existing public programmes rather than simply replacing previously planned public projects.

CONSTRUCTION TAX PACKAGE

11. In the second section of this Memorandum, the details of the Federations' proposals for encouraging housing investment through mortgage tax relief and stamp duty amendments, as well as for encouraging business investment through better first-year depreciation allowances, will be set out. The total tax expenditure cost of those specific "construction tax package" measures would be no greater than £500m in a full year. Within a Budget judgement that could envisage room for between £2,000m and £3,000m fiscal adjustments, these are modest measures to encourage domestic output and investment compared with the much higher costs of across-the-board personal tax reductions for which the domestic output, as opposed to import benefits are highly dubious.

PART II - TAXATION RECOMMENDATIONS

1. BETTER CAPITAL ALLOWANCES FOR BUILDINGS:

1.1 We strongly recommend that a new special 100% capital allowance should be introduced as part of the Government's urban renewal programme, specifically to encourage the refurbishment, reconstruction or conversion of existing commercial or industrial buildings for re-use. Throughout the UK, there are many empty and disused factories, mills, warehouses and offices etc in towns and inner cities which could be adapted and put to use, so creating more badly needed permanent jobs as well as extra work for the construction industry. We believe that an imaginative approach along these lines would serve as a particularly valuable stimulus to economic regeneration in localities adjacent to Enterprise Zones.

1.2 Industrial Buildings Allowance:

We would again ask that consideration should be given to raising the IBA rate from its present level of 75% closer to the level of the full 100% allowance given for plant and machinery. We also recommend that the IBA arrangements should be improved in the following three respects:-

- the permissible office content of an industrial building for IBA purposes is unrealistically low and outdated, particularly in relation to new high technology industries; it should be increased from 1/10th to 3/10ths of the total construction cost;

- the definition of "industrial building" should be widened to include all buildings falling within Classes III to X of the Town and Country Planning Act 1971. In addition to increasing the categories of buildings that would qualify, this would have a twofold administrative advantage: it would simplify the procedures for verifying whether or not a building qualifies for IBA, and also enable this to be determined in advance with certainty;

- in the rule governing the transferability of IBA by the landlord of an industrial building to his tenant, the definition of "long lease" needs amendment: the requirement that the lease must be for a term exceeding 50 years is seen as unnecessarily restrictive and out of touch with normal commercial practice; we urge that the qualifying period should be reduced to one of 25 years or over.

1.3 Commercial Buildings:

1.3.1 In our view, there is an overwhelming case for the introduction of an allowance for commercial buildings. For many years past, successive Governments have acknowledged that the existing tax discrimination against commercial buildings is unjustified and anomalous, and we greatly hope the Chancellor will finally "unlock the door" in the forthcoming Budget.

1.3.2 Ideally, we should like to see an annual allowance of 2% for all commercial buildings. But we appreciate that this could be very costly to the Exchequer, and accordingly suggest that as a first step, entitlement to the allowance should be restricted to capital expenditure on new commercial buildings incurred after Budget day.

3.3 We therefore recommend that the present exemption from ad valorem stamp duty should be raised by £10,000 to £35,000 - at least for purchases by individuals of private dwelling accomodation.

3.4 We also recommend that the "slab system" of assessment should be abolished and replaced by a "slice system" - once again at least for purchases by individuals of private dwelling accomodation. A simplified version of the slice system, which we would support, would be a charge at a single flat rate of 2% on the excess over the proposed £35,000 exemption limit.

4. VALUE ADDED TAX

4.1 We were most concerned that the overall effect of the proposed VAT changes regarding building alteration work which the Chancellor outlined in his March 1982 Budget speech (but which have since been deferred as a result of certain litigation now before the Courts) would have been to impose an even heavier VAT burden on this industry than hitherto. We cannot emphasise too strongly that we are looking to the Government for measures which will alleviate the impact of VAT on the industry and help its economic recovery.

4.2 We would particularly urge that consideration should be given to the removal of VAT from building repairs and maintenance - a move that would benefit many millions of private householders and also curb the very serious problem of the Black Economy in this sector of the construction market by helping to reduce the present unfair distortion of competition against bona fide VAT-registered builders. According to official estimates, the cost of extending zero-rating relief to repair and maintenance work carried out by VAT-registered building firms would be about £150 million a year (Hansard - 15 June 1982). Such a VAT change would achieve a clearly defined social purpose and be of direct benefit to the ultimate consumer.

4.3 We also recommend that the existing zero-rating concession for supplies of reconstructed buildings (as described in paragraph 20 of Customs' Public Notice No 708) should be put onto a statutory basis, in order to remove the legal uncertainty stemming from a recent VAT Appeal Tribunal decision (in the case of David Wickens Properties Ltd -v- Customs & Excise).

4.4 The scope of the present scheme for giving relief from VAT on bad debts is too narrow and urgently requires revision; the requirement that the debtor must be formally insolvent should be abolished.

5. NATIONAL INSURANCE SURCHARGE:-

5.1 The Federations warmly welcome the proposed measures which the Chancellor announced in his November 1982 Statement to reduce the existing NIS burden on employers. The promised 1% cut in the NIS rate from next April down to 1½% is certainly a helpful and encouraging step in the right direction; and we are very glad to note that employers will be getting some interim relief next February.

5.2 Whilst in principle we wish to see NIS abolished completely, we recognise that this would be costly to the Exchequer. A significant proportion of our members, particularly in the Civil Engineering Industry attach much greater priority to the need for capital investment, particularly in the National infrastructure, which is a basic essential to the efficiency and competitiveness of all manufacturing industry.

6. DEVELOPMENT LAND TAX

The Government has introduced a series of changes which have mitig d the worst effects of DLT; in spite of this we feel that fundamental objections remain which can only be eliminated by the complete abolition of this tax. It is an inordinately bureaucratic statute to operate, particularly the deemed disposal mechanism, with high administrative costs and a relatively low yield to the Exchequer. Repeal of the Act will give rise to considerable manpower savings.

7. STOCK RELIEF AND CONSTRUCTION - Treatment of Houses Taken in "Part Exchange" by Private Housebuilders

7.1 The construction industry is subject to a special constraint in that "land" (including buildings) which forms part of a firm's trading stock - eg. a housebuilder's land bank - does not count for relief unless of a type ordinarily sold only after a process of development.

7.2 This condition was apparently intended to exclude relief claims by mere speculators who buy and re-sell properties in an unaltered state: that is a general purpose with which the construction industry need not quarrel. But the actual wording used has the unde sirable effect of denying the character of trading stock to a house which a housebuilder takes from a buyer in part-exchange.

7.3 In the present state of the market for middle-range houses, the need for part-exchange schemes to facilitate sales is expected to be a continuing feature, and we ask that for the sake of much-needed stimulation, the general rule referred to should be qualified by making a statutory exception for residential property bought from a customer on the occasion of, and in connection with, the sale to him of property that was trading stock before its sale.

8. CONSORTIUM RELIEF

8.1 A consortium company structure for international collaboration helps overcome overseas taxation difficulties that arise when a joint venture is used as the operating "vehicle".

8.2 It is regrettable, therefore, that the restrictions in the consortium relief rules should prevent potential benefits and reliefs being obtained by the members of a consortium. In practice, this is often the sole reason why UK contractors are constrained to use a joint venture rather than a consortium company. The Minister for Housing and Construction is aware of the difficulties caused when, for UK tax reasons, a joint venture rather than a consortium company is the vehicle negotiating to obtain large interational contracts in new markets particularly where English is not the official language of the country.

We recommend that the law should be amended in three particular aspects, namely:-

8.2.1 The loss which is available for surrender by a consortium company to any of its corporate members should also be capable of surrender to any other company that stands in a group relationship with a member company.

Similarly any loss available for surrender under the normal group relief procedure to a member company should also be capable of surrender to consortium companies.

8.2.2 It should be possible for a consortium claim, within the meaning of Section 263(5) Income and Corporation Taxes Act 1970, and a claim other than a consortium claim to be made in respect of a loss for an accounting period.

We see no reason why it should not be permissible to fully utilise a loss incurred by a company for an accounting period by surrender wholly or partially to any company that stands in a group relationship and wholly or partially to any consortiom company.

8.2.3 . The participation of a non-resident company as a member of a consortium company should not prevent its UK resident corporate members benefiting from their aliquot share of reliefs which would be available if all the members were companies resident in the UK.

9. BENEFITS IN KIND

The statutory definition of "higher-paid employment" for benefits in kind purposes should be amended and simplified. In practice, it not only gives rise to serious anomalies as between individual employees but also imposes a heavy and unnecessary administrative burden on employers. The definition should be amended by excluding all tax deductible expenses from the reckoning of "emoluments" for the purposes of the "higher-paid" threshold.

JCT/JBR/JH
December 1982

The House-Builders Federation
82, New Cavendish Street, London W1M 8AD
Telephone 01-580 5588 . Telex 265763.

JRH/JCS/AC/107 24th January 1983

The Rt. Hon. Sir Geoffrey Howe M.P., P.C.,
Chancellor of the Exchequer,
H.M. Treasury,
Whitehall,
London. SW1

Dear Chancellor,

I am pleased to submit our 1983 Budget Memorandum. You have already received a Memorandum covering a wide range of issues affecting the whole of the construction industry from the Joint Taxation Committee of four of the major construction industry federations. However, in this further submission on behalf of house builders we highlight the particular advantages of an increase in private new house building for Government revenue and for the economy.

Yours sincerely,

J.R. Humber
Director

HD.83.30

HOUSE BUILDERS FEDERATION

MEMORANDUM TO THE

CHANCELLOR OF THE EXCHEQUER

BUDGET 1983

INTRODUCTION

The House Builders Federation's 1983 Budget Memorandum begins by placing the house building industry within the broad economic environment. The industry has a crucial role to play in leading the process of economic recovery. This is particularly important at present because, more than any other item of consumer expenditure, new houses create new jobs and have a minimum impact on imports. The industry also has a crucial role to play in enabling the Government to achieve one of its main policy priorities - the expansion of owner-occupation.

The Memorandum then considers specific tax changes which could be made to help increase housing output and improve the industry's profitability.

2. HOUSE BUILDING & THE ECONOMY

The important decisions taken by house builders are inevitably based on an assessment of housing demand any time between three months and three years into the future. This means that survival depends on how accurately house builders assess future prospects in the housing market. However, it also means that there is an element of self-fulfilling prophesy for the economy in these decisions. House building quickly generates substantial numbers of new jobs, while the domestic content of materials used in house building is relatively high. By starting work on houses for sales which are expected three or six or even twelve months ahead, house builders automatically provide a rapid boost to any upturn in the economic cycle as soon as they perceive a change in consumer confidence or in the general financial and economic climate. It is precisely because of these reasons that housing starts are a key variable in the Government's Longer Leading Indicator of the U.K. economic cycle.

However, house building is of particular economic importance at present. There is strong evidence that a consumer led economic recovery will result in a substantial increase in imports, with little impact on jobs and domestic output. Your own Autumn Economic Statement set out these risks very clearly. Yet with prospects in other sectors of the economy so uncertain, the recent increase in consumers' expenditure is a welcome sign of emergent recovery which must be encouraged.

The unique feature of new housing is that, although it is classified as an investment good in National Income accounts, it is paid for directly out of consumer sector income. Expenditure on a new house has much greater first round effects on jobs and domestic output than equivalent expenditure on any other consumer good.

House builders have made many changes over the last three years to their product mix and their marketing activities. Despite very difficult economic conditions, the industry has increased starts by almost 50 per cent since the trough of 1980. However, there are a number of factors impeding the operation of the housing market over which house builders have no control. If the industry is to be able to play its full role in the economy in both the short and long term, these factors must be addressed in the 1983 Budget.

3. INTEREST RATES

The key economic concern at present must be the trend in interest rates. Any rise in the mortgage rate would be extremely damaging to consumer confidence. House builders believe that a blow to confidence at this time would undermine the housing market even more than the direct effect of the rise in borrowers' monthly mortgage costs.

4. TAXATION

There are four specific tax changes which the Federation proposes for consideration in the 1983 Budget. When taken together, these changes would considerably improve the immediate trading environment in which house builders operate. However, they are also essential steps towards removing some of those factors which, in the long term, impede the ability of house builders to meet demand at the right price and in the right place. This in turn will mean that more new jobs can be created, while less consumer income will go into expenditure on goods with a high import content.

4.1 MORTGAGE TAX RELIEF

The House Builders Federation believes that a rise in the mortgage tax relief limit should be a Government priority in the 1983 Budget. For many years, Governments have been able to argue with justification that the £25,000 limit only affects a very small number of home owners and therefore should not be raised. This is no longer the case in London and many parts of the South East. House builders are able to quote new housing developments aimed at first purchasers and families on relatively modest incomes where 30 per cent, or even 50 per cent of borrowers take out mortgages of £25,000 or above.

The Government's commitment to maintaining the present system of mortgage tax relief is beyond question. What is less certain is the degree of commitment to maintaining the role of mortgage tax relief in real terms. There are many outside Government who argue that by leaving the £25,000 limit unchanged, mortgage tax relief can be allowed "to wither on the vine" without arousing public concern. Because the Government's attitude to this argument is not at all clear, a modest rise to £35,000, at a cost of less than £100 million, would provide a clear signal that the Government does not believe that relief should be allowed to erode gradually under the effects of inflation.

The mortgage tax relief limit should be raised to at least £35,000 in the 1983 Budget. Because this is well below the £50,000 required to fully restore the real value of relief to its 1974 level, the Government must also give a firm commitment to index the limit in subsequent years in line with any increase in house prices.

4.2 STAMP DUTY

The Government has raised the stamp duty thresholds twice since 1979, changes which the industry has welcomed on both occasions. However, this should not disguise the fact that approaching 50 per cent of new houses and 35 per cent of second-hand houses sold in the third quarter of 1982 under a building society mortgage were priced at over £25,000. A tax which began as a luxury tax is still effectively a tax on almost half of all house purchases.

It may be argued that stamp duty is a convenient and economical revenue source for the Exchequer, and that a further rise in the thresholds cannot be afforded under present economic circumstances. The House Builders Federation would ideally advocate a return to the 1974 position where stamp duty applied to only a small minority of house purchase transactions. It is a tax which places a substantial extra financial burden on ordinary house buyers at a time when they are already faced with a multitude of other costs. It also reduces demand for new houses as demonstrated by the fact that many house builders are paying stamp duty for their new house buyers. This costly measure would clearly be unnecessary if stamp duty had no effect on demand.

Because full restoration of the 1974 position would be costly under present economic circumstances, HBF suggests that the thresholds be raised by a minimum of £5,000, but preferably by £10,000 in 1983. For example, the first of these options would cost the Exchequer only £60 million, but it would remove an extra 10 to 15 per cent of new and second-hand house sales from payment of stamp duty. The present "slab" system should also be put on a more equitable "slice" basis.

4.3 DEVELOPMENT LAND TAX

The Government has done much to mitigate the effect of DLT on the replacement of house builders' land banks over the last three years, although the one major problem still remaining is the burdensome exercise of assessing DLT on deemed disposals. This latter problem is an extremely time consuming and laborious process both for builders and the DLT office, and furthermore it produces a fairly low proportion of the total DLT yield.

HBF, therefore, recommends the abolition of the DLT deemed disposal arrangements, at a cost of only £15 million, as these have the most detrimental effect on bona fide development as well as substantial public sector manpower implications. We understand that such a move might need to be accompanied by further provisions to prevent this from being used as a tax avoidance loophole but, having considered this point, we feel sure the necessary safeguards can be achieved by restricting deemed disposal exemptions to registered housebuilders starting a scheme which has received full approval from a local planning authority.

4.4 STOCK RELIEF - Treatment of Houses Taken in "Part Exchange" by Private Housebuilders

The house building industry is subject to a special constraint in that "land" (including buildings) which forms part of a firm's trading stock - e.g. a housebuilders land bank - does not count for relief unless of a type ordinarily sold only after a process of development.

This condition was apparently intended to exclude relief claims by mere speculators who buy and re-sell properties in an unaltered state: this is a general purpose with which the construction industry need not quarrel. But the actual wording used has the undesirable effect of denying the character of trading stock to a house which a housebuilder takes from a buyer in part-exchange. In the present very poor market for middle-range houses, house builders have offered part-exchange or buy-in facilities as part of a whole range of purchaser incentives. Some of these will be discontinued as the market improves. However, many in the industry now believe that the buy-in will become a permanent element within the overall marketing package offered by house builders.

We ask that the stock relief general rule referred to should be qualified by making a statutory exception for residential property bought from a customer on the occasion of, and in connection with, the sale to him of property that was trading stock before its sale.

JCS/AC
January 1983

Extract from internal DOE Housing Market Assessment: 4th Quarter 1982.

First-time purchasers and former owner-occupiers

11 Building societies made half as many advances again in the 4th quarter 1982 as a year earlier and 15% more, in seasonally adjusted terms, than in 3rd quarter 1982. First-time purchasers' advances rose to 134,000, another record (excluding LA sitting tenants the figure was 109,000, just below the 3rd quarter 1971 record). Former owner-occupiers' advances in the 4th quarter were 123,000, 7% above the previous record in 4th quarter 1977.

12 The average income recorded by building societies was 7% higher than a year earlier for first-time purchasers and 12% for former owner-occupiers, compared with an increase of 8% in national average earnings. The rise in the first-time purchasers' average has been curbed by the growing number of council tenants buying their houses with building society mortgages.

(Banks to excluded)

13 The average building society advance to first-time purchasers in the 4th quarter was 11% higher than a year earlier and to former owner-occupiers 17% higher. In the second half of 1982, 6% of first-time purchasers and 13% of former owner-occupiers received loans above the tax relief limit of £25,000; in Greater London 23% and 30%, respectively.

Local authority sitting tenants (Table 3)

14 In the first half of the financial year 1982/83, 91,000 council houses were sold in England, of which about half were mortgaged to the councils for an average of £9,100. From the 5% sample survey, building societies provided loans averaging about £8,700, for about a third of the sales in that half-year. The higher average council advance is partly explained by relatively fewer building society advances being in the high priced London and South East areas.

15 In 1982 as a whole, in the whole United Kingdom, the societies granted 75,000 mortgages on council houses, about 24,500 of these in the 4th quarter. The average price rose to £11,010 (equal to 56% of the price paid by other first-time purchasers) from £10,140 in the 3rd quarter. Local authorities' P1 returns gave an average price of £9,700 (58% of the valuation) for council houses sold in England and Wales in the 3rd quarter.

16 LA sitting tenants borrowing from the societies were older than other first-time purchasers, had lower incomes and borrowed a lower multiple of their income (average 1.3 against 1.9), but their advances were for a slightly higher

E

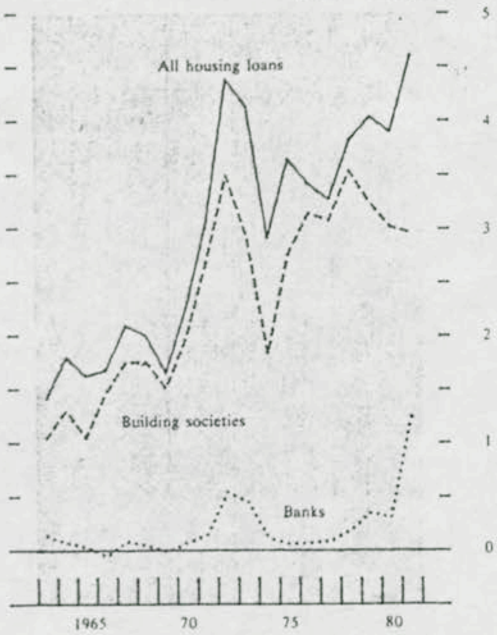
Mortgage lending and the housing market

This article, which has been prepared mainly by E P Davis and I D Saville of the Bank's Economics Division, argues that:

- *Now the banks have entered the housing market in a major way, the market for mortgages is more likely to be cleared mainly by interest rate movements rather than by rationing.*
- *The recent sharp rise in mortgage lending reflects the removal of restrictions, allowing persons to increase their capital gearing, and probably does not reflect a significant rise in the demand for housing.*
- *A substantial part of mortgage lending does not ultimately finance new or improved housing, but is available for the acquisition of other assets or other spending.*
- *House prices are somewhat low in real terms, and may recover in the course of the next few years.*

The last two years have seen a sustained, though not unprecedented, rapid growth in the stock of mortgages outstanding—substantially faster than the growth in either the general price level or the price of houses. Banks have once more become substantial lenders, accounting for a third of recent flows. So far, this has had little obvious repercussion either on house prices in real terms or on housebuilding, both of which are little above their lowest levels of recent years. This article examines developments in the mortgage market, and their likely consequences for the housing market.

Chart 1
Real flows of house purchase loans[a]



(a) Deflated by the consumer price deflator.

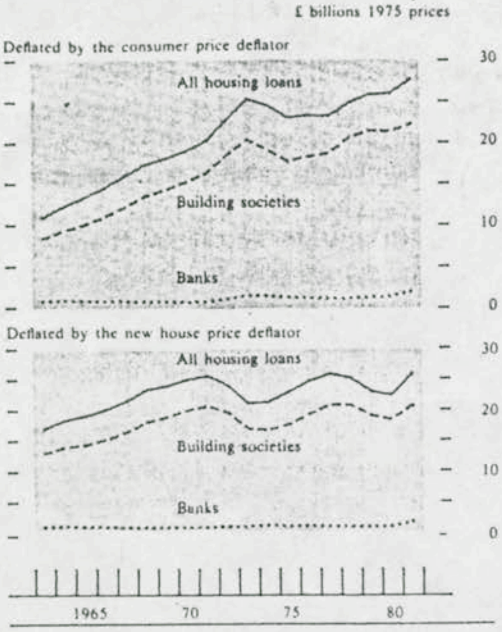
Developments in the mortgage market

New mortgage lending has recently been growing rapidly in real terms (Chart 1), and since the summer of 1980 banks have been taking an important and growing share. The 'real' stock of mortgage lending outstanding, deflated by consumer prices, is now at a record level (Chart 2). (The recent rise is even more pronounced when an index of house prices is used to deflate the stock).

The real stock of mortgages fluctuated quite widely during the 1970s, after some years of steady growth. The reasons for this are complex and rooted in the behaviour of building societies. Building society interest rates tended to be more stable than market rates. This was partly because of the administrative costs of changing them, but also to protect borrowers from the full effect of high interest rates. When market rates were rising, building societies could, for a time, partially maintain lending by running down liquid assets; but would later introduce rationing devices such as queuing and giving priority to certain types of loan, leaving some demand for housing finance unsatisfied. When interest rates fell, societies were initially content to accumulate (or rebuild) liquidity from which to satisfy future mortgage demand. But they would eventually drop their rates to avoid an excess of lower yielding liquid assets, and in response to pressure to reduce the burden on borrowers.

The consequences of this behaviour are demonstrated in Chart 3. Building societies offered very competitive deposit rates in 1971–72 (see, for example, the difference between the gross share rate and the three-month local authority deposit rate), and maintained high liquidity despite a rapidly growing real stock of lending. As interest rates generally rose, their deposit rates became much less competitive in 1973 and 1974, and their liquidity fell away. This was followed by a fall in lending in 1974, which

Chart 2
Real stocks of house purchase loans



continued into 1975, as societies raised their rates to attract deposits and rebuild liquidity. In subsequent years up to 1979, growth in real lending resumed, financed partly by a falling liquidity ratio against a background of generally weak competitiveness. (Exceptionally high competitiveness in 1977 had surprisingly little effect on inflows.) More recently, the growth in the real stock of mortgage loans has slowed, and there has been some rebuilding of liquidity. Competition for deposits from national savings and from the banks has been an important factor in recent years.

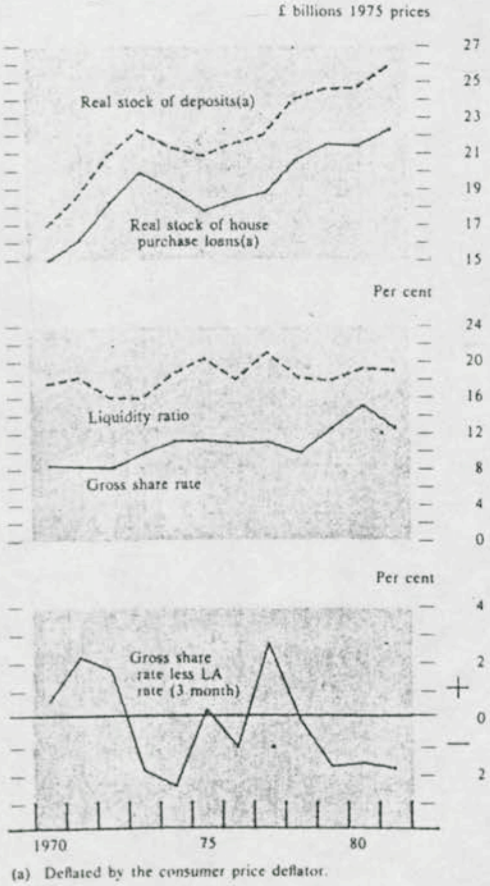
This analysis has placed little emphasis on the demand for loans, since rationing was in force for much of the period. Clearly, however there were periods when queues were short: but these were generally at times when interest rates and other factors combined to produce weak demand. Thus in 1973 and 1974 high rates were coupled with flat or falling real incomes, and this pattern was repeated in 1977. In periods of high and increasing demand, rationing by building societies became important.

Other institutions did not generally fill the vacuum created by rationing. Local authorities and insurance companies have made a comparatively minor contribution, as have banks until rather recently. This is in contrast to experience elsewhere; for example, in the United States, banks account for 17% of outstanding housing loans, and 45% in France, compared with about 7% in the United Kingdom in 1981. The banks in Britain have tended to concentrate more on lending to the corporate sector. This has been partly for historical reasons, and partly because controls imposed on bank lending for monetary policy purposes may at various times have inhibited them from entering this market. Moreover, the building society movement became important at an earlier stage in the United Kingdom than in other countries.

In the period between the introduction of 'competition and credit control' in 1971 and the imposition of the corset[1] (and the onset of much higher interest rates) at the end of 1973, the banks took over 10% of mortgage flows (Chart 1). The abolition of the corset in 1980 may have been a factor in stimulating the banks' re-entry to the housing market in the last two years. There are, however, differences between recent activity and 1972–73. In the earlier period, lending for house purchase was not generally distinguished by the banks from other personal lending; interest rates were tied to base rates, and applications processed in the same way as other personal loans. By contrast, the recent resurgence of bank lending has seen separate mortgage schemes vigorously marketed, and, more important, a divorce of rates charged on mortgages from base rates. Bank mortgage rates are now more closely associated with the building societies' recommended rate, making mortgages offered by banks more competitive in general with those from building societies. Building societies have responded to this competition by reducing or eliminating additional charges for large loans.

With the banks willing to expand their lending freely, the effect has been, broadly speaking, to satisfy all demand for mortgage finance, and to make the building societies more responsive to market interest rates and keener to compete for funds. (A separate influence affecting building societies in the same way was a drive to attract more funds to

Chart 3
Building society activity



(a) Deflated by the consumer price deflator.

(1) See 'Competition and credit control', June 1971 *Bulletin*, page 189, and 'The supplementary special deposits scheme', March 1982 *Bulletin*, page 74. The corset was not in operation between February 1975 and November 1976 and between August 1977 and June 1978.

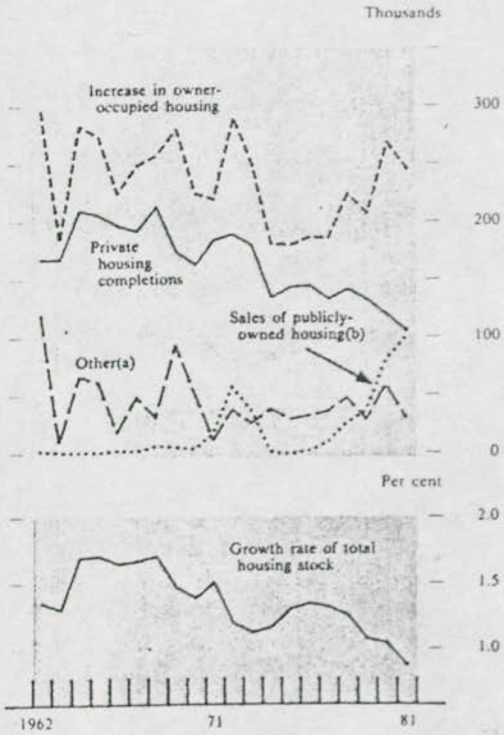
national savings.) Although the banks' introduction of special rates for mortgage lending may have increased the stability of interest rates for these borrowers (compared with a situation in which they were charged a rate more closely related to base rate), the effect on borrowers from building societies may prove to be the reverse, with building societies probably under greater pressure than before to follow market interest rates.

The entry of the banks into the mortgage market in a major way in mid-1981 probably eliminated the rationing which had persisted since the house price surge of 1972–73. However, in recent months some banks have begun to limit the growth in their mortgage lending (which, in the second quarter of this year, represented 26% of all their outstanding personal lending, compared with 15% two years ago). Further rises in corporate loan demand might reinforce a tendency for banks to stabilise mortgage lending at some target share of their portfolio. It remains to be seen, therefore, whether the elimination of rationing will prove to be permanent.

The supply of housing

It would be natural to interpret sharp rises in the real stock of mortgage lending as an increased desire to own dwellings which would be transmitted either into increases in the stock of the owner-occupied housing through new building, or into a rise in the real price of housing. The lending surge of the early seventies was indeed followed by a sharp rise in real house prices; private housing completions recovered somewhat from the depressed level of 1969–70, but only to levels well below those of the middle sixties, and they fell sharply in 1974 (Chart 4). Sales of dwellings from public ownership were also high in 1972–73, but there were few additions by conversion of existing property or transfers from the private rented sector, net of demolitions.(1)

Chart 4
Changes in the housing stock



(a) Conversions, transfers from the rented sector *less* demolitions.
(b) Including new towns.

House building is generally the principal source of dwellings for owner occupation. There are several characteristics of the supply of dwellings in this form(2) which differentiate it from the supply of most other goods. In the long term, the supply of dwellings is virtually unlimited; in the medium term, the number of plots with planning permission limits building; and in the short term (under a year), the number of dwellings which can be completed is constrained by the number already under construction. Dwellings are very long lived, and even what is by normal standards a high level of completions has little effect on the size of the overall stock. Furthermore, sales of new dwellings can differ from the number of completions, because of selling before completion in a boom, or leaving them unsold in a stagnant market.

The stock of dwellings is thus little affected in the short run by changes in demand. The degree to which the supply can respond to demand is important in determining how far increased demand is passed on in increased house prices. In recent years, the rate of growth of the national housing stock (including the rented sectors) has been declining (Chart 4). In the mid-1960s, the annual rate of increase was often over 1.5%, whereas, since 1970, it has never exceeded 1.3%. The 1970s have seen two peaks in growth, in 1971 and 1976, but these were followed by declines. Completions, the main influence on the housing stock, have been at a much lower rate in the 1970s than the 1960s, with peaks in 1970–71 and 1975–76. They fell to their lowest level since the war in 1981, though a small recovery in starts has occurred this year.

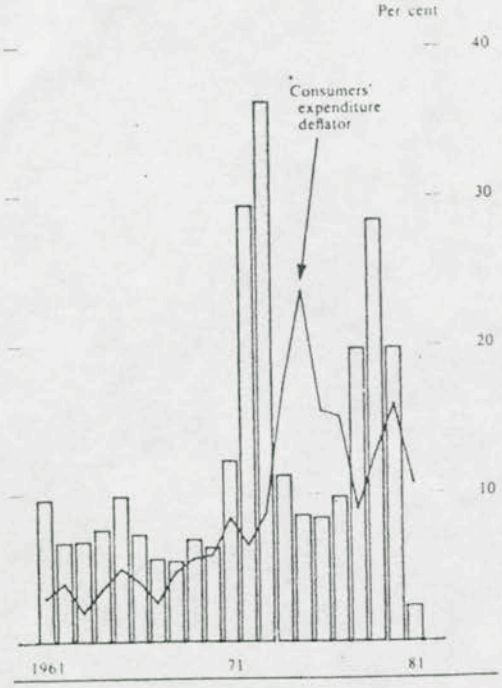
The determinants of new building are imperfectly understood. Most econometric models of housing emphasise costs (labour, materials and interest rates) and the level of house prices (as an indicator of demand and profits). All of these have moved sharply against builders in recent years, 'explaining' the slump in building. Mortgage lending is not used to determine housebuilding in these models, except in so far as it affects price increases.

The demand for housing, and house prices

The long-lived nature of the housing stock, and the slowness with which it can change, suggest that any increase in the demand for owner-occupied housing will be reflected, initially at least, principally in higher house prices, and to a lesser extent in net conversions of existing property and transfers from the public and private rented sectors. The underlying demand for all housing (including rented) is likely to depend on the number of actual (and potential) households and on social trends affecting the size and quality of housing wanted. Furthermore, movements in

(1) These additions, and council house sales, add to demand as well as supply, but by a lesser amount.
(2) The other sources of supply referred to in the text have not until recently been very important—see Chart 4.

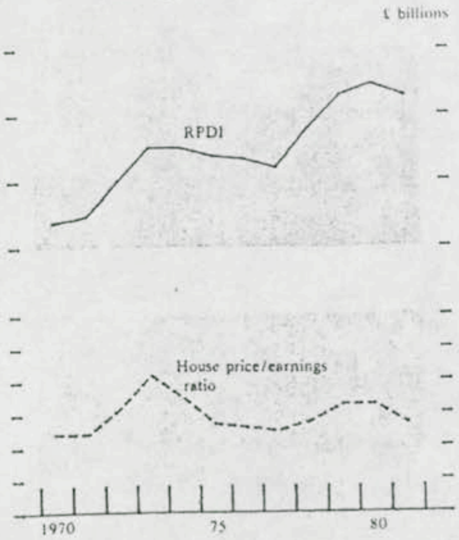
Chart 5
Rate of growth of house prices



real incomes, real house prices and mortgage rates may be influential in producing fluctuations particularly in demand for owner-occupied housing, since prospective buyers can generally advance or postpone their purchase—by continuing to live with parents, for example: incomes are also important because maximum loans are an infrequently-changed multiple of the borrower's income.

The gap between post-tax mortgage rates and the rate of increase of house prices indicates the financial gain to be made from borrowing to buy housing; but when interest rates are high, the proportion of income devoted to debt service may be so high as to choke off demand for mortgages to buy housing, even if rates are still negative

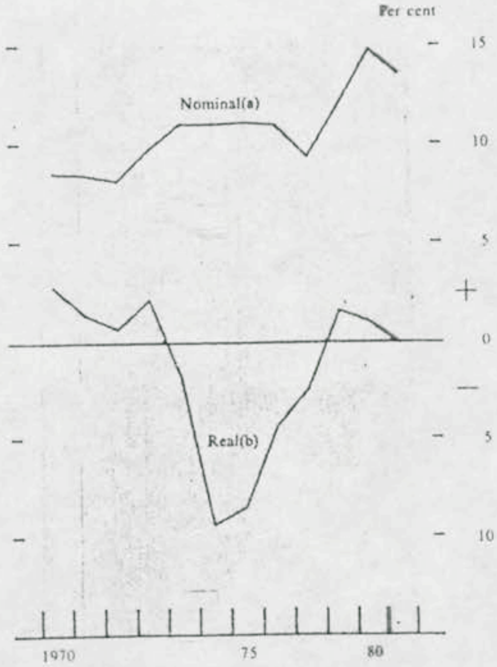
Chart 6
Real personal disposable income (RPDI) and the house price/earnings ratio[(a)]



(a) The average price of new dwellings on which building society mortgages were approved divided by average earnings.

in real terms. When mortgages are freely available at a market-clearing price, house prices will be determined by the interplay of a demand, determined by all these factors, and a supply of housing that is largely—in the short term—fixed. The amount of mortgage lending was an important additional explanatory factor during the period of rationing, since demand was only effective to the extent that funds were available to those wishing to buy for the first time, or to trade-up.

Chart 7
Mortgage interest rates



(a) The building societies recommended rate.
(b) The nominal rate *minus* the average rate of consumer price inflation over the previous two years.

Experience of the seventies

The experience of the seventies illustrates some of these influences. In 1970, house prices were at their lowest level in relation to average earnings since 1963. However, in the same year, real personal disposable income (RPDI) began to grow steeply following several years of stagnation (Chart 6). It continued to rise until 1973, increasing the demand for house ownership, and hence for mortgages, especially since it was accompanied by a large increase in potential first-time buyers resulting from the post-war 'baby boom' (Chart 8). The value of the stock of mortgages rose by 32% more than consumer prices over this period, and was largely financed by an increase in building society inflows. Initially, the stock of new houses for sale was large and house prices rose only slightly (Chart 5). But, by the end of 1971, the annual rate of increase of house prices had risen to 16%, as the stock of unsold new houses ran down; and an announcement of increased local authority rents raised demand further. Moreover, the cut in the mortgage rate to 8% early in 1972 stimulated demand further, and real rates fell fast from 1973 (Chart 7). Large rises in RPDI during 1972 and 1973 (15% in all) also helped to encourage demand (Chart 6). The increase in housing loans peaked in the second quarter of 1972, and fell until 1974, as interest rates [illegible]e; but the slowdown in lending had little early effect in restraining house prices. These accelerated to an annual rate of growth of 48% early in 1973 in a market largely determined by speculative purchases.

In the second phase, 1974–77, mortgage rates were high in nominal terms and RPDI was stagnant. This produced only slow rises in house prices, of around 7% per annum, far below the general rate of inflation.

In 1977, a further turning point was reached. RPDI again started to increase, and the number of building society commitments rose to almost 800,000; this was possible because of the sharp increase in real inflows into the building societies of the previous two years. Over the year, the market was able to absorb the demand, but, by the end, house prices began to look low in relation to earnings. At the same time, the interest rate, fell in stages from $12\frac{1}{4}$% to $8\frac{1}{2}$% by January 1978. The continuing rise of RPDI in 1978 and 1979, and the rundown of the stock of unsold new and secondhand houses built up in the previous three years, combined to produce a rise in house prices of 28% in 1979.

New building society lending was reduced in 1978, following a government request, but effective demand for housing continued at a high level. The rate of price increase slowed with the recession of 1980–81, with both nominal and real[1] mortgage rates high, and RPDI flat. This stagnation has continued to date, despite the growth in lending and slump in completions discussed above. However, in both previous episodes, rapid increases in house prices followed the growth of lending with a lag.

The experience of the early 1970s when a sharp rise in house prices was followed by a sharp rise in inflation might suggest a link, with house prices being a leading indicator of more general inflation. Thus, higher house prices might increase perceived wealth and lead to excess demand for goods; at high levels of activity this might lead to 'demand-pull' inflation. Alternatively, rising house prices and a buoyant labour market might raise wage claims and produce 'cost-push' inflation. If so, it is relevant to consider whether the recent rise in mortgage lending may have implications for house prices and inflation.

Prospects for house prices

Econometric models attempting to explain house prices with parameters based on the experience of the seventies, assign an important role to the real stock of mortgages. This is used as an indicator of whether underlying demand is allowed to become effective, as well as giving some weight to the more fundamental factors discussed above. If these models, were used to forecast house prices now, they would suggest large rises, stemming principally from the recent substantial rise in the real mortgage stock. The failure of house prices to show much movement in recent months, despite high lending, may be consistent with the experience of the seventies; a substantial backlog of houses remaining unsold during the period of falling real house prices may yet have to be cleared.

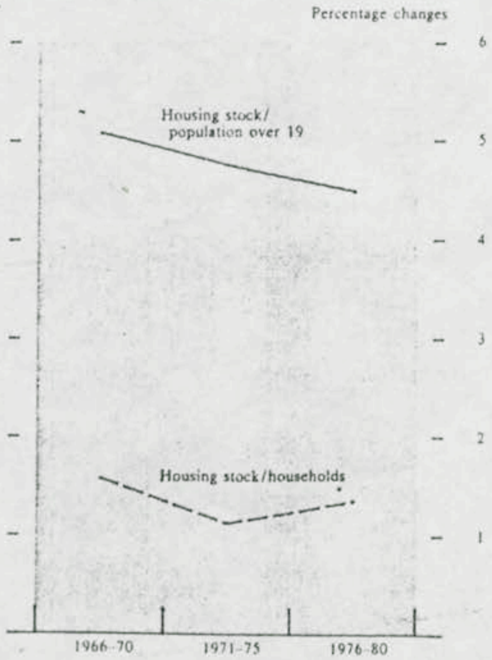
Although recent experience does not yet give cause clearly to reject the relationships which predict substantial rises in house prices, a number of modifying factors need to be considered. One is that most forecasts for the United Kingdom suggest that no sustained rise in RPDI is in prospect. Both of the house price booms of the last decade were accompanied by very substantial rises in RPDI (Chart 6). The econometric relationships estimated over the seventies may thus have difficulty in separating adequately the effects of RPDI and real lending. Continuing high levels of unemployment may dampen demand for trading-up, and by increasing uncertainty about future incomes, make people more reluctant to borrow. In addition, about 100,000 council houses were transferred into owner-occupation in 1981, adding about 1% to the stock of owner-occupied housing, while increasing demand for houses to own by rather less. On the other hand, the total housing stock has not grown so fast in the seventies as the sixties (Chart 4), and its rate of growth has fallen relative to the growth of the adult population, and to a lesser extent, the number of households (Chart 8).

Attractions of mortgage finance

Tax relief on mortgage interest offers a significant incentive to individuals to use mortgage finance when buying a dwelling. In particular, interest on housing loans up to £25,000 is subject to income tax relief, and the treatment of houses for capital gains tax has been particularly generous. However, the limit for tax relief on interest has not been indexed, and has fallen in real value significantly over the years. The introduction this year of indexation of capital gains tax on all assets means that housing is no longer a uniquely advantaged asset.

These changes may reduce the relative attractiveness of housing as an asset. (But in practice, most house-owners,

Chart 8
Indicators of demand for housing



(1) Allowing for current consumer price inflation. See Chart 7.

luding first time buyers, have home loans of less than £25,000. The average loan by building societies in the first quarter of 1982 was £15,385, or 1.68 times borrowers' average income, so most interest on housing loans is still fully tax-deductible.)

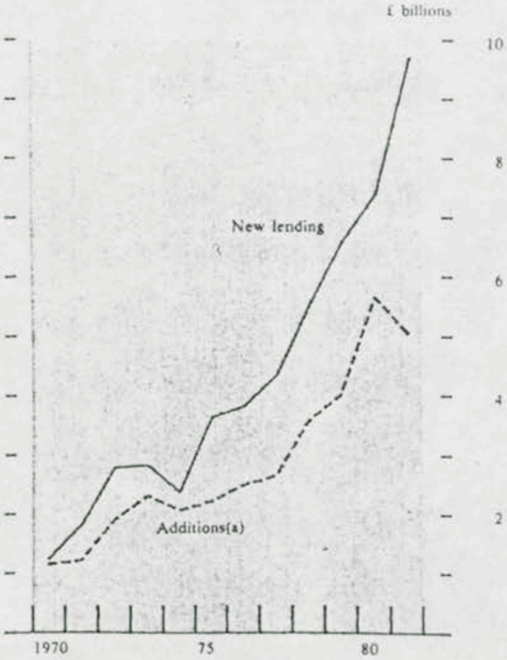
Another attraction of housing as an investment good has been its value as a hedge against inflation. The increase in house prices between 1970 and 1981 was 440%, compared with a 280% rise in consumer prices. However, recently, house prices have risen more slowly than consumer prices (Chart 5); this trend, if continued, should reduce such demand for housing. And falling inflation and high interest rates now being experienced have provided positive real returns on other assets, including most recently some liquid assets. Furthermore, the indexation of some gilt-edged stocks and national savings instruments provides some investments with a guaranteed real return.

The use of mortgage funds

The most important recent development has probably been the removal of rationing, which may have allowed borrowers to restore their gearing (ratio of debt to assets) towards desired levels, without necessarily raising demand for housing. The rise in mortgage lending may therefore reflect principally a demand for assets other than houses, or to maintain consumption.

Not all of mortgage lending is used to finance additions or improvements to the housing stock. If all 10,000 or so houses completed monthly for sale to the private sector were purchased at the average house price on a 100% mortgage, only about £300 million of new lending would be required. Since most completions are thought to be at the cheaper end of the market, little more than a third of total net lending can be for new houses. Council house sales also need to be financed, and more have been financed through banks and building societies than might have been expected. (The lower-than-expected lending by councils is one reason for the public sector borrowing requirement undershoot in 1981/82.) But this, and some small transfer of formerly rented property, could account for only another 10%–15% of new lending. Home improvements could account for a further substantial element. Nevertheless it seems certain that a sizable amount of new lending has gone indirectly to finance spending on goods or other real or financial assets, rather than additions or improvements to the owner-occupied housing stock (Chart 9 shows an estimate of this flow, including borrowing to finance improvements).

Chart 9
New lending and the estimated value of additions to the owner-occupied stock



(a) Calculated by multiplying the number of houses entering the owner-occupied stock (as in Chart 4) by average house prices.

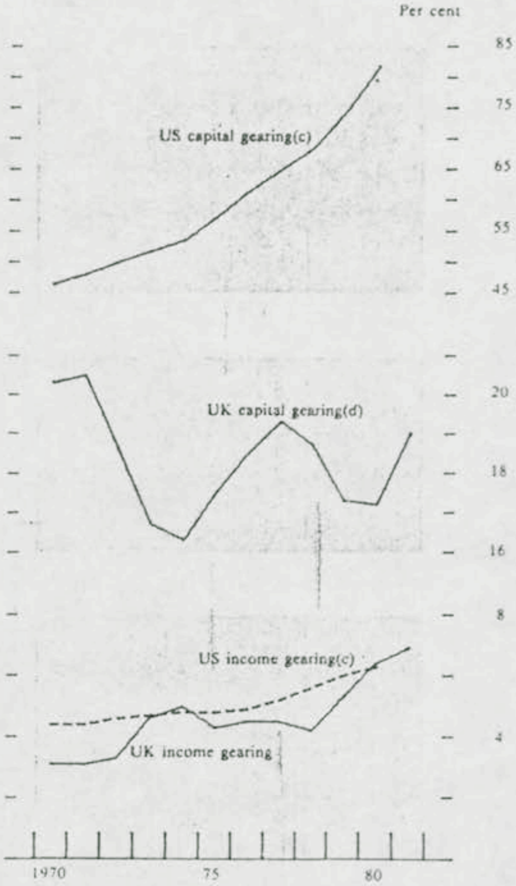
In fact this is inevitable; every chain in the secondhand housing market has an end: the final house comes onto the market because its owner-occupier has died, or ceased to own his house for other reasons, or because it is put on the market by its landlord after the tenant has left. The final seller will end up with cash equivalent to all the increases in mortgage lending granted to members of the chain, *plus* any equity they have injected, *minus* professional fees and taxes caused by purchases in the chain, and *less* any equity that members of the chain have converted into cash. The rapid growth in owner-occupation of a generation ago may suggest that more people are now ceasing to be house-owners—from death or other causes— than in the past. But the number of households continues to grow, perhaps partly because elderly people are now less likely to move to live with their children than in the past, although the net effect is small.

Apart from these withdrawals of equity it is possible that unemployment has persuaded some to trade down and use the cash realised to support their living standards in other ways. Cash will also add to consumption, if mortgages are used to finance estate agents' and solicitors' fees, repairs and maintenance to houses purchased, and new fixtures and fittings purchased at the time of moving. There may have been some increase in the number of formerly rented houses sold over the period and the proceeds invested in other assets or used for consumption. And schemes aimed to help the elderly to purchase annuities with the equity in their house may also have absorbed a small part of higher mortgage lending. It must be presumed that a substantial part of net mortgage lending has gone to sustain spending, repay other debt, or increase holdings of financial assets through these routes.

The destination of these mortgage flows cannot be measured at all precisely because most of the information collected about house purchase transactions, for example, through the Building Society Mortgage Survey, is about purchasers and not sellers. But the Department of the Environment's estimates of the sources from which second-hand houses come onto the market[1] suggest

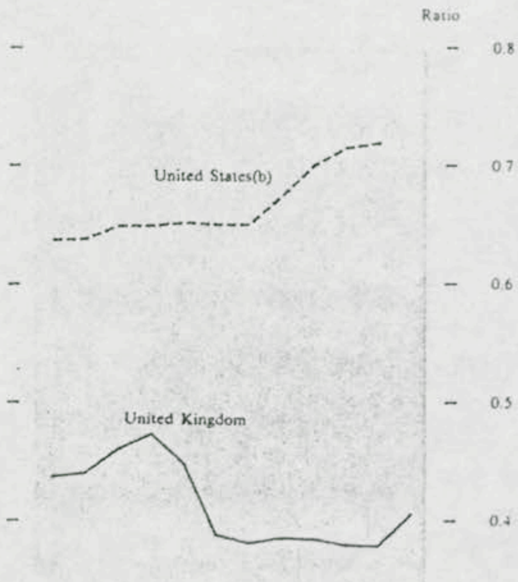
(1) Published in the *Housing Policy* Technical Volume, Chapter 3, Table III 10.

Chart 10
Income[a] and capital[b] gearing in housing



(a) Interest payments divided by personal income.
(b) Outstanding mortgage loans divided by the value of the housing stock.
(c) Household sector. Data unavailable for 1981.
(d) Bank estimate for 1981.

Chart 11
Debt income ratios for the personal sector[a]



(a) Total liabilities divided by gross personal income.
(b) Household sector. Data for 1981 not available.

strongly that sales by the estates of deceased owner-occupiers, and by owner-occupiers moving to other tenures or ceasing to be householders, accounted for the largest part of the money leaving the housing market. Lending on houses for purposes other than house purchase (mainly home improvement) has risen considerably.

Gearing in the housing market

The readier availability of funds in the mortgage market has relaxed a frequently binding constraint on personal financial behaviour. There is no obvious reason why individuals should not respond by increasing their capital gearing in housing (raising mortgage lending as a proportion of house values); particularly as tax concessions still provide an incentive for most home owners to do more borrowing in this way. Trading-up, financed entirely by an increased mortgage, will achieve this: but as noted above, some indirect drain of mortgage funds from the housing market inevitably occurs in this process particularly if trading up is matched by others trading down. Concern about the possibility of direct withdrawal of equity from housing by borrowers obtaining more finance than required for house purchase, and its possible implications for credit and monetary aggregates, prompted a request to mortgage lenders by the Bank of England and the Treasury in January 1982 to limit this possibility.

The capital gearing associated with housing—mortgage loans outstanding divided by the value of the owner-occupied housing stock—fell from almost 22% in 1969 to 20% in 1970, and to around 17% in 1980 (Chart 10). Most of the fall occurred during the early seventies, with the sharp rise in the real price of houses. In 1981 gearing recovered to 19%, but there would seem to be scope for further rises on this account. Estimates for the United States are also shown on Chart 10: during the seventies capital gearing there rose very sharply as borrowers took advantage of their houses to secure their borrowing, in a much freer mortgage market. This may owe something to the fixed interest rates at which many US mortgages have been advanced, when interest rates may have been expected to rise with inflation. (Also anti-usury laws have set a ceiling on interest rates.)

It is possible that the US experience represents a switch, not yet paralleled in the United Kingdom, from unsecured borrowing to borrowing on mortgage. Chart 11 goes some way to confirming this, in that the ratio of all personal sector liabilities to personal income has risen less strongly for the United States, and has fallen less for the United Kingdom up to 1980 than capital gearing on houses alone.

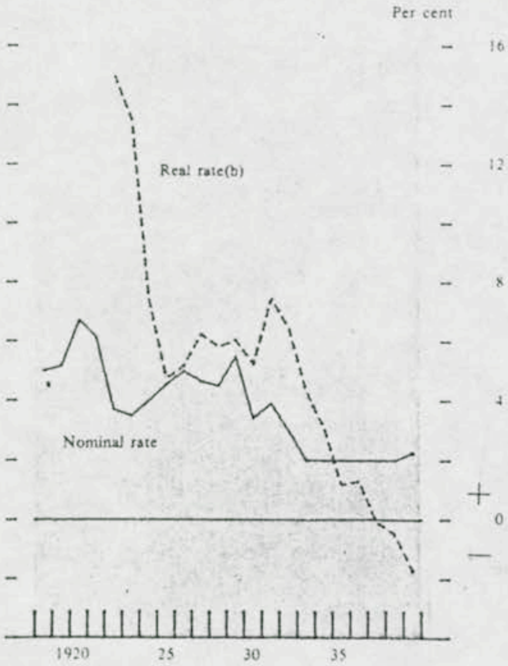
One factor which may constrain borrowing is the level of income gearing (the ratio of debt interest to personal income). Although inflation may act to reduce the burden of repayment in later years, high interest rates with a conventional mortgage impose a heavy front-end burden on borrowers. A summary measure of income gearing for the personal sector is shown in Chart 10, and has risen during the last decade. But this measure includes other interest payments besides those on mortgages, and adds together borrowers with new and old mortgages; it thus understates the deterrent effects of the large share (20%) of average income pre-empted to service an average new mortgage in the first year of the contract. A relaxation of the income gearing constraint could come from the wider availability and greater take-up of low-start mortgages.

The consequences of innovation

It has been argued that the banks' substantial and probably permanent move into the housing market represents a considerable financial innovation. A rather similar change took place in Britain in the early 1930s, when building societies became much less restrictive in the proportion of the purchase price and the period over which they would lend: and, more important, in their attitude to lending to those with low incomes. Previously, low income borrowers had been unable to accumulate a sufficiently large deposit, or finance borrowing over the short terms available.

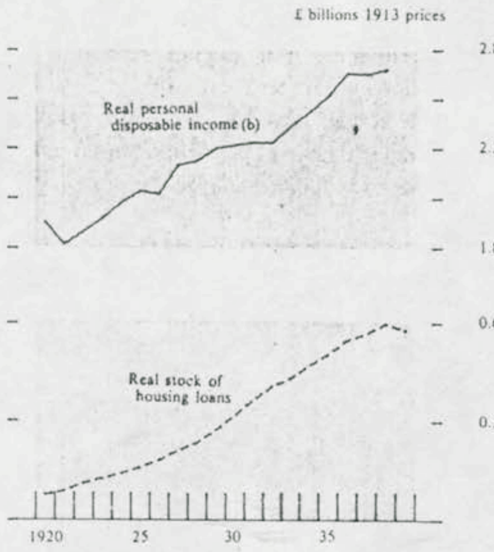
These changes in building societies' practices owed much to the availability of deposits from investors discouraged by profitability prospects for real capital; and to a reduction in the uncertainty which the sharp contraction of activity and price falls of 1930–32, had brought about. They relaxed an effective constraint for many potential home-owners. As Matthews[1] puts it, this amounted to 'an additional factor—a financial innovation—separate from the purely monetary fall in interest rates'.

Chart 12
Bank rate[a]



(a) See footnote (4).
(b) Bank of England Bank rate minus the average rate of consumer price inflation over the previous two years.

Chart 13
Real incomes and housing loans[a]



(a) See footnote (4).
(b) Data for 1939 not available.

The fall in nominal interest rates from 1931, followed by falls in real rates as prices started to rise again in later years, was substantial, and also influential (Chart 12). It enhanced borrowers' ability to fund mortgages, and directly reduced speculative builders' costs. In addition, several other factors favoured a rise in house building. Demand for houses had built up since, and as a consequence of low levels of building during the war; the number of families increased;[2] migration occurred from the more depressed areas to the South and Midlands; and local authorities took a larger share of house completions during the twenties. From 1932, RPDI grew sharply, after stagnating since 1928 (Chart 13).

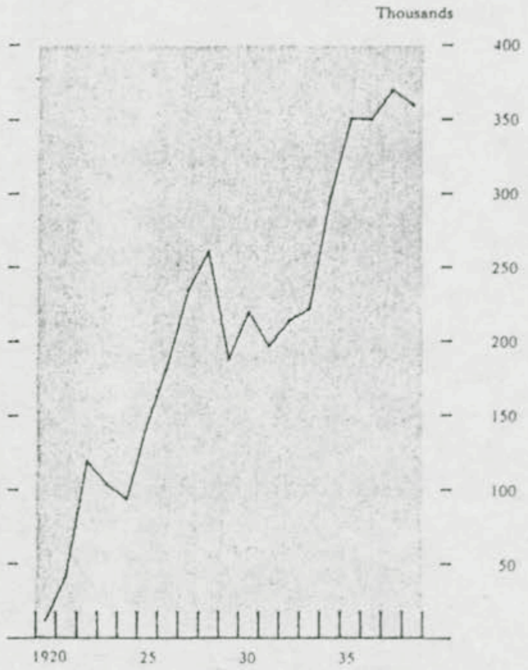
The result was a sharp rise in private completions from 1932 (Chart 14)[3] financed largely by mortgage borrowing. Although little evidence is available, house prices did not appear to rise during the building boom. Improved transport and absence of planning controls in the thirties meant that land for building was in very elastic supply: and building costs actually fell, under the influence of higher productivity, until early in 1935. The outcome was a house building boom which was an important—though far from the only—element in the recovery of the middle thirties, accounting directly for an extra 300,000 jobs between 1932 and 1937.

Although there are some similarities between financial innovation in the thirties and today it seems unlikely that a revival in housebuilding on the scale that took place then will recur. Several of the features of the thirties are lacking today. Interest rates have fallen in nominal terms, but remain high in real terms by the standards of the seventies. Real incomes are not rising strongly, and building land is in rather inelastic supply. The housing stock is high in

(1) R C O Matthews, 'The Trade Cycle' (1959) Page 111. *The Cambridge Economic Handbooks.*
(2) This had grown by 30% in the ten years from 1921 in London and the South East, for example.
(3) Chart 14 shows all completions, since private completions can only be estimated rather imprecisely.
(4) Data sources for Charts 12 and 13: see D K Sheppard, *The growth and role of UK financial institutions 1880–1962* Methuen & Co Ltd 1971, and C H Feinstein, *Statistical tables of national income expenditure and output of the UK 1855–1965*, Cambridge University Press, 1976.

comparison to the population over nineteen[1] by recent standards, after some years of rapid growth in the sixties; and migration of population within the United Kingdom is not occurring on the scale of the thirties. Recent demographic trends which imply more rapid growth of the adult population in the next decade, and the slowdown in building, may presage a degree of pent-up demand in future years, but do not seem to be influential as yet.

Chart 14
Total housing completions



(1) Other indicators of pressure on housing are either themselves influenced by economic conditions, or unreliable for other reasons.

SUBJECT

cc Master ops

Not sent

2

SECRET AND PERSONAL

10 DOWNING STREET

MLS.

THE PRIME MINISTER

Personal Minute

No.

CHANCELLOR OF THE EXCHEQUER

Mortgage Interest Relief

I couldn't disagree more with your paper on this subject.

It is fundamental to our policies that we raise the mortgage interest relief ceiling by a significant amount. It is fundamental to our policies for home-ownership, the property-owning democracy and the family.

It was Labour who imposed this ceiling for precisely the reasons which should lead us to raise it. Ideally, we should this year double the ceiling, and thereafter at least index-link it, as Arthur Cockfield believes. But, given the Budget arithmetic, I would be prepared to settle for a ceiling of £33,000 - i.e. index-linked since May, 1979.

On the arguments in your paper:-

(i) Of course, the £25,000 ceiling affects a minority of cases. It is bound to, because there is such a penalty in borrowing more than £25,000. But, as the figures in your para. 1 show, increasing the ceiling would increase the number of mortgages over £25,000 - and, I suspect, would relieve a log-jam in the market at the same time.

/(ii) There

(ii) There is an undue emphasis in your paper on the position of first-time buyers. We do, indeed, want to help them; but we should also help those already with large mortgages who are our natural supporters, and who are always the target of downwards-levelling policies of successive governments, aided and abetted by inflation.

(iii) It is quite beside the point that these people are better off now than when mortgage rates were around 15%. It was under us that they suffered the hike to 15%-: we are only just below where we were in May, 1979 on this.

(iv) I accept that the tax treatment of housing is already favourable as compared with that for industrial and other investment. So it should be: the first house is a home for for life and home ownership is at the centre of our philosophy.

(v) There is an inconsistency between your view (para. 6) that the favourable tax treatment of housing has switched funds from the equity market and your view (para. 8) that much mortgage lending ends up financing non-housing expenditure. I am astonished by your argument that tax relief encourages higher borrowing and so leaves more funds for people to spend as they choose: what conceivable objection is there to that?

(vi) Nor do I rate highly your monetary arguments. There simply is no evidence that our present monetary stance is lax as a result of excessive mortgage lending (para. 9).

/(vii) I note

(vii) I note the comparisons between owner-occupiers and council tenants (which, by the way, take no account of rent and rate rebates). The switch away from subsidising council houses and to assisting home ownership is precisely what we wish to achieve.

There is a further point on which I would be grateful for your view. Under the scheme whereby mortgage relief is deducted at source,will there not be a manpower argument for increasing the ceiling above £25,000? Does not every mortgage above that figure need to be processed by the Inland Revenue, at high and growing manpower cost?

I very much hope that you will now agree to double the ceiling; or, at least, to increase it to £33,000.

28 February, 1983

10 DOWNING STREET

1

Prime Minister

Mortgage Interest relief Ceiling

Here is the Chancellor's paper ; and a note from Alan Walters.

I have taken the liberty of annotating the paper (with Robin's help) with the counter-arguments.

As I warned you, they are all united in this view - and it is a concerted view.

MCS 25/12

E
FILE

aa

Copy No. 2 of 2 Copies

25 February 1983

PETROL, DERV AND VED

The Prime Minister was grateful for the Chancellor's minute of 24 February.

She agrees with his proposals.

MICHAEL SCHOLAR

John Kerr, Esq.,
HM Treasury.

Econ Pol
(2)

Prime Minister

ENGINEERING INDUSTRIES ASSOCIATION MS 23/2

REPRESENTATIONS
TO THE
CHANCELLOR OF THE EXCHEQUER

BUDGET 1983

FEBRUARY 1983

ENGINEERING INDUSTRIES ASSOCIATION

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER

BUDGET 1983

1. INTRODUCTION

Consideration of the Green Paper on Corporation Tax is now well into the stage when thoughts must be in the chrysalis form before translation into action. There is even more need to simplify the tax system as a whole, and the Association feels that now is the time to look at the whole structure of taxation. The present system has grown up from the last effort at consolidation in the Income and Corporation Taxes Act 1970, which over the years is rapidly approaching a point of complexity which is as unnecessary as it is incomprehensible.

The keynote is simplicity, with a corresponding restraining hand on the Inland Revenue practice of weaving the most simple language into the most complicated web of anti-avoidance devices. For example, the Association has had the benefit of talks with members of the Department of Industry who have been most helpful throughout the year, as in previous years - leading to assurances that one scheme in particular, the Business Start-up Scheme, was straightforward as far as the tax rules go. Yet as late as December 1982 a Member of Parliament MP Nicholas Baker is on record as saying that he would certainly like to see the rules eased up more. Other vital needs in the tax system must be (or remain)

- to aim for the stimulation of British Industry production for both home and export markets. Adequate investment/reinvestment in plant is vital to this aim, and this takes cash which is in short - or negative - supply to the small firm in particular.
- the introduction of a profits plough-back scheme as suggested in paragraph 5.2 of our 1982 Representations where we noted comments from the Report of the Select Committee on Corporation Tax and pointed out that other countries, in particular Japan, Germany, France and the United States have built into their economies an adequate plough-back of profits for investment in new competitive plant and machinery. British Industry must have a similar facility if it is to survive against the onslaught of cheaper foreign imports.
- the acceptance that there should be some form of POSITIVE incentive through the tax system of allowances to encourage the purchase of British made goods, in particular plant and vehicles.

2. SMALL ENGINEERING FIRMS INVESTMENT SCHEME (SEFIS)

The introduction of SEFIS following the Association's representations on the Budget 1982 was most welcome. A sure sign of its popularity and need was the speed with which the scheme was taken up, closing after only two months of its inception. We are, however, concerned that there is apparently no intention to renew this scheme. The Secretary of State for Industry, Mr Patrick Jenkin, was kind enough to spare the time to attend the last Council meeting of the EIA on 9 December 1982.

He accepted that SEFIS had been popular and it had achieved its aim but he made no promises about future schemes such as SEFIS.

Mr John Bolton, President of the Association, pointed out that billions of pounds were to be spent on supporting people but much needed aid such as SEFIS was measured in millions only, despite the fact that capital investment would create sources of much-needed new cash inflow. No only would this be an investment in the revival of British Industry but would foster the creation of real jobs and help put this country back on a competitive basis.

The Government has certainly introduced a number of successful schemes designed to help the small company during its term of office, yet EIA membership has again fallen drastically since the last budget. In 1981 the Association lost five times the number of member firms (representing 50,000 employees) over the previous year. In 1982 we have lost a further 493 member firms representing a further 30,000 employees. Can this go on much longer and remain compatible with Government's oft-repeated acknowledgment of the vital role of the small firm in British Industry?

The Association repeats its urgent message that more investment help is needed, and quickly, if we are to survive, and our members not to join the statistics of 'the billions of pounds spent on supporting people and not jobs'.

Surely a scheme such as SEFIS is a must towards the reversal of this downward trend.

3. THE LOAN GUARANTEE SCHEME

The President, Mr John Bolton, raised the subject of the Loan Guarantee Scheme with Mr Jenkin, particularly in view of lower interest rates . This too, has been a successful scheme, and we are glad to learn that it is to continue. One bank's contribution to the scheme had created 5,500 jobs, and 8,000 businesses had received loans totalling £250 million; 44% of these in the engineering sector.

Mr MacGregor has followed up his statement in the House on European Community loans for small businesses with the signing of an agreement with ICFC for loans at attractive rates of interest to small and medium-sized companies in Britain, ranging from £15,000 to £250,000. The interest charge of 11½% at present includes a charge for exchange risk cover.

The Association welcomes this move. Many firms in EIA have invested heavily in expansion, putting up new buildings and buying new machines for increased production and efficiency, only to face crippling interest charges. The drop in the original Loan Guarantee Scheme is a help here but members have asked us "Would it not be sound planning to create a special funding for small companies to borrow at a low rate (5% was mentioned) with a term of repayment on the lines of a proper mortgage, with the usual mortgage securities?".

/3...

This proposal does have its attractions, and would be a major step in the right direction in implementing our proposals last year under the heading 'Investment Grants in Industry' and 'Small Companies.'

Cash flow would be eased with a lower interest rate, and the scheme could go one stage further to ensure a plough-back of profits that, as an overall package, should go far to reverse the present dismal downward spiral of efficiency and competitiveness into the first signs of a breakthrough into an upwards spiral.

4. IMPORT SUBSTITUTION

last year the Association made a strong case for a move towards import substitution and correlating creation/preservation of jobs.

The Economic Progress Report for December 1982 tells us that imports of manufactures have grown three times as fast as exports, and that 'part of the rise in import penetration in manufacturing in recent years can be attributed to the loss of competitiveness since 1979.' It is this loss of competitiveness that MUST be halted and reversed if many more British firms are to be saved from going under.

The creation of jobs is important, and the recent television programme on the Japanese setting up a 'Video in the UK' plant carried with it the creation of new jobs in Telford. However, the question was asked, and is one that we all must be asking every day, "is this a genuine attempt to set up in the UK instead of exporting from Japan, or is it a token to head off mounting Japanese imports into UK? More new jobs could be created in Telford and multiplied all over the country by more energetic and rewarding schemes like SEFIS and the Loan Guarantee Scheme.

Government must be aware that this is so!

5. VALUE ADDED TAX

VAT itself is now the most complicated (indeed the most unnecessarily complicated) of any single tax. In last year's Budget Representation we urged that the time has come for the codification and simplification of VAT, and we repeat this plea.

Other urgent changes needed are:

- VAT should not be chargeable between registered traders. A great deal of unnecessary work and expense could be cut out by this change.

- There should be a much higher minimum turnover level for compulsory registration for VAT. Last year we suggested £100,000 - even this low figure entails a turnover of less than £2,000 a week and would relieve only the smallest of small firms and traders.

/4....

- VAT relief for bad debts needs to be extended from its present very limited base. The accountancy profession has made detailed submissions on this need, and we suggest that this relief could be policed by the accountancy profession in the same way that bad debts are handled for corporation tax purposes.

6. ENERGY COSTS

The members of EIA express their real concern about the high energy costs in this country. These energy costs, as you are aware, do greatly affect the price of materials and very obviously over the last few years have assisted particularly this country's competitors, it being found that machined items could be imported cheaper than the actual material can be bought in this country.

We are not suggesting that there should be a Government subsidy on energy but are expressly critical of the "hidden taxation on industry" created by national government policy that nationalised industries must charge to create prices well above an economic price and reasonable profit as illustrated by the high profits published by the gas industry. The Government's policy of fixing monopolistic prices rather than leaving the nationalised industries to fix their prices according to market forces and normal commercial practice are greatly detrimental to our industry.

7. MISCELLANEOUS

We repeat our assertions that:

- the investment income surcharge is a positive disincentive to investment and should be abolished.

- the national insurance contributions are a burden to the smaller employers in particular, and even the 'limited increase' to employers is an added burden.

- the cost of administering Stamp duty is out of all proportion to the income derived, and should be abolished.

- we note that the 'petrol and other fuel benefits' charged to directors and higher paid employees as from 6 April 1983 have no provision for tapering relief. It seems to be unnecessarily harsh that if petrol or other fuel is provided for private motoring and this is not refunded by the employee entirely, then the full scale benefit will apply. Is it really Government's intention that a 'partial refund' (even of 99%) will NOT affect the imposition of the <u>full</u> scale benefit?.

WTW/jv/18283.

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CH/EX REF NO B(83)12

COPY NO 1 OF 8 COPIES

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

Prime Minister

Agree these proposals?

MES 24/2

Yes mo

PRIME MINISTER

PETROL, DERV AND VED

We spoke last night about the duty increases I have in mind for petrol and derv. This note sets out my proposals in a little more detail for these duties and for Vehicle Excise Duty. I need to settle this now, so that Customs and Transport can go ahead with printing the detailed tables.

2. As I told you, I plan to increase the duty on petrol by 4p, which will yield £190 million in the coming year. This is slightly less than full revalorisation, which would have meant an increase of 4½p and an increased yield of £20 million. I propose that derv should go up by 3p, yielding £40 million. Full revalorisation would have meant an increase of 3.7p yielding £10 million more.

3. In both cases, the increases are relatively modest, but the revenue yield important. I am sure that this is the right course to take, particularly at a time when oil prices are falling.

4. If VED on cars and light vans were revalorised exactly this would mean an increase from the present £80 to £84.32. I propose to round this up to £85 which will yield £90 million. In deciding about VED on goods vehicles we have to bear in mind our commitment to move as quickly as possible to a position in which taxation, through derv duty and VED, is sufficient to ensure that each lorry group covers its road costs. To this end, and assuming 3p on derv, I am accepting proposals from David Howell to increase VED on the heavier and more damaging lorries by up to 26 per cent, which would still leave them short

of fully covering their road costs, and to fulfil our commitment to charge sufficient VED to ensure that road costs will be fully covered from the outset for the 38 tonne lorries which will be allowed on the road from 1 May. But we also plan to <u>reduce</u> VED by up to 10 per cent on over 300,000 lighter lorries, which is about 60 per cent of total goods vehicles. Even with this reduction, which will be a useful bonus to the operators concerned, road costs will still be covered for these particular lorry groups.

5. All these proposals have been discussed with David Howell and Nigel Lawson; and I have discussed the proposals for petrol and derv with George Younger, Nick Edwards and Michael Jopling. All are content. I should be most grateful if you could let me know, by Monday morning, whether you too are happy with them.

GH

(G.H.)
24 February 1983

Econ Pol

BUDGET CONFIDENTIAL

SW

10 DOWNING STREET

From the Private Secretary

24 February, 1983

Dear John,

HOUSE OF LORDS DECISION - WICKS V FIRTH
JOHNSON V FIRTH : EMPLOYER SCHOLARSHIPS

The Chancellor sent the Prime Minister a copy of his letter to the Secretary of State for Education and Science, dated 23 February.

The Prime Minister has minuted that she is opposed to the decision; and that it will be seen as act against the middle income groups.

I am sending a copy of this letter to Imogen Wilde (Department of Education and Science).

Yours sincerely,

Michael Scholar

John Kerr, Esq.,
H.M. Treasury

SW

BUDGET CONFIDENTIAL

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

PRIME MINISTER

MORTGAGE INTEREST RELIEF

... I attach the note by my people which I mentioned to you. I know you won't like it, but I am bound to say that I find the case against an increase in the ceiling on mortgage interest relief pretty convincing. I have discussed this with all your Treasury Ministers. None of us believes that it would be right to raise the ceiling.

2. As you will see from the figures in the note, the costs of making a move would significantly affect the Budget arithmetic. To raise the ceiling to £30,000 could in the end cost about as much as a full percentage point increase this year in all the income tax thresholds, which would in practice be far more beneficial. Gains would go mainly to existing owners: because house prices would be pushed up, benefits to first-time buyers would be minimal.

why only first-time buyers.

3. I believe the politics point in the same direction. Any change on this front will increase our exposure to the charge that the Budget (like the income tax changes which we rightly made in 1979) leans too much in favour of the better off. And it would be criticised for favouring the "affluent South" to the disadvantage of the North.

/4. If you remain

4. If you remain unhappy about this, I will of course be happy to have another word. But I really do think that to increase the ceiling would be a mistake.

G.H.
24 February 1983

MORTGAGE INTEREST RELIEF

Costs of increasing the limits

1. The cost of mortgage interest relief in 1983-84 will be some £2.1 billion. The following table gives broad estimates of how the costs would rise if the ceiling were raised:-

- on what assumptions about take-up?

Increase ceiling to:	1983-84 cost	1984-85 cost (including initial extra borrowing)	Eventual* cost (at 1983-84 prices and income levels) including the effect of additional borrowing
	£m	£m	£m
£30,000	50-75	75-100	100-200
£35,000	75-100	100-125	200-300
£40,000	100-125	125-150	250-350
£60,000	125-150	150-200	350-450
£80,000	150-175	200-250	400-500

*This cost would build up over about 5 years.

If the ceiling were raised in line with average increases in house prices in the life of this Government it would be about £33,000.

- but what would it be if increased to its real value when it was imposed - £60,000?

Mortgages and house prices

2. The figures for building society average new mortgages show that the £25,000 ceiling affects only a minority of cases, and that these are concentrated in London and the South East.

it would, wouldn't it - there is such a penalty in going above £25,000 at present

Average new mortgages:
(Building Societies only)

	UK	Greater London	Rest of South East
	£	£	£
All buyers (Q4 1982)	16,900	22,600	20,100
First-time buyers (Q4 1982)	15,700	22,300	19,300

- if this is the average there must be many at or already above £25,000 in London & SE

The Inland Revenue estimate that out of nearly six million mortgages only about 100,000 to 150,000 are currently over £25,000.

3. House prices rose by 6 per cent from Q4 1981 to Q4 1982. The house price/earnings ratio is lower now (3.3:1) than at any time since the introduction of the mortgage interest ceiling in 1974 - at the end of 1973 the ratio was 4.5:1. Gross mortgage repayments for first-time buyers now average 20 per cent of income, compared with 27 per cent at the end of 1981, and 26 per cent at the end of 1973.

So what: — partly because interest rates have fallen since 81 & partly because of the £25,000 ceiling for the 73 comparison?

Gainers and losers

If so, it is surprising that the tax loss figures in para. 1 are so high.

4. The main beneficiaries of a ceiling increase would be existing owners with big mortgages who would pay less tax. First-time buyers at the top end of the market might benefit for a time, but lower mortgage costs are likely to increase house prices (especially when the market is rising anyway). Raising the ceiling is thus unlikely to make housing cheaper for first-time buyers. ?

The effect of lower interest rates

5. The mortgage rate fell from 15 per cent to 10 per cent in 1982.

The mortgagees to be blamed for historically high interest rates which they had no choice but to endure for 3 years.

So what?

- a purchaser taking out a £25,000 mortgage in December 1981 would have paid interest gross of £3,750, or net of tax relief at the basic rate, of £2,625;

- for the same house now, and allowing (generously) for a 10 per cent increase in mortgage to cover house price increases, a £27,500 mortgage would cost only £2,000 a year net despite the £25,000 limit;

- the £2,625 net he would have paid in December 1981 would now pay his net interest on a £33,750 mortgage.

Investment in housing or

Investment in housing or in enterprise

Of course – it is one's home for life

6. The tax treatment of investment in housing already compares very favourably with the treatment of investment in risk projects. Tax concessions to home ownership are already worth over £5 billion. In addition to mortgage relief, the sale of a taxpayer's main residence is exempt from capital gains tax, but other gains from investment are not, and tax and investment income surcharge is levied on the income they generate. As the Tax and Savings Group pointed out, this has channelled funds away from the equity market, raised the cost of capital, and so contributed to the decline in private equity and business investment, which we wish to stimulate. see comment on para 8

7. The following table summarises the contrast in treatment:-

	House	Own Business	Shares
Tax relief			
- on investment	No	Yes	No (1)
- on interest payments	Yes	Yes	No
Tax			
- on income from asset	No	Yes	Yes
- on capital gain from asset	No	Yes	Yes

Note:

(1) But relief is given at the company stage in the form of a capital allowance against corporation tax.

Monetary implications

8. A large part of mortgage lending is of course used to finance additions to the stock of owner-occupied houses, or to finance improvements. But most of the remainder undoubtedly ends up financing

/additional

This is inconsistent with the argument at the end of para 6: the Chancellor can't have it both ways!

spending or purchases of other assets. There are perfectly legal ways in which this kind of leak can occur. For example, a large part of the funds raised for housing inevitably accrues as cash in the hands of the last person in the chain, who is ceasing to be an owner-occupier; and tax relief encourages people to borrow more than they otherwise would, leaving more of their own funds free for other uses. and why not?

9. Total bank lending to persons rose by 45 per cent and bank lending for mortgages by 85 per cent in the year to January 1983. A recent Messels survey suggested that mortgage lending which becomes available to finance other forms of spending will amount in 1983 to some £7.2 billion. This is probably an over estimate: a figure of some £4-5 billion out of total mortgage lending of around £12 billion is more likely. But the impetus this gives to monetary growth, consumer spending and ultimately inflation is disturbing, and would increase if the ceiling on mortgage interest relief were raised.

because of a structural change in housing finance away from Building Soc's to banks

but we're not worried about our monetary growth - if anything it has been tight in 1982

Comparison between owner-occupiers and council tenants

10. Between 1979-80 and 1983-84 council rents will have more than doubled. Tenants will be paying some 80 per cent more from their own resources than in 1979. Most mortgagors will, however, be paying less in cash now than at any time since 1979 because of the fall in interest rates and because they still have the same mortgage.

from a very low base

11. As the following table shows, owner-occupiers have also done better from the subsidies under this Government. Mortgage tax relief has increased by 50 per cent while direct subsidies to public sector housing have halved.

	1979-80	1983-84
Council house subsidies	£1.95 billion	£0.85 billion
Mortgage tax relief	£1.4 billion	£2.1 billion

Personal

Feb 25th 1982

Prime Minister

Mortgage Interest Tax Relief

I am sorry to have to say that the Treasury note (Feb 24th) is economically correct. There is no faulting the economic case.

It would be best to concentrate all possible tax relief into raising the thresholds.

It is painful for me to oppose a measure on which you have such strong views — but I must.

Alan Walters

BUDGET CONFIDENTIAL

Prime Minister

The Chancellor proposes to legislate to make company scholarships taxable as a fringe benefit.

This will be seen as a mean act against the middle income groups. I am against it.

MCS 23/2

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

23 February 1983

The Rt. Hon. Sir Keith Joseph Bt MP
Secretary of State for Education and Science

Dear Keith

HOUSE OF LORDS DECISION - WICKS V FIRTH, JOHNSON V FIRTH

EMPLOYER SCHOLARSHIPS

You are already aware of this House of Lords decision, given on 16 December last.

The case concerns scholarships provided through an educational trust set up and financed by ICI for the children of its employees. The House of Lords was asked to decide whether the value of the scholarships received by the students were taxable as fringe benefits of the parents. For the Revenue it was argued that, while Section 375 of the 1970 Taxes Act applied to exempt the scholarships from tax in the hands of the scholars, the exemption did not apply to such benefits when they came effectively to the parents because of their employment by ICI. This argument was accepted by a majority in the Court of Appeal. The House of Lords, however - also by a majority - decided that while the scholarships were undoubtedly fringe benefits of the parents, Section 375 extended to exempt them in the parents' hands.

I have considered whether we could simply live with the Lords' decision on the grounds that schemes of this kind are a means of indirectly attracting, albeit upon a selective basis that was essentially dependent upon the parents' employment, additional financial resources to education. However, I have concluded that this would be wrong, and in the last resort indefensible. Employers' scholarships of this kind are indistinguishable from any other "fringe benefit". Like many other such benefits, they came into existence (as I know from my own experience with one company) as a means of mitigating the high marginal tax rates which we got rid of in 1979. To leave them with a special tax advantage would be widely seen as unfair - and inconsistent with what we ourselves have often said about the "perks" society.

Morever, while the tax loss would currently probably be no more than £m10 a year, that figure could be expected to grow rapidly if no action were taken. After all, schemes do not only provide scholarships for undergraduates but some cover everything from preparatory school to doctorates. And already Press articles are suggesting that companies should take advantage of the situation created by the House of Lords' decision in Wicks v Firth on the basis that there is little to lose if the Government did legislate.

I felt it right to tell you that I propose to introduce in this year's Finance Bill a provision designed to bring into charge on the parents the benefit of scholarships which come to students because of their parents' employment. The charge will apply to payments made for the academic year 1983/84 and later years - payments for earlier periods will be exempt in accordance with the House of Lords' decision. Employers will naturally still get a tax deduction for the money they spend on these schemes. This is right and fair because the costs are part of the remuneration package they offer to their employees along with salary, pension rights and company car.

There is of course no question of taxing genuinely charitable scholarships won in open competition; these will remain tax free for scholars and parents alike. The intention of Section 375 would thus continue to be fulfilled. This was originally enacted in 1920 in order to exempt scholarship income from tax in the hands of the person being taught, and that purpose is as desirable today as it was (rightly) thought to be in 1920.

As you will imagine, I did not arrive at this decision lightly. In particular I have been conscious of the need to avoid causing possible hardship to those parents who are currently enjoying the value of scholarships which will now give rise to taxable benefits. But I think it is true to say that all those affected will have recognised and accepted at least the possibility of taxation when the scholarship first became payable. In any event I hope that the period of grace to the end of this academic year will give them time to appraise the changed situation and make any dispositions that are necessary.

Much too soon

For the record, I should point out that we are not concerned with school fees etc paid by employers when the parents are abroad on business. These are and will continue to be covered by quite separate categories of relief which in different forms provide special treatment for service overseas of employees in both the public and the private sectors.

Likewise, the same tax rules apply to Crown servants and others who continue to draw boarding school allowance while serving in the United Kingdom. In such cases boarding school allowances paid are fully taxable as an addition to remuneration. In short, we are not vulnerable to criticism that by bringing scholarship schemes like ICI's into tax we are taxing the private sector while tolerating an anomaly in the public sector - on the contrary we are acting to maintain consistency of tax treatment.

I realise the difficulties of this course of action, with an election not far away; and some of our supporters will be disappointed by what I propose. But to leave this unintended tax advantage in place would be to allow a relatively small number of people, whose remuneration was arranged in a particular way, to achieve help with their school fees by the "back door". Many people who are not offered similar facilities by their private sector employers, and all in the public sector, would not be able to benefit from this. If we want to provide tax relief for private education, we should decide to do it for all as a matter of deliberate policy. I am sure it would be wrong to do so simply by turning a blind eye to the consequences of a decision in the House of Lords.

One final and not unimportant point. I am considering for my Budget on 15 March a number of measures which will include significant benefit to those with larger incomes and capital. I am firmly convinced that measures of this kind (even when they are placed alongside the other similar reliefs that we have already introduced) are fully justified. But we must be prepared to rebut the inevitable criticism from our opponents. And to do this convincingly, we must be able to show that we are equally firm when arrangements of the kind which we are now discussing confer an unfair advantage.

I am copying this letter to the Prime Minister.

GEOFFREY HOWE

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C/EX REF NO B8311

COPY NO 33 OF 35 COPIES

RECORD OF THE FIFTH BUDGET OVERVIEW MEETING AT 11 AM ON 22 FEBRUARY

Present:

Chancellor	Mr Burns	Mr Kemp
Chief Secretary	Sir Lawrence Airey (IR)	Mr Cassell
Financial Secretary	Mr Fraser (C&E)	Mr Ridley
Economic Secretary	Mr Littler	Mr Hall
Minister of State (C)	Professor Walters (No 10)	Mr Evans: Item 1 only
Minister of State (R)	Mr Bailey	Mr Green: (IR) Items 3&4
Sir Douglas Wass	Mr Middleton	Mr Kerr only
Sir Anthony Rawlinson	Mr Moore	

Papers:

i. Post-Budget Forecast and Draft IAF (Mr Evans' minute of 21 February)

ii. Petrol, Derv and VED (Minutes of 18 February from Mr Moore and Mr Freedman, and of 21 February from Mr Bone)

iii. Corporation Tax (Mr Battishill's minute of 17 February)

iv. Progress Report (Mr Kemp's minute of 21 February)

v. Budget Speech (Mr Norgrove's minute of 18 February)

ITEM 1: Post-Budget Forecast

It was noted that the provisional post-Budget forecast appeared to imply that the fiscal adjustment in 1983-84 might be some £0.5/1 billion lower than in the January forecast. But it was still subject to a number of uncertainties, for example the oil price assumption, and further work was in hand. The forecast for inflation was rather better than before. The 1982-83 outturn PSBR might now be only some £7.5 billion, though further work too was in hand on it.

2. The Chancellor noted that further discussion of the post-Budget forecast would be required. But Mr Evans' submission illustrated the need to keep close to the lower end of the cost-bracket for Budget B in the annex to Mr Kemp's minute. A separate meeting on the draft industry act forecast (and the MFTS) had been arranged for 24 February.

/ITEM 2: Petrol

ITEM 2: Petrol and Derv

3. It was agreed that increases of 4p and 3p in the excise duties on petrol and derv should be the preferred option. The alternative option of increases of 4½p and 3½p should however be kept alive, pending discussions with the Secretaries of State for Transport, Energy, Scotland, and Wales, and with the Chief Whip and the Prime Minister.

ITEM 3: Corporation Tax

4. It was agreed that, in the light of the provisional post-Budget forecast, corporation tax options involving a reduction in the main rate from 52 per cent to 50 per cent should now be dropped. Cutting the small companies rate from 40 per cent to 38 per cent was regarded as a higher priority, and it was agreed that option 6b in Mr Battishill's minute should be included in the Budget. The lower profit limit would remain at £0.1 million, but the upper limit would rise to £0.5 million. The new marginal rate would be 55½ per cent, and the cost some £40 million in 1983-84, and £70 million in 1984185.

ITEM 4: Progress Report

Budget Balance

5. It was suggested that some might see the proposed NIS reduction as the marginal item, and the proposed 8½ per cent increase (above Rooker Wise) in income tax thresholds as the essential element, if the fiscal adjustment were squeezed. Others, including the Chief Secretary, however suggested that the increase in thresholds and the NIS cut should be regarded as central to the Budget. Given the forecast, it was agreed that it would be important not to exceed "Package B" on oil taxation, now under discussion with the Secretary of State for Energy: the Minister of State (R) would indicate to the Energy Secretary on 23 February that the Chancellor could not go beyond the position described in his letter of 21 February. The ACT and DTR

/options should

options should remain under consideration, though both might suffer in the event of a serious squeeze. It was noted that the risk of pressure for assistance for petrochemicals, or on energy prices, appeared to have receded. Discussions on the mortgage interest relief ceiling were proceeding: a concession must be strongly resisted. And on employment measures, it appeared that the sum now at risk was [now] only of the order of £25 million, since the Employment Secretary was not pressing for the temporary short time working scheme. (No provision need be made in the Budget arithmetic for tax reliefs on NIC for the self-employed.) The Chancellor would talk to the Employment Secretary (on 23 February)

Public Expenditure

6. Apart from the separate question of the adjustment of the social security uprating, it was noted that the public expenditure position was reasonably satisfactory, given the reduction from £120 million to £25 million in the amount at risk on employment measures.

Packages

7. The Chancellor thought the technology and innovation package - as described in the note of 18 February - satisfactory, though it must of course remain subject to review in the event of a squeeze. In the construction package, as described in the note of 21 February, only items 4 and 7 were contentious. Urgent advice from the Inland Revenue was required on item 7 (stock relief: householder's part exchange); while the Chief Secretary should consult Lord Cockfield about item 4 (extension of hotel allowance to self-catering). Final decisions on the caring package should await other decisions on social security matters, and a meeting with the Secretary of State for Social Services (subsequently arranged for 28 February). It was noted that the most costly item - the extension of widow's bereavement allowance - was also probably the most attractive: the Chancellor thought that it should if possible be retained. In the miscellaneous package, the Chancellor asked

Chancellor asked for early submissions on items 10 and 12 to 17 in the list of 21 February. It was noted that item 11 could now be dropped.

8. The Central Unit were asked to provide revised and condensed tables, covering the overall Budget and the packages, for further discussion, perhaps before the next overview meeting.

BUDGET SPEECH

9. The Chancellor commended the draft Budget speech circulated by Mr Norgrove on 18 February. Drafting suggestions should be submitted to the Central Unit by close of play on 23 February, bearing in mind the desirability of shortening, rather than lengthening, the present text.

J O KERR
22 February 1983

Distribution:

Those present

Mr Freedman - Customs and Excise
Mr Howard - Customs and Excise
Mr Isaac - Inland Revenue
Mr Battishill - Inland Revenue
Mr Mountfield
Mr Robson
Mr Griffiths
Mr French
Mr Harris
Mr Norgrove

A 1B

PRIME MINISTER

THE BUDGET

As is usual at this time, new work from the forecasters suggests that we shall have between £½ and £1 billion less to use for reductions in taxes than we thought last week. (The main elements in the change were revisions on the oil price and on tax receipts.) I expect there will be some more movements in the estimates before the Budget is finalised, but I doubt if they will be significant. All this shows the wisdom of planning for a low PSBR in the initial stages of Budget discussion.

I am afraid, however, that the central elements of the Budget strategy, in particular the raising of the thresholds by Rooker Wise plus at least 8½%, will come under additional pressure as the arithmetic becomes harder. In past years it has been treated as the residual legatee. In earlier discussions we took the view that this year it would be first not last on our list.

I think it would be wise to remind the Chancellor of your commitment to the increase in the thresholds. The question he may pose to you is would you then prefer that there be no half-a-per-cent reduction in NIS. I know your answer to this, but I believe there is in the Treasury still a tendency to regard NIS reductions as somehow superior to threshold increases. You may have to offset that bias.

You may also wish to enquire about the contingency plans if there is a fall in the price of oil to, say, $25 a barrel. Such a value does not appear as the central consideration of the Budget arithmetic - and perhaps rightly so. But I believe that contingency planning would be no bad thing.

AW

ALAN WALTERS
22 February 1983

1A

CH/EX REF NO 13 (83) 9

COPY NO 1 OF 3 COPIES

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

PRIME MINISTER

BUDGET ARITHMETIC

A brief note on the Budget arithmetic may be useful before today's meeting on social security matters.

2. As you know, I envisage that in the Budget:-

(a) Most specific duties would be fully revalorised.

(b) For industry there should be a further ½ per cent NIS cut from August, some concessions (which I am still discussing with Nigel Lawson) on the North Sea oil regime, and some movement on Corporation Tax.

(c) For individuals I envisage a major increase in the thresholds - perhaps 8½ percentage points, over Rooker-Wise (5.4 per cent), for all bands and rates. I also hope to increase child benefit substantially - hopefully taking it back to its level in April 1979

(d) I am also putting together a series of lesser measures to assist enterprise and small firms, technology and innovation, construction, and charities - including a major (but not inexpensive) simplification of the Business Start-Up Scheme.

3. The PSBR cost of the Budget measures in 1983-84 is of the order of £1.6 billion to £1.9 billion. The comparable costs for 1984-85 are about £1.9 billion to £2.4 billion.

/These

4. These figures have to be seen against our present estimate - which may contract - of "fiscal adjustments" - that is, room for manoeuvre - of £2 billion for 1983-84 and between £2.5 and £3 billion for 1984-85. If this week's forecast narrows the room for manoeuvre (and it looks likely to do so), I would be driven to the lower figures in paragraph 3 above, and might if necessary have to pare down some of the measures described in paragraph 2 above - not least because we must be able to show a reasonable "fiscal adjustment" remaining for 1984-85. But I would hope that the main measures would stand, for they constitute an effective package, split almost exactly equally between businesses and persons (taking into account measures announced in the Autumn), and would be seen as politically helpful while also continuing our prudent monetary and fiscal policies. (There would be a continued reduction in planned borrowing.)

5. But overhanging all this is the question of the social security over-provision. The amount at stake here amounts to some £180 million in 1983-84 and £530 million in 1984-85. If we were to have to drop all action to deal with the over-provision, and also to proceed with some of the attractive concessions which we have been considering, with Norman Fowler, the figures would rise to £250 million in 1983-84 and £725 million in 1984-85.

6. You will see that these amounts would have a very serious effect on the Budget arithmetic. If the fiscal adjustment does have to be revised downwards in response to the latest forecasts, some of the key paragraph 2 measures would have to be dropped. Even if no revision proves necessary, following the forecast, we would still be left with a derisory, or negative, fiscal adjustment for 1984-85. Moreover, the public expenditure position, particularly for 1984-85, would be particularly difficult.

7. In short:-

(a) If the forecast turns against us we shall have to keep the cost of our Budget measures to the lower figures in paragraph 3 (or even lower), which means omitting some attractive measures.

/In

(b) If in addition we were to drop action on social security over-provision, the result would be a most unattractive Budget: a relatively small amount of reliefs etc, with (certainly in the second year) the social security beneficiaries taking a very large part, leaving relatively little for the rest of the personal sector and for industry.

8. It follows that, whether we proceed by the Chief Secretary's route or by Norman Fowler's, we really must act on the over-provision. My preference is for the Chief Secretary's route, because I judge it easier to win that way in the House. But win we must: that is the key point.

Margaret O'Meara

for (G.H.)

21 February 1983

(approved by the Chancellor and signed in his absence)

PERSONAL
COVERING BUDGET SECRET

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

Michael Scholar, Esq
10 Downing Street
LONDON SW1

17 February 1983

Dear Michael,

BUDGET

I promised last night to let you see some material showing where we now are on Budget work. I accordingly ... enclose a set of records of the weekly "stock-taking" meetings, together with a copy of the score card which was discussed at this week's one. Budget B on the score card shows where we are now heading, though much of course depends on what surprises the forecasters have for us next week.

We plan to send you a minute on 22 February, for discussion on 23 February. And we are priming our incendiary device on Mortgages.

Yours ever,

John K.

J O KERR
Principal Private Secretary

PERSONAL
COVERING BUDGET SECRET

:T PROGRESS REPORT

BUDGET SECRET

DATE: 11 FEBRUARY 1983

TABLE A

.R COSTS (indexed base) £m

		Firm or Open	BUDGET A 1983-84	BUDGET A 1984-85	BUDGET B 1983-84	BUDGET B 1984-85	BUDGET C 1983-84	BUDGET C 1984-85	Comment
Specific Duties	Overall	F	10	10	10	10	10	10	Cigarettes and Cider
	Petrol	0	-	-	-	-	50	50	Possible petrol
Industry	NIS	F	200	300	200	300	200	300	½% NIS from August, private sector only
	Oil	F	90	140	90	140	90	140	Oil - Package B) Note: Mr Lawson looking
	Oil	0	-	-	-	-	15	(30)	Oil - PRT reliefs) for £200m in total) 1983-84
	CT	0	-	-	130	180	130	180	Cockfield on CT or Reduce CT rate by 2% etc
	CT	0	-	-	-	-	-	100	ACT/DTR options
Persons	R/W	0	700	730	990	1040	1140	1200	R/W + 6-8½-10%
	CB	0	[90]	[250]	[90]	[250]	[90]	[250]	CB (P/Ex charged to the Reserve)
	IIS	0	-	-	-	-	5	35	Reduce IIS to 10%
Packages/Risks	Misc	0	400	550	400	550	400	550	(say) see separate notes
			1400	1730	1820	2220	2040	2535	
Fiscal Adjustments		0	2000	3000	2000	3000	2000	3000	Depending on forecast.
PSBR		0	8000	7500	8000	7500	8000	7500	Depending on decisions.

REVENUE COSTS OF BUDGETS £m

	BUDGET A 1983-84	BUDGET A 1984-85	BUDGET B 1983-84	BUDGET B 1984-85	BUDGET C 1983-84	BUDGET C 1984-85	Comment
Indexed	1530	2130	2015	2805	2255	3290)	)
Non-indexed	1760	2585	2345	3260	2485	3745)	) These might appear in Table 1 of the FSBR

Direct Split - Revenue costs

	BUDGET A 1983-84	BUDGET A 1984-85	BUDGET B 1983-84	BUDGET B 1984-85	BUDGET C 1983-84	BUDGET C 1984-85	Comment
Budget							
Persons	1020	1315	1360	1735	1570	2085	
Businesses	510	815	655	1070	685	1205	
As above	1530	2130	2015	2805	2255	3290	Indexed revenue costs as above
Budget plus Autumn							
Persons	1020	1315	1360	1735	1570	2085	
Businesses	1210	1615	1455	1870	1485	2005	
As above plus Autumn	2230	2930	2815	3605	3055	4090	Indexed revenue costs as above plus 1% NIS from April (£700m 1983-84, £800m 1984-85)

C/EX REF NO B (83) 8

COPY NO 34 OF 34 COPIES

RECORD OF THE FOURTH BUDGET OVERVIEW MEETING AT 11AM ON 15 FEBRUARY

Present:

Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Sir Lawrence Airey (IR)

Mr Burns
Professor Walters (No 10)
Mr Middleton
Mr Moore
Mr Kemp
Mr Cassell
Mr Ridley
Mr Kerr
Mr Robson

Mr Fraser (C&E), Mr Bailey Items 1-3 only

Mr Freedman (C&E) Item 3
Mr Howard (C&E) only

Mr Isaac (IR))
Mr Blythe (IR)) Item 4
Mr Spence (IR)) only

Papers:

i. Progress Report (Mr Kemp's minute of 14 February)

ii. Budget Packages (Sir D Wass's minute of 14 February)

iii. Indirect Taxes, Petrol and Derv (Mr Fraser's minutes of 11 February)

iv. Income Tax Options (Minutes of 7 and 11 February from Mr Spence, Mr Blythe and Mr Isaac)

v. Budget Speech (minute of 14 February by Mr Kemp)

ITEM 1: Progress Report

Budget Balance

The meeting considered whether Budget B (£2 billion fiscal adjustment, half on income tax thresholds) in Table A to Mr Kemp's minute was the best "central case" for planning purposes. It was suggested that, if in the light of the forecast which would be available in the week of 21 February a larger fiscal adjustment seemed possible, the increased relief should be tilted more to industry than in the present Budget C. Cabinet and backbench opinion favoured action to benefit industry, and such public opinion poll evidence as was available suggested that this preference was widely shared. It was also argued, however, that the likely future oil price movement might justify some caution about the fiscal adjustment, and that business and industry would benefit substantially, although indirectly, from increases in the income tax thresholds.

2. It was agreed that Budget B should remain the "central case"; but the Chancellor asked that the next progress report should incorporate variants to Budget C which would tilt it further towards direct help to industry. (Action: Central Unit)

3. The meeting briefly considered the extent to which it would be possible at Budget time to take credit for the Autumn NIS reductions. It was suggested that only one of the two (half point) NIS reductions announced in the Autumn Statement could fairly be taken into the Budget arithmetic for presentational purposes. The Chancellor asked that the matter be further considered in the next progress report. (Action: Central Unit)

ITEM 2: Packages

Construction

4. The Financial Secretary expressed concern that small operators were excluded from the extension of the Allowances envisaged for self-catering accommodation. He thought it important that some relief for the small operators should be found, particularly if the larger operators were to benefit. The Chancellor asked that the matter be considered further. (Action: FST/MST(R))

West Midlands

5. The Chancellor and the Chief Secretary noted a reference, in Sir Douglas Wass's minute, to the possibility of giving the West Midlands development area status. It was noted that this should be seen as a warning, rather than a recommendation, and that the case against it had been put in a minute by Mr Chivers. It was agreed that the possibility should not be considered for the Budget: decisions on the designation of future development areas should await the consideration of the Quinlan regional policy study.

<u>Fairness in Taxation</u>

6. The <u>Chancellor</u> agreed that it would probably be wrong to envisage a specific package on "fairness in taxation" at Budget time. But some of the measures now being considered under this heading might well be appropriate to the Budget, and to presentation <u>seriatim</u> in the Budget Speech. (Action: FST/MST(R))

<u>Review of Packages</u>

7. It was noted that the overview meeting on 22 February would review progress on packages, and the balance between them, following individual meetings on each in the current week. The <u>Chancellor</u> asked that the packages should be presented, for that meeting, in a collated form, listing and costing firm decisions, and remaining options, on each. The options should be set out in the order of preference of the Minister coordinating each package. (Action: Central Unit)

ITEM 3: Excise Duties

<u>Tobacco</u>

8. The <u>Economic Secretary</u> reported on the position reached on the residual tobacco duties, which had been referred to him following the decision already taken on cigarettes. He suggested, and the <u>Chancellor</u> agreed, that the duty on cigars should be increased in line with that on cigarettes. As for pipe tobacco, he was attracted by the case - made, among others, by the Secretary of State for Northern Ireland - for no increase this year. The cost would be only some £2.5 million. The <u>Chancellor</u> agreed that there should be no increase in the duty on pipe tobacco.

<u>VED/Petrol/Derv</u>

9. Although this would be slightly above revalorisation, it was agreed that VED should rise by £5.

10. The <u>Chancellor</u> was inclined to think that straight revalorisation would be right for petrol, and probably also for derv, though there might

be a case for increasing the differential in favour of derv. It was noted that some rural interests would be offended by a duty increase on either petrol or derv (though real farm incomes rose by some 32 per cent in 1982) and the chances of a substantial revolt in the House were probably lower this year than last year, and could be further reduced if briefing material were available promptly on Budget Day. The Chancellor asked for the preparation of a short analysis of the Secretary of State for Transport's arguments for increasing petrol duty over and above revalorisation. (Action: Mr Moore) Meanwhile the options could be narrowed to full revalorisation of both petrol and derv, and increases of 4p a gallon (petrol) and 3p a gallon (derv). The cost of the latter would be £25 million. (Action: Customs & Excise)

Paraffin

11. It was decided not to pursue the Secretary of State for Energy's proposal to abolish the 1p a gallon duty on domestic paraffin.

ITEM 4: Personal Taxation

Income Tax Thresholds

12. The meeting considered the impact of an 8½ per cent increase in income tax thresholds. The inter-action with NIC was noted: figures including NIC would have to be included in the tables published on Budget Day. It was suggested that the tables, when converted from a static to a dynamic basis, would be less disturbing, but that to convert using a 6½ per cent factor could have a damaging impact on pay expectations.

13. The Chancellor agreed that planning should proceed on the basis of an 8½ per cent increase in thresholds. Tables should be prepared using the assumption of a 6½ per cent increase in average incomes, and also that of a 4½ per cent increase in average incomes. A final decision on the incomes increase(s) to be shown would be taken later.

Higher Rate Bands

14. It was suggested that the higher rate bands should be raised only by revalorisation, or at least by less than revalorisation plus 8½ per cent. Indexation plus 8½ per cent could provoke criticism. It was also suggested that such criticism could best be defused if the higher rate bands were raised only sufficiently to compensate for non-indexation since 1979, with a view to returning to the position reached in the 1979 Budget. It was however argued, particularly by Sir L Airey and Mr Isaac, that there were no obvious stopping-places short of 8½ per cent, that picking 1979 as an ideal year could be counter-productive, and that it was not unreasonable that those paying tax at the higher rates, who suffered most when the thresholds were not raised, should gain most when they were. The Financial Secretary agreed, and thought that an 8½ per cent increase across the board would give elbow-room for action against the more dubious reliefs, and defuse criticism of non-revalorisation of the mortgage interest relief ceiling.

15. It was agreed that the higher rate thresholds and bands should increase in line with the main personal tax allowances.

Investment Income Surcharge

16. The meeting considered the options of indexation, indexation plus 8½ per cent, indexation plus a reduction in the rate from 15 to 10 per cent, and an increase in the threshold to £11,000. It was noted that the Revenue cost of the last two options would be some £85 million, though the PSBR costs would be negligible in 1983/84, and only some £35 million in 1984/85.

17. The Financial Secretary and the Economic Secretary were attracted by the third option (ie a reduction in the rate): it would signal the Government's intention to abolish IIS in due course, whereas raising the thresholds would paradoxically make abolition more difficult. It was however noted that reducing the rate would create no staff saving. The Chief Secretary, Sir Lawrence Airey, and the Minister of State (C) argued for the second option; and the Chancellor decided that the IIS threshold should rise in line with the income tax threshold.

Age Allowance

18. It was also agreed that the age allowance should rise by the same percentage as the main tax thresholds.

ITEM 5: Budget Speech

19. The Chancellor commended the "building blocks" for the Budget Speech circulated with Mr Kemp's minute of 14 February. He had been encouraged by the progress so far made on the Speech. He asked that any general comments on the shape, scope, and structure of the draft should be forwarded to the Central Unit by close of play on 16 February.

J O KERR

Distribution:

Those present

Mr Littler
Mr Evans
Mr Hall
Mr French
Mr Harris
Mr Norgrove

C/EX REF NO B/83/7

COPY NO 27 OF 27 COPIES

RECORD OF THE THIRD BUDGET OVERVIEW MEETING AT 11AM ON 8 FEBRUARY

Present:

Chancellor	Mr Burns	Sir L Airey (IR)) Item 1
Chief Secretary	Professor Walters (No 10)	Mr Fraser (C&E)) only
Economic Secretary	Mr Middleton	Mr Moore)
Minister of State (C)	Mr Kemp	
Minister of State (R)	Mr Cassell	Mr Evans)
Sir Douglas Wass	Mr Ridley	Mr Monck) Item 2
Sir Anthony Rawlinson	Mr Kerr	Mr Odling-Smee) only
		Mrs Lomax)

Papers:

i. Budget: Public Expenditure (Sir A Rawlinson's minute of 7 February)

ii. Economic Effects of Lower Oil Prices (Mr Kerr's minute of 7 February)

iii. Budget Packages (Sir D Wass's minute of 7 February)

iv. Progress Report (Mr Kemp's minute of 7 February)

v. Medium Term Financial Strategy (Mr Burns' minute of 3 February)

vi. Monetary Targets in 1983/84: M1 (Mr Monck's minute of 26 January)

ITEM 1: Progress Report

Public Expenditure

The Chancellor noted that the Chief Secretary and Sir A Rawlinson envisaged that Budgetary proposals for public expenditure could be charged to the Contingency Reserve up to a maximum of £350 million. It was also noted that any excess over £100 million should reduce the fiscal adjustment pro tanto.

Oil

2. Noting that the uncertainties about the future oil price were if anything greater than in the run up to the 1982 Budget, the Chancellor asked that consideration be given to the case for not only making clear at Budget time the oil price assumption underlying fiscal plans, but also taking powers to adjust these plans in mid year if the assumption proved unfounded. A sophisticated version of the regulator might be appropriate. If the

oil price fell more sharply than anticipated, excise duties on petrol and derv might rise. Alternatively, if the price stayed higher than expected, some fiscal relaxation - eg a further move on NIS - might be feasible. It was suggested that action to raise the duty on petrol and derv would be readily understood, but that action to lower NIS would be harder to explain. It was also noted that the effect on inflation and on monetary growth of a sharp decline in the oil price would be fairly small. A short study on what form of regulator would be most appropriate, and whether and how it should be announced, was nevertheless commissioned. (Action: Mr Middleton).

Packages

3. It was agreed that Lord Cockfield should be asked to put forward, by 14 February, any proposals he might have for a tourism package. (Action: Chief Secretary). The "fairness in taxation" package should be ready - with the other packages - for meetings in the week of 14 February. (Action: FST/MST(R)).

Budget balance

4. The Chancellor reported that the balance of opinion in Cabinet on 3 February had been in favour of a Budget along the lines so far emerging, ie weighted more towards tax reliefs for persons than for industry. He nevertheless wished to test the arguments once again. In a tour de table, it was pointed out that the proposed balance of the 1983 Budget would only partially offset that of recent Budgets, which had been tilted heavily in favour of industry; that business was pressing for action on the income tax thresholds; and that the balance was in fact pretty even, if the Autumn Statement measures were taken into account. It was also noted that action on thresholds would be beneficial to industries' costs, in that it should encourage further pay moderation. On the other hand, it was argued that public opinion would be surprised if tax thresholds were raised by as much as 8½ percentage points above revalorisation.

5. It was agreed that the balance of Budgets A and B in Table A of Mr Kemp's minute of 7 February was probably about right: that of Budget C

was however perhaps tilted too heavily in favour of the personal sector. The Chancellor asked that for the overview meeting on 15 February the progress report should present an assessment of the balance of the alternatives then on offer. (Action: Mr Kemp).

ITEM II: MTFS

MTFS: objectives

6. It was agreed that the MTFS should again open with a general statement of the Government's medium term objectives. It should be along the lines of the formula in paragraph 5 of the MP paper attached to Mr Burns' minute, though the second sentence should be revised to read: "The objective over the medium term is to continue reducing inflation, so providing the foundation for the sustainable growth of output and employment".

MTFS: treatment of the exchange rate

7. It was agreed that the MTFS text should be prepared on the basis of no major change in the 1982 exchange rate formula.

MTFS: monetary ranges

8. It was suggested that a reduction in the monetary ranges - to 6/10, 5/9, and 4/8 - for the three years 1983-84 to 1985-86 might be appropriate, taking account of the progress already made, and as an encouragement to more. It was also noted that such a reduction would be helpful as a way of increasing the credibility of the inflation forecast, should an optimistic variant of it be chosen. On the other hand, it was argued that the best course would be to hold to the 7/11, 6/10, 5/9 ranges, both on the grounds of prudence, and because further reductions might create new fears. The Chancellor, noting that a final decision was not an immediate requirement, asked that text should be prepared on the basis of last year's guidelines for 1983-84 and 1984-85 (ie 7/11 and 6/10) and a further 1 per cent deceleration in 1985-86 (ie to 5/9). (Action: MP).

1983-84 PSBR

9. It was argued that the options for the 1983-84 PSBR were not only £8 billion or £7.5 billion: there was a case, particularly in terms of output,

for considering £8.5 billion. It was however noted that this would probably mean a substantial increase on the 1982/83 outturn; and that recent exchange rate movements had both provided a boost to output and increased the arguments for caution over the 1983-84 PSBR. The Chancellor concluded that a 1983-84 PSBR of above £8 billion need not be excluded. He however regarded £8 billion as the central case. If in the end it became clear that £8 billion would permit a fiscal adjustment of only £1 billion or less, he would wish to look again at £8.5 billion: conversely, if it became clear that it would permit a fiscal adjustment of £2 billion or more, he would wish to look again at £7.5 billion. For the moment, the MTFS drafts should be prepared on the basis of £8 billion. (Action: MP).

PSBR: 1984/5 and 1985/6

10. The Chief Secretary suggested that, given a 1983-84 PSBR of £8 billion, the MTFS should show £7 billion in 1984-85 and £6 billion in 1985-86. This would demonstrate downward pressure rather more convincingly than did variant A in Table 5 of the MP paper, but would be less harsh than variant B. Mr Burns and Mr Cassell saw advantage in variant A - £8 billion again in 1984-85, and £7 billion in 1985-86. The Chancellor asked that MP work to a path showing 2¾ per cent of GDP in 1983-84, 2¼ per cent in 1984-85, and 1¾ per cent in 1985-86. The final choice would probably be between this path, and that at variant A. (Action: MP).

MTFS: economic assumptions

11. It was agreed that work should proceed on the basis of the assumptions set out at column A in Table 9 of the MP paper (Action: MP).

12. It was agreed that texts of the key MTFS passages should be available for consideration by the Chancellor early in the week of 14 February. A meeting with the Governor would then be arranged, either later that week, or early in the following week.

Jim Ruth

PP J O KERR

Mr Kerr

CH/EX REF NO B(83)5

COPY NO 21 OF 33 COPIES

RECORD OF THE SECOND BUDGET OVERVIEW MEETING AT 11.45AM ON 1 FEBRUARY

Present:-

All Ministers	Mr Middleton	Mr Green IR	(CT/N Sea only)
Sir Douglas Wass	Mr Bailey	Mr Battishill IR	(")
Sir Anthony Rawlinson	Mr Cassell	Mr Crawley IR	(")
Sir Lawrence Airey (IR)	Mr Kemp	Mr Wicks	(")
Mr Burns	Mr Moore	Mr Robson	(")
Mr Fraser (C&E)	Mr Howard (C&E)	Mr Kerr	
Professor Walters (No 10)	Mr Ridley	Mr Hall	

Papers:-

i. Budget Packages (Sir Douglas Wass's minute of 31 January)

ii. Progress Report (Mr Kemp's minute of 28 January)

iii. NIS/Corporation Tax (minutes of 26 January from Mr Battishill, and of 27 and 31 January from Mr Moore).

iv. North Sea Fiscal Regime (minute of 28 January from the Minister of State (Revenue).

Budget Security

The Chancellor expressed concern at press speculation about the Budget. Some of the weekend (29/30 January) stories had been disconcertingly precise. Contacts with the press should be minimised until after the Budget, and Treasury Ministers and officials should decline to be drawn into discussion of its likely contents.

Budget Packages

2. Sir Douglas Wass drew attention to the references in various packages to possible changes in CTT. It was agreed that a meeting specifically on CTT would be arranged for 8 February. DHSS should also be asked to forward their Budget proposals very quickly.
(Action: Private Office)

3. The Chancellor said that he would also wish to hold meetings on each of the main packages immediately after his return from Washington. Ministers were asked to ensure that submissions on individual packages presented a range of options, in the recommended priority order, rather than a single, take it or leave it, proposal.

Capital Expenditure

4. The Chancellor said that he thought it would be presentationally important to draw attention, at Budget-time, not only to the additional capital expenditure element in particular packages (eg. the construction package) but also to the allowance made in the public expenditure plans for increased overall capital expenditure. Ideally, the presentation should specify particular projects which the increase would buy. The danger of appearing to revert to volume planning was noted; but it was agreed that the public expenditure section of the Budget speech should be made as project-specific as possible. (Action: Sir A Rawlinson)

PSBR Cost of Budget Options

5. The Chancellor noted the references in minutes of 28 January from Mr Kemp and Mr Blythe (IR) to changes in the personal tax options, apparently resulting in part from a re-estimate of PSBR costs following a decision to revert to the assumption of fixed exchange rates, rather than a fixed money supply. He has not been aware of this decision, and was inclined to query it, though noting that the PSBR costs of 1982 Budget measures had been prepared on a fixed interest rate assumption; and that the Inland Revenue thought this the correct assumption to use again. It was agreed that a note should be prepared describing the options, and the case for each; assessing the significance of the choice; and making recommendations. (Action: Mr Middleton)

6. It was noted that the personal tax options, together with the options on child benefit, and on investment income surcharge, would

be considered at a separate meeting on 3 February; and that the main subject for discussion at the third overview meeting on 8 February would be the MTFS.

Corporation Tax

7. Four options for CT changes were identified:-

(a) assistance to small companies, by increasing the lower profits limit to £120,000, raising the upper limit to £360,000 and reducing the marginal rate to 55 per cent. (Para 10 (d) of Mr Battishill's paper).

(b) (a) plus a cut in the CT rate from 52 per cent to 50 per cent.

(c) Lord Cockfield's proposal for a slice system, with the rate on the first slice reduced from 40 per cent to 35 per cent; and

(d) a cheaper move to a simpler slice system, on the basis of the present 40 per cent rate and the first £100,000 of profits (para 13 of Mr Battishill's paper).

8. Sir Lawrence Airey argued for (c) - and against the alternative of a cut in NIS. The Chief Secretary, though strongly preferring a cut in NIS to action on CT, agreed that a move to a slice system would make better sense than a cut in the top rate from 52 per cent to 50 per cent. It was noted that both (c) and (d) were cheaper than reducing the rate to 50 per cent. The Minister of State (Revenue) pointed out that both (c) and (d) would reduce future scope for further measures specifically to benefit small business; and the Financial Secretary thought that the adoption of (d) would cause the small

business lobby to drop their campaign for the introduction of a slice system, and argue against the measure.

9. It was agreed that option (d) should be discarded. Further work should be done only on the other three options, though the Chancellor thought that (b) might in the end prove too expensive. (Action: IR)

NIS

10. Noting that the abolition of NIS would be too costly for this Budget, and that a cut of a full point would leave NIS at the absurdly low rate of ½ per cent, the Chancellor thought that the only realistic options this year were a ½ point cut, or no change. The analysis in Mr Moore's minute of 27 January had suggested that the economic effects, and the benefit to manufacturing industry, of a cut in NIS would exceed those of a comparable reduction in CT. Some scepticism was expressed about the MP table annexed to Mr Moore's paper, but the Financial Secretary pointed out that cuts in CT would benefit only profitable companies, while cuts in NIS would help all, including those now hard pressed, and fighting import penetration. The Minister of State (C) thought it important to show once again that the Government were making progress towards the abolition of the NIS "tax on jobs".

11. It was decided that the Budget should include a ½ point cut in NIS. (Action: FP)

North Sea Fiscal Regime

12. The Minister of State (Revenue) described the three options set out in his paper of 28 January: all included the agreed measure of appraisal relief, and the difference in their costs arose from different methods of phasing out APRT. His own recommendation was for option (b), but he had envisaged that this would be combined with some CT relief. The Chancellor agreed that option (b) by itself would not be sufficient, and Mr Wicks pointed out that the Energy Secretary might press for the

(costly) phasing out of royalties on existing fields, but could perhaps instead be offered a doubling of the oil allowance on new fields - a concession which would be cost-free in the short term.

13. The Chief Secretary thought that there was little public sympathy for the oil companies. Concessions designed to encourage future development would be understood: concessions which merely improved current cash flow would not. Mr Crawley added that UKOA in fact appeared to be pressing more for incentives to future development than for assistance with current cash flow.

14. The Chancellor agreed that the proposition which he should put to the Energy Secretary on 2 February was option (b) plus the doubling of the oil allowance for future fields. He would not mention the possibility of a 2 per cent reduction in the CT rate.

JOK.

J O KERR

Distribution:

Those present
Mr Littler
Mr Mountfield
Mr Evans
Mr French
Mr Harris
Mr Norgrove

CH/EX. REF. No. B(83)2
COPY No 35 OF 35 COPIES

1. ~~Mott~~
2. JR.
3. FERC again

RECORD OF THE FIRST BUDGET OVERVIEW MEETING AT 11.AM ON 25 JANUARY

Present:

All Ministers	Mr Middleton	Mr Cassell
Sir Anthony Rawlinson	Mr Bailey	Mr Evans
Sir Douglas Lovelock	Mr Kemp	Mr Kerr
Sir Lawrence Airey	Mr Moore	Mr Hall
Mr Burns	Mr Howard (C&E)	Mr Norgrove
Mr Littler	Mr Ridley	

Papers:

i. The Forecast (Mr Evans' minute of 21 January)

ii. The 1983-84 PSBR, and Fiscal Options (Mr Kemp's minute of 21 January)

iii. Packages (Sir D Wass's minute of 24 January)

iv. Draft Cabinet Paper (Mr Kerr's minute of 24 January).

Item 1: The Forecast

Introducing the January forecast, Mr Burns drew attention to the prospect of significant growth in both demand and output, with the latter forecast to revive at a rate faster than the average of the 1970s. Real interest rates were however expected to remain high. It was noted that the prospect for the balance of payments was rather better than in the Autumn Statement: surpluses of £1 billion in 1983 and £2 billion in 1984 were now foreseen. The long term inflation forecast caused concern, and would be further discussed in the light of further advice. [Action: Mr Burns]

1983-84 PSBR

2. The Chancellor said that the forecast suggested that a PSBR of £8 billion (2¾ per cent of GDP) would permit a fiscal adjustment of £2 billion. But this, on top of the measures announced in the Autumn Statement, might strike the markets as excessive. Mr Burns agreed that any move away from £8 billion should be downward. Mr Middleton thought that there was in fact a good case for a PSBR of £7.5 billion,

argued that full revalorisation across the board would be right. The Chancellor agreed, though warning that pressure for a concession could build up. It was agreed that the possibility of a concession of some £150 million (£2 billion module)/£100 million (£1.5 billion module) should in future be shown under the "fiscal risks" category, rather than as a desirable fiscal option. It was noted that a separate and smaller meeting on the specific duties was being arranged for 28 January.

7. On assistance to industry, it was suggested that no reduction in NIS could be accommodated within the £1.5 billion module. The Chief Secretary and the Minister of State (C) however expressed a preference for reducing NIS rather than corporation tax. The Minister of State (R), Financial Secretary and Economic Secretary expressed the opposite view. The Chancellor asked for the preparation of a separate submission comparing the relative merits of NIS and CT reductions. /Action: Mr Moore/MST(R)/.

8. On assistance to persons the Chancellor agreed that it would be sensible at this stage to envisage that the largest single component in both modules should be a substantial rise, over Rooker-Wise, in income tax thresholds. One might plan on 8 percentage points in the £2 billion module, and 6 points in the £1.5 billion module. Whether child benefit should be increased pro tanto should be further considered: the increase in the 1982 Budget had been in line with other benefits, not prices. A full submission was required. /Action: Mr Monger/Mr Moore/.

9. On North Sea Oil taxation, the Chancellor asked for a very early submission, with a view to his opening discussions with the Secretary of State for Energy before the Cabinet on 3 February. /Action: Mr Middleton/ MST(R)/.

Packages

10. The meeting reviewed the work described in Sir Douglas Wass's minute of 24 January, and agreed on the allocation of responsibilities

Fiscal risks

16. The meeting then considered note (c) attached to Sir D Wass's minute of 24 January.

17. It was agreed that the Treasury at all levels should resist the idea of new subsidies to bring coal prices down. Pressure for early action on industrial rates ought to be easy to resist, on purely practical grounds. It should also be possible to resist the suggestion that the car tax should be reduced or abolished, since the case for such action was extremely weak. (A submission from FP was promised.) The case for abolition of the investment income surcharge was rather stronger: a note on it, and on the case for further changes in stamp duty, was also promised. /And the Chancellor asked for the preparation of a note to inform Cabinet colleagues about the introduction of MIRAS. Action: FP/.

Budget Speech

18. It was noted that the Central Unit would circulate a first provisional outline of the Budget Speech, incorporating some initial suggestions from the Chancellor. Ministers were invited to suggest alternative themes and frameworks. /Action: Mr Kemp/.

JOK

J O KERR

26 January 1983

Distribution:

Those present
Sir Douglas Wass
Mr Lovell
Mr Monger
Mr Mountfield
Mr Robson
Mr Griffiths
Mr French
Mr Harris

Econ Pol
S+P

MR. MOUNT

CHILD SUPPORT AND THE
POVERTY TRAP

The Prime Minister has seen your note of 15 February; and the Chancellor's of the 14th.

She intends to raise this with the Chancellor when she next sees him on 23 February.

I hear from the Treasury that the Chancellor is hoping you will be talking to the Financial Secretary and others, so there may be some merit in arranging that before next Wednesday.

M. C. SCHOLAR

17 February 1983

NR

POLICY UNIT

15 February 1983

PRIME MINISTER

CHILD SUPPORT AND THE POVERTY TRAP
AND TAX ALLOWANCES FOR THE ELDERLY

The Chancellor's response is fair and sympathetic but negative. He recognises that what we now have is a travesty of our original tax credit scheme. Yet he believes that we are boxed in. And he sees no way out of the box except by a substantial reduction in public expenditure and an equally substantial rise in tax thresholds. After talks with Treasury and Revenue Officials, I still feel, however, that there is a modest but useful supporting role which a tax allowance for child support could play in this process.

1. The Chancellor acknowledges in paragraph 6 that "to reverse policies now and to provide at any rate part of child support via the father through the tax system would to some extent redress the harm done to the level of take-home pay". But he believes that the equal opportunities lobby would launch the same attack on the transfer from purse to wallet as they did when they forced the original change.

But we are not proposing to abolish child benefit. All we are saying is that a proportion of the money now earmarked for tax allowances should go to child support. This is just what the equal opportunities lobby want. That is why they propose the abolition of the married man's allowance (although they want the proceeds to be distributed in benefits). Our own supporters would welcome a tax allowance for children.

Moreover, the Chancellor recommends his own proposals for ITTA on the grounds that ITTA would tend to assist families with children more than the present system. Surely a Family Responsibility Allowance would be a much simpler way of doing this.

2. The original objection to child tax allowances - that they benefited only the middle and upper income groups - carries far less weight now, since almost all family men now pay income tax - and, I fear, will continue to do so for some years yet on the Chancellor's present projections for public expenditure.

3. We are in a new situation from ten years ago, and one in which families with children are relatively much worse off. How are we most likely to adjust the status quo to their advantage? There are three choices.

(a) Large increases in child benefit are not popular among our own supporters because of the painful revenue cost and because they are perceived as welfare benefits.

(b) Switching over to a system of husband-and-wife taxation which was rather more favourable to the non-working wife would be an extremely delicate political operation, because of the danger of infuriating the millions of losers, particularly the professional women.

(c) A family responsibility tax allowance - whether paid to all families now drawing child benefit or to those with at least one child under five - would be popular and painless.

4. There would be substantial staff costs. But there were very substantial, if hidden, public costs incurred when we switched over to child benefit as the sole means of child support; it meant a sharp rise in public expenditure and hence upward pressure on pay claims.

? offset by an increase in tax revenue MCS

5. The case against reduced rate bands is, in the present situation, a strong one. Most of the benefit would not go to family men - but to juveniles and part-timers. Reduced rate bands would help family men (as they do on the Continent) only if thresholds were much higher - which is where we came in.

6. The Dependent Relative Allowance has been allowed to wither on the vine, principally on the grounds that help for the elderly is better "targeted" through benefits.

Officials argue that people in work should not be subsidised to look after an elderly parent - while elderly people living on their own get no extra help beyond the pension. There is said to be a lot of deadweight involved - people who do not in fact spend the allowance on co-resident parents, people who would look after granny, allowance or no allowance. It is even argued that we should not "force" elderly people to live with their children.

All of this seems to miss the central point about taxation - which is that the Revenue ought to recognise in framing its demands the differing burdens that taxpayers have to meet. It is a question of equity, imperfect and approximate no doubt, but essential to the belief that the system is fair. Taxpayers who have a dependent elderly relative do in general have greater expenses and so have reason to expect some modest abatement in the Revenue's demands.

7. If we were proceeding majestically towards a full-blown tax credit system administered through the pay packet, then it might be conceded that tax allowances for children and the elderly were an impediment and a relic of an earlier system - "outmoded" to quote the DHSS paper on the Elderly.

But we are not so proceeding. We are trying to do our best with an overloaded and intellectually incoherent system which lays increasingly severe burdens, relatively, on families with dependent members under 16 and over 75. We are not responsible for the worst flaws in the system, but we are responsible for doing our best to alleviate them.

8. If you think that the theme is worth pursuing, would you like to discuss it with the Chancellor (I am sending him a copy of this note)?

Or would you like it discussed in the Family Policy Group?

FM

FERDINAND MOUNT

Prime Minister ①

Please see

Ferdie's note on this (attached)

~~MLS 15/2~~

✓ FM

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

Agree to discuss - in the first instance - with the Chancellor rather than the FPG?

MLS 16/2

PRIME MINISTER

Yes with the Chancellor only.

CHILD SUPPORT AND THE POVERTY TRAP

Pt 9

Your Private Secretary's letter of 20 December asked me to let you have a note of the possibility of re-introducing an income tax allowance for child support and of re-introducing lower rate bands of income tax.

2. We all share Ferdie Mount's deep concern about the poverty trap and about the burden of taxation on families and those on or below average earnings. But we cannot ignore that the main reason for this is the high level of public spending. The dilemma was made very clear in the note (of which I enclose another copy) that I have already circulated to the FPG. That said I am sure neither the re-introduction of child tax allowance or reduced rate band offer the right way out of this box.

3. In his note Ferdie compares the impact of child tax allowance and child benefits on take home pay, family support and the poverty trap. Perhaps I could look at those points one by one.

Take Home Pay

4. The original tax credit scheme, which I certainly favoured, was designed to do three things:

/i. On the

i. End the complexity of having several systems at the same time - which involved paying a cash benefit that was too small to help the poorest and yet taxing it in the hands of the richest.

ii. To provide the means of delivering, through a universal system, a sum that would help the poorest (which child tax allowances did not) even if they did not pay tax.

iii. To do it by means of a credit against the breadwinner's tax bill - which would have helped to keep up tax thresholds and so the level of take-home pay.

5. But as we know it did not work out like that. Under pressure before the Parliamentary Select Committee we were obliged to concede that the child credit should instead be paid as a cash benefit to the wife. Child benefit was thus diverted from the husband's take-home pay and given to the mother. This transfer "from wallet to purse" was hailed - though notably not by the TUC - as a major reform in its own right quite independent of the effect on total family support discussed below.

6. To reverse policies now and to provide at any rate part of child support via the father through the tax system would to some extent redress the harm done to the level of take-home pay. It would in effect restore the pre-1972 position with child tax allowances and family allowance alongside each other. But we would inevitably attract the same sort of political attack from the equal

/opportunities

and poverty lobbies who forced the original change on our predecessors. We did not win the argument then and I see no reason to believe that we would win it now.

Family Support

7. The original tax credit scheme of 1971 envisaged that the abolition of child tax allowances and their substitution by child credits would offer particular help to families with too large an income to qualify for means tested benefits but too low an income to enjoy the full benefit of tax relief. As Ferdie Mount rightly points out ten years of inflation and indexation of social security benefits have changed all this. The tax threshold is all too often well below the threshold for means tested benefits and there is thus little to choose between a modest child tax allowance or a modest increase in child benefit as a means of family support. To me that underlines the priority of action on the main personal allowances. The choice between child benefit or a child tax allowance is a subsidiary question.

Poverty Trap

8. On the poverty trap the comparison is complex. The trap extends from about one quarter to three quarters of average earnings. Most families in the trap are in the upper part of this range. That means that a large increase in the tax threshold is needed to take a lot of families out of the poverty trap. And insofar as we make in-roads into the poverty trap by means of child tax allowances we would be doing so at the expense of the lower paid who did not have high enough earnings to benefit. That is just one facet of the all too familiar problem that measures to alleviate the poverty trap tend to increase the problems of poverty.

/Reduced Rate Band

<u>Reduced Rate Band</u>

9. Turning to the reduced rate band, clearly we must continue to work for lower tax rates and higher tax thresholds. Ferdie compares the position on income tax both here and overseas. His comparison as it stands is rather partial because it is important to look not just at tax but also social security contributions which ... tend to be higher overseas. I attach an annex to cover this point.

10. The case against a lower rate band, which would have to be reasonably narrow if it were not to be as expensive as a reduction in the basic rate is that it gives help, overwhelmingly, to the wrong people. Before we abolished the reduced rate band in 1979/80 25 per cent was the marginal rate for some 4 million taxpayers. Of these however 1.3 million were wives of men also in work, who were paying tax at the basic rate and above. Most of the remainder were juveniles or people in part-time employment. Relatively few adult primary earners - in particular relatively few of the family men whom we are looking to help - had earnings below the threshold for the full basic rate of tax. Today it would need a reduced rate band costing £1 billion to affect the same number of people as the old band did. But that would not meet the problem that we would be directing help at the wrong people.

11. If that same amount were used to increase tax thresholds by 6 per cent, it would take over half a million people out of tax entirely and save 300 Revenue staff. That compares with the 1,300 extra staff we would require to administer a re-introduced reduced

/rate band.

I remain convinced that we were right in 1980 to abolish the reduced rate band and to concentrate on raising thresholds and reducing the basic rate.

Staff Costs

12. We cannot ignore the question of staff costs. This of course has been one of our concerns throughout and it is quite distinct from what Ferdie describes as "the convenience of the Revenue". The Revenue saved 1,600 staff from the abolition of child tax allowances in 1979, a further 1,300 from the abolition of the reduced rate band in 1980 and another 300 from the higher thresholds that the abolition of the reduced rate band made possible. The changes also opened the way to other simplifications of the tax system which have helped the Revenue reduce staff by 11,000 since we took office.

13. To go back on these changes would be very costly in staff terms. The precise cost would obviously depend on the particular scheme. But it would make no sense whatsoever to try and run two schemes of child support side by side. DHSS now employ 1,800 staff in paying child benefit. Given our commitment to reducing civil service staff we could not retain child benefit and leave these DHSS staff in place while at the same time introducing child tax allowances and have the Revenue take back large numbers of staff.

Conclusion

14. Overall I have much sympathy with Ferdie Mount. The present position is unsatisfactory. But I do not believe that the right way forward is to try and go backwards in these two areas. Politically we would be reversing the actions of this Government and of the

/last Conservative

last Conservative administration. We would be attacked for the switch from purse to wallet. We would be criticised for being uncaring and insensitive towards the poor. I do not think we could carry our own supporters with us on such changes, let alone the country at large. I certainly do not think we could justify the waste of giving child support simultaneously to the father and the mother. And most crucially I do not see child tax allowances or a reduced rate band as ways of solving the problems of the poverty and unemployment traps. These are better tackled by raising thresholds and incentives are better tackled by reducing the basic rate of tax. And we cannot do either of those until we do much better still on public expenditure.

15. I am sending a copy of this minute to Norman Fowler and Ferdie Mount.

G.H.
14 February 1983

cc CST
FST
EST
MST(C)
MST(R)
Sir Douglas Wass
Sir Anthony Rawlinson
Miss Kelley
Mr Monger
Mr Moore
Mr Mountfield
Mr Robson
Mr Ridley
Mr Harris
Mr Kemp
Mr Isaac - IR
Mr Painter - IR
PS/IR
Mr Corcoran

CONFIDENTIAL

CHANCELLOR OF THE EXCHEQUER

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

Tim Flesher Esq
10 Downing Street
LONDON
SW1

26 November 1982

Dear Tim,

FAMILY POLICY GROUP

I attach a paper by the Chancellor which is designed to serve as background to the general discussion at the meeting of the Family Policy Group on 30 November.

Yours sincerely,

Jill Rutter

JILL RUTTER

FPG(82)4

The background to the group's work

Memorandum by the Chancellor of the Exchequer

The purpose of this paper is to set out what I see to be some of the wider background against which we should take our decisions, and to comment briefly on our programme of work.

2. At the meeting of the Group on 10 September, the Prime Minister said that the main thread running through the programmes we discussed was the need to return to consumers the power to make their own choices, to return to them more of their own money to spend as they saw fit, and to pass to them control in many areas which are at the present controlled by bureaucracies. I agree, and in the key principles for the work of the Group which were set out in my note of 31 August I said as much. In my view the points which Ferdinand Mount makes in FPG(82)1 will help us towards achieving these aims.

3. But much depends on the overall economic picture. Economic decline does not make for a stable and contented society. Fostering individual responsibility, and substituting personal responsibility for a collectivist attitude - the aims of the Group - will continue to depend in large measures on the success of our economic policies. And we shall only succeed in restoring growth on a sustainable basis, and reducing unemployment - itself so corruptive of society - if we continue to implement responsible fiscal and monetary policies.

4. Which poses us with a dilemma. The Group will recognise how difficult, but how necessary it is to restrain public expenditure and control public sector deficits. Yet many of the individual proposals that are being put forward in FPG(82)2 will inevitably involve some additional public expenditure or some reduction in tax receipts. To that extent they would operate against the overall requirement to contain the public deficit.

5. This dilemma is not new. I have faced it in each of the four Budgets I have presented since we came to office. I have endeavoured to reconcile the containment of the public deficit with my desire to make room for worthwhile measures even though they involved some additional public expenditure or some reduction in tax receipts. I intend to continue this way, and I suggest that that is the way which the Group, too, should proceed. I would only ask that we bear the dilemma in mind. And I would suggest that as a matter of mechanics, and to help the work of the Group, the Treasury and the Inland Revenue should always be

consulted on the drafting of papers as appropriate where such costs are involved.

6. I have referred to my last four Budgets. I shall be presenting my fifth Budget to Parliament next Spring. Clearly some of the sorts of proposals which might be processed forward through the Group would be relevant to this, and could indeed be helpful in enabling me to present a useful and attractive social and political mix. Some of these I am already discussing with colleagues; for others I would hope that our work can be so organised that I have the benefit of the Group on matters which might be appropriate to my Budget. As always there will be other pressures and other imperative calls on whatever room for manoeuvre I may have. But I would hope that the views of this Group will be available to me. It might be useful if Treasury and Inland Revenue officials were to consider with the Secretaries the Group's programme of work with this in mind.

7. I turn to another point. As we agreed at our first meeting, we need to keep our discussions as specific and as practical as possible. And, indeed, insofar as anything might find its way into my Budget, that is only too obvious. From this point of view, we must not allow ourselves to be swamped under a tidal wave of paper - I note, for instance, that Appendices A to C by themselves call for no fewer than 19 papers from Group members. I do not think that we should take up time next Tuesday on procedural matters. But I am sure that we can in practice do all we want, and do it better, with fewer papers, more sharply focussed.

8. Finally, I attach a paper on the origins of the poverty and unemployment trap which is interesting in its own right but which should also provide useful background to our discussions of the tax and social security aspects of our work. It demonstrates what can happen when, with the best of intentions, successive Governments take decisions in the tax and social security field without consideration for their long-term implications. It is not going too far to say that if different decisions had been taken, the existence of the present Group might not be necessary.

THE ORIGINS OF THE POVERTY TRAP AND THE UNEMPLOYMENT TRAP

The unemployment trap can mean that people are little or no better off in work than out of work. The poverty trap affects people in work on low income can mean that an increase in their earnings results in little or no extra money in purse or wallet.

2. This note examines how this unsatisfactory and perculiar position has arisen and what can be done to improve it.

3. The traps arise from the overlap, or near overlap, of the tax and social security systems. Over the last 25-30 years the gap between benefits and tax thresholds has been compressed.

4. Benefits have been increased broadly in line with average earnings. Thus we get :

	(% average earnings)			
	1950	1960	1970	1980
Supplementary Benefit (married couple)	29	31	30	30
Unemployment Benefit (man plus dependent wife)	26	30	32	29
Child Support (one child family tax allowances, FAM and child benefit)	7	5	3	4

While the figures move around a bit, the picture is one of a fairly stable relation with average earnings. Child support is something of an exception; the child support figures for FAM and child benefit alone (for a 2-child family) would be 2 per cent in 1950, 1 per cent in 1960, 2 per cent in 1970 and 8 per cent in 1980.

5. Meanwhile on the tax side, income tax thresholds have been rising generally in line with prices and so have been falling in relation to average earnings :

	(% average earnings)			
	1950	1960	1970	1980
Tax thresholds				
- for married man with no children	63	46	37	35
- for married man with 2 children	100	79	52	35
- for single man	39	27	25	23

Comparing the two tables above, it can clearly be seen that the gap between benefits and thresholds has declined dramatically. On the second table the differences over the period 1970 to 1980 in the figure for a married man with no children and for a married man with two children reflects the abolition of child tax allowances.

6. Why has the tax threshold fallen in this way? Two factors have been at work. First, the rise in public expenditure required higher and higher levels of taxation. Total tax receipts rose from about 30 per cent of GDP in 1955 to about 36 per cent in 1980. It is not easy to get a consistent series of figures over time for the share of public expenditure in GDP. Public expenditure in 1980 was about 44 per cent of GDP; in 1970 it was 38 per cent; in late 1950s it was around 32 per cent. The main programme responsible for the growth of total public expenditure is social security which has risen by the equivalent of about 5 per cent of GDP since the mid 1950s. Health, education and housing have also shown considerable but smaller increases.

7. Second, Governments have tended to seek higher tax receipts by way of direct taxation, not indirect taxation. In 1980 indirect taxes receipts were about the same percentage of GDP as in the mid 1950s and in the early 1960s. Over the same period income tax receipts rose by the equivalent of 3-3½ per cent of GDP and social security contribution by 2½-3 per cent of GDP.

8. In part this result - high expenditure coupled with high taxation - was genuinely unplanned. Successive Governments planned their expenditure on over-optimistic assumptions about economic growth. When that growth did not materialise the money had to be found from somewhere - so taxes were increased. It was easier to do this by failing to increase income tax thresholds than by raising rates of tax.

9. Internationally these same phenomena have been at work throughout the OECD - public expenditure rising as a percentage of GDP and the tax burden being shifted onto direct taxes and social security contributions. Our income tax thresholds are not much out of line with other countries, but we do start paying at a relatively high rate of income tax.

For married person without children in 1982 :

	Threshold (£)	Income tax rate (%)	Rate of income tax plus employees social security contribution (%)
UK	2445	30	39
USA	3270	12	19
Sweden	1710	30	30
Netherlands	3150	16	35
Japan	2730	14	19
Italy	1795	10	16
Germany	3000	18	35
France	3250	7	17

One reason why other countries have a lower onset rate of income tax is that they rely much more heavily than we do on social security contributions; in 1980 such contributions were about 17 per cent of UK total tax receipts compared with 43 per cent in France, 34 per cent in Germany, 35 per cent in Italy, 29 per cent in Japan and 26 per cent in USA. The final column of the above tables picks this up and shows the combined rate above the income tax threshold of both income tax and employees social seucrity contributions. It does not, of course, pick up employers social security contributions which are relatively high in e.g. France.

10. The traps therefore arise from a contribution of :

a. attempting to alleviate poverty and hardship. To do this social security benefits have been increased with earnings;

b. using means testing to hold down the cost of benefits. Means testing means withdrawal of benefits as income rises and so acts in the same way as a tax;

c. despite b. the cost of social security has risen markedly, as have the costs of certain other programmes;

d. as a result of c. the tax burden has risen;

e. tax has fallen increasingly on incomes rather than expenditure. This is partly a reflection of further policies to help the poor as indirect taxes tend to hit them relatively hard;

f. the result of e. has been to hold down income tax thresholds (relative to earnings) and increase rates of income tax and of social security contributions. This has produced a compression of the gap between benefits and tax and, combined with the withdrawal of means tested benefits, high marginal rates of "tax" on in-work income.

11. What can we do? The long term answer is to work towards a reversal of the trends that have got us where we are. This means lower public expenditure as a proportion of GDP which in turn means slower growth of public spending and faster growth of GDP (in both cases relative to the past). This would lead to a reduction in the burdens on the taxpaying population.

12. In the short term this approach would involve concentrating whatever scope there is for tax reductions of income tax, particularly on thresholds.

13. The only other approach would be to reduce the benefits of social security recipients. This would mean cutting benefits in real terms. This would ease the traps both by cutting benefit income and by providing scope for tax cuts which would increase take home pay from work. The difficulties are obvious.

ANNEX A

INTERNATIONAL COMPARISONS

1. As Mr Mount says in his note, the onset rates of income tax in the UK are high by international standards. But a comparison on this basis ignores social security contributions which have a similar impact on take-home pay and which are generally higher overseas than in the UK. If these are included, the difference in onset rates is less stark, particularly in the case of Germany (see Table 1 below).

2. Whilst it is true that UK thresholds are low by international standards, comparisons of this kind are notoriously difficult to make. They are affected by differences in the tax system, different levels of earnings (and the UK is low on the international scale), differences in purchasing power and variations in exchange rate. Table 2 therefore sets out the comparisons over a wider range of countries both in straight exchange conversion terms and in relation to the earnings of an average production worker.

TABLE 1

Comparative onset rates (i) excluding, and (ii) including, social security contributions.

	(i)	(ii)
UK	30%	38.75%
France	7.2%	17.7%
Germany	18.0%	35.0%

TABLE 2

Comparative thresholds in £ sterling and as percentage of average production worker's (APW) earnings for married couple (no children, employment income all the husband's) as at April 1982

	Thresholds in £ sterling	Thresholds as % of estimated APW earnings
France	£3,770	59
Germany	3,500	35
Italy	2,070	36
Japan	3,340	28
Netherlands	3,550	38
Sweden	1,190	17
USA	3,420	31
United Kingdom	2,445	33

ANNEX A

NOTES

1. All thresholds take account of minimum deductions for expenses and other flat rate reliefs, etc.

2. The exchange rates used to convert the thresholds to sterling are those for 11 January 1983. Such conversions may not reflect differences in purchasing power between sterling and other countries.

3. The thresholds are those for 1982 (1982/83 for the United Kingdom). The Italian threshold is provisional. The thresholds relate to national tax.

4. Child benefits have been left out of account.

5. APW earnings are the average wage of male manual workers in manufacturing industry.

6. The estimates of APW earnings at 1 April 1982 have been provided by the Treasury. The estimates are derived from OECD figures for 1980; we understand however that the OECD itself has serious reservations about their validity as a basis for comparison.

Econ Pol,
Budget Pt 10

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10 DOWNING STREET

From the Private Secretary

10 February 1983

1983 European Community Budget Refunds

The Prime Minister has noted the contents of the Financial Secretary's minute of 9 February on the above subject.

A. J. COLES

Martin Donnelly, Esq.,
Financial Secretary's Office,
HM Treasury.

DS

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cc RJ

(2)

FROM: FINANCIAL SECRETARY
DATE: 9 February 1983

Prime Minister

A.J.C. 9/2

PRIME MINISTER

1983 EUROPEAN COMMUNITY BUDGET REFUNDS

I went to Strasbourg yesterday for the latest in a series of lobbying discussions I have been having with MEPs and others about the Supplementary Budget for our 1982 refunds. I thought you would like to know the latest position.

The outlook is now more promising. The European Parliament's influential Budget Committee have not recommended any amendment to the draft 1983 Supplementary Budget agreed by the Council of Ministers in January. This contains provision for our agreed basic refund for 1982. The Parliament will debate this Budget on Thursday afternoon and on present plans will vote on it that evening. One can never count one's chickens, but my impression is that, although there will be some votes against it, mainly from the Socialist and Communist groups, the opposition will not be sufficient to block it.

All being well the Parliament should also give an opinion on the enabling Regulations for the UK's refunds. Provided that there is no further opposition in the Council, the way should then be clear for us to receive the main instalment of our basic refund by the 31 March deadline.

I am copying this minute to the Chancellor of the Exchequer, the Foreign and Commonwealth Secretary, and to Sir Robert Armstrong.

NR

NICHOLAS RIDLEY

File BA

10 DOWNING STREET

From the Principal Private Secretary

8 February 1983

Dear John,

I am sorry not to have written to you before to congratulate you on your new appointment. I can now do so, having read the CBI's Budget Representations, which you sent to me with your letter of 26 January. I do not expect that you were able to have much to do with this set of representations, but you clearly have a high tradition to maintain, and I am sure that you will do so.

It would be useful if we could be in touch nearer the time about any ideas you have of ground which might be covered in the Prime Minister's April speech to the CBI. Perhaps we might have lunch together ?

Yours ever,

Robin Butler

J T Caff Esq.

AH

SUBJECT

CONFIDENTIAL

Econ Pol
Pt 8

cc Master

cc A Walters

10 DOWNING STREET

From the Private Secretary

4 February 1983

Taxation of International Businesses

At her discussion with the Chancellor yesterday, the Prime Minister drew his attention to a minute she had received from John Sparrow about the Inland Revenue's latest consultative memorandum, together with the proposals put foward at the end of 1981, about the taxation of international businesses.

The Prime Minister said that she was inclined to agree with John Sparrow's conclusion that there was a case for deferring legislation until comprehensive proposals could be brought forward to deal with all of the problems in the light of wider Government policies for the health of industry as a whole and for stimulating investment overseas. The Prime Minister was particularly struck by Mr. Sparrow's assertion that legislation would affect many international companies based in the UK.

The Chancellor said that he would be glad to see John Sparrow's minute, and he would let her know his reaction to it. I accordingly attach a copy of this minute, together with the background note attached thereto.

I am sending a copy of this letter and enclosure to Andrew Hudson (Minister of State's Office, HM Treasury) and the letter only to John Sparrow.

M. C. SCHOLAR

Miss Jill Rutter,
H.M. Treasury.

CONFIDENTIAL

Econ Budget Pt 9

FROM: R I G Allen
DATE: 3 February 1983

For Information:

Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Mr Burns
Mr Cassell
Mr Kemp
Mr Gleed
Miss Deyes
Mr Ridley
Mr Harris
Mr Hall
Mrs Lomax

No 10
PS/S/S
Employment

CHANCELLOR

TUC ECONOMIC REVIEW 1983

As proposed in my minute of yesterday, I attach some notes on the TUC's Economic Review published at 12.15 pm today.

2. The material is as follows:

A. A note by Miss Deyes on the relationship between the Review, and in particular its Budget proposals, and earlier Reviews; the measures are a fairly familiar mixture. The note also summarises the relationship between the Review and recent TUC/Labour Party Liaison Committee and Labour Party plans.

B. A note by Mr Gleed of MP1 assessing the TUC's programme for the Budget.

C. Some defensive Q/As on the main points of the TUC programme - more public sector investment; more expenditure on training, etc; planning agreements; the NEA; use of Treasury model, and so on - and other aspects of the Review particularly critical of Government policies and achievements - unemployment, productivity, and so on.

RIGA

R I G ALLEN
EB

encs

Extract from the TUC Economic R_eview 1983 , summarising proposals

THE TUC ALTERNATIVE

The TUC recovery package is divided into two parts: *Action Now* is a one-year action plan that could be started now. The *Five Year Expansion Plan* is the follow up — a wide ranging strategy designed to promote jobs, growth, democracy and more equality in Britain.

ACTION NOW

£10 billion Budget package

Reconstruction of Britain programme: housing/education/hospitals/energy/roads/cities/water and sewers/telecommunications	£3,200 million
Manpower, Education, Training measures	£1,800 million
Aid to Regions	£850 million
Local Authorities inner city aid	£250 million
State Pensions increase	£700 million
Social Benefits increase	£750 million
NHS extra spending	£175 million
Cut in VAT from 15 to 12.5 per cent	£2,300 million

Devaluation of £

Selective import controls

motors/machine tools/textiles/tyres/furniture

FIVE YEAR EXPANSION PLAN

Economic

- Development of *Action Now* strategy geared to 4 per cent annual growth rate.
- 10 per cent cut in working time over five years.
- £30 billion Reconstruction of Britain (public investment) programme.
- selective import controls.
- expansion of manpower/education/training programmes.

Democratic Planning

- annual tripartite National Economic Assessment of how economic resources/priorities are shared out.
- new Department of Economic and Industrial Planning.
- new National Planning Council to provide links between Government, employers and unions.
- Agreed Development Plans: Government/company/union planning agreements on jobs, investment, products, etc.
- new information, consultation and representation rights for unions at work.
- new National Investment Bank channelling public wealth into British Industry.
- Regional Development Planning Authorities to give new planning framework a regional/local dimension.

RESULTS

The TUC has tested the effect of this Budget package on the economic model used by the Treasury. After one year these are some of the results over and above the effect of current policies:

unemployment	down 574,000
national output	up 3.3 per cent
prices	up 0.9 per cent
living standards	up 3.2 per cent

RESULTS

The points above are the broad guiding principles of an expansion plan — the TUC is not laying down a minutely detailed blueprint. A programme based on these principles will:

- lay the basis for a successful, growing economy;
- get unemployment below 1 million after five years;
- create a new democratic way of planning how our industries and economy develop – instead of abandoning them to 'market forces';
- radically improve income and job opportunities for women; and
- tackle income inequalities and low pay.

TUC ECONOMIC REVIEW 1982 AND ITS PREDECESSORS

1. TUC Economic Review 1983 covers recommendations for the next Budget, providing £10 billion expansion in 1983-84 compared with £8.3 bn in 1982-83 - described as similar 'in proportionate terms' to last year's 'because the amount of spare capacity in the economy is the same' (para 4.8 of the Review). (Recommendation for 1981-82 in Economic Review 1981 was £6¼ billion.) See para 4 below for Budget breakdown.

2. Budget recommendations are once again seen as part of 5 year programme for recovery - the same perspective as in 1982 and in 1981. This 5 year programme (chapter 5 of the Review), involves, as in 1982 and 1981, system of 'democratic planning'; a National Economic Assessment; active manpower, education and training policies; expansive public spending programmes; lower interest rates and competitive exchange rate (but see para 6 below for reaction to recent fall in sterling); and 'managed trade' to prevent effects of import surge to meet increased domestic demand.

3. Also present in the 1983 Economic Review, as in 1981 but not 1982, is reference to the international dimension - particularly policies to help developing countries to expand (chapter 8).

4. Budget Breakdown (para 4.10)

Spending Measures	1981 £	1982 £	1983 £
1. Public sector construction	400m	2,100m	3,200m
2. plus nationalised industries (EFLs)	600m	200m	
3. aid to industry/ industrial strategy	250m	600m	-
4. regional policies	-	-	850m
5. sems or training	710m	1,700m	1,800m
6. improved State pensions	750m	750m (to yield 'real terms' improvement)	700m
7. other State benefits (inc CB)	400m	700m (to yield 'real terms' improvement)	750m
8. NHS	300m	60m	175m

9. educational services	1,150m	included in 5 above	included in 5 above
10. other local govt services	160m	225m	250m
Revenue measures			
Income tax allowances to be raised in line with inflation	(amount not specified in text)	assumed	assumed
Reverse employees' NIC increase 1981-82	(amount not specified in text)		
Reduce NIS by ½%	540m	-	-
Reduce VAT to 12½%	-	2000m	2,300m
Total Budget package (gross)	6.2 bn	8.3 bn	10 bn
Change in PSBR	unspecified increase	less by £28 mn.	extra £6.4bn

5. Within the Budget package the 1983 Review sticks to the 1982 formula in calling for a cut in VAT (the 1981 Review proposed cutting NIS but the 1982 Review preferred VAT for the more immediate impact on demand and the direct effect on price inflation; the 1983 Review adds scepticism (para 4.19) about employers using NIS cuts to help employment). As compared with 1982 the 1983 spending allocates relatively much more to investment than to current spending (pensions and benefits combined attracting no more additional money than last year). Spending on industry is not isolated in the 1983 breakdown but in 1982 it included some regional assistance: this is now shown as a separate item and includes an employment subsidy (para 4.12) whereas the 1982 Review noted work was being done on what regional incentives were needed.

6. The fall in sterling since the 1982 Review has elicited a shift from the 1981 and 1982 recommendations for depreciation of the £. The 1982 Review called for an 'orderly' and 'limited' depreciation of the £ to 'more realistic levels' and recommended reduction of high UK interest rates as a useful method; thereafter increased efforts should be made at international level to achieve orderly trading in foreign exchange; jettisoning of the monetary targets would free the Government to do more to 'regulate the exchange markets'. The 1983 Review advoccates (para 4.6) 'a reimposition of exchange controls' - not specified in the 1982 Review but commended in 1981 - and 'an exchange rate which is maintained at a lower level from its overvaluation in 1982'. What this level should be is not stated and the Review specifically recognises 'that the system of floating exchange rates makes it difficult for any Government to pursue an exchange rate in isolation'. 'Nevertheless', it says, 'the active use of interest rate policy, intervention by the Bank of England and the use of exchange controls could give the Government some influence.'

7. Relationship with Labour Party proposals

Proposals for reflation within a framework of national and company-level planning and accompanied by a 'National Economic Assessment ' were brought together as far back as July 1981 in a TUC -Labour Party Liaison Committee document ('Economic Issues facing the next Labour Government '). That also envisaged exchange controls and 'planned trade' .

They were elaborated in a further Liaison Committee document which was adopted at the Trades Union Congress and Labour Party Conference last autumn ('Economic Planning and Industrial Democracy '). The same ideas reappeared in 'Labour's Programme 1982 ' - the manifesto-in-embryo issued in June 1982.

A five year programme for public sector investment to cost £24 billion was put forward by the TUC in 'Reconstruction of Britain' in August 1981. The 1983 Review upvalues this to £29.5 billion ,with £ 3.2 billion in year 1 rising to £ 9 billion of extra public sector investment in year 5.

The £ 10 billion Economic Review Budget package for 1983-84 compared with Mr Shore's estimated direct costs of £8-9 billion in each of the next five years recommended in the 'Shore Programme' put out last November ('Programme for Recovery '). That involved progressive reduction of VAT (2 per centage points in year 1 and year 2), abolition of NIS (not in the TUC 1983-84 Budget), and total extra public spending rising from £ 5 billion in year 1 to £18 billion in year 5, split equally between capital and current.

The 1983 Economic Review package envisages a PSBR of 4.7 per cent in 1983-84; Mr Shore's package(illustrative simulation) involved a PSBR of around 3-4 per cent of GDP in each of the five years.

290/216

FROM: MR GLEED
DATE: 3 FEBRUARY 1983

~~MR ALLEN~~ - 9/2nd

cc: Mr Burns
Mr Cassell
Mr Kemp
Mrs Lomax
Mr Mortimer
Mr Hartley

TUC ECONOMIC REVIEW 1983

You asked for a fairly quick assessment of the TUC's programme for the Budget.

2. As is clear from the Review, the fundamental approach of the TUC differs considerably from that of the Government. Their aim is not the control of public expenditure in order to provide room for a combination of lower budget deficits, lower interest rates and tax cuts, but instead a major expansion of the public sector to provide jobs - both direct, in central and local government and on special employment measures, and also indirectly, via higher public investment and as big expansion of public sector orders.

3. As we have emphasised before, particularly in the NEDC paper, the Treasury Model is not well equipped to handle major changes in strategy of this kind, because the behaviour of financial markets, wage bargainers and economic agents in general depends on how they expect governments to react to inflationary pressures. If people believe that the Government will be unwilling or unable to resist inflationary pressures, they are likely to push that much harder on the door. Part of the deceleration in inflation over the past few years, eg. the squeeze on profit margins, has been due to the Government's perceived strategy on inflation. A different stance on this would affect inflationary expectations adversely.

4. This qualification needs to be borne in mind when assessing what effect the TUC's results would show on the Treasury model. Assuming no major change in behaviour or inflationary expectations, and no increase in interest rates, the results the TUC obtain do not seem unreasonable. They differ from the NEDC results - which showed a fairly rapid crowding out of higher public sector investment - mainly because the TUC assume that interest rates would not have to rise, and that the higher public sector borrowing involved would be accommodated by faster monetary growth. (On a package of this size £M3 growth might be 4-5% higher in 1983-84 than otherwise). However, a major deterioration in inflationary expectations - which the results make no allowance for - would increase the inflationary costs. It might also prove difficult to avoid raising nominal interest rates if inflation were 3% or more higher than otherwise, and this would tend to reduce the output and unemployment effect on years 3 and 4.

5. The results also show only the first stage of the TUC's programme, and, even on the TUC's estimates, would only

TUC's estimates of effect of their proposals	Change to level of GDP (%)	Change to growth of GDP (% points)
Year 1	3.3	3.3
Year 2	4.3	1.0
Year 3	4.7	0.4
Year 4	4.2	-0.5

provide a boost to the growth in GDP for the first two years. So, as the document indicates elsewhere, further reflationary measures could be expected to meet their 4% p.a. growth targets (eg. the full Reconstruction of Britain public investment package would cost £29.5 bn over 5 years, or £6 bn a year - twice the amount allocated to public investment in the budget proposals for 1983). This again would worsen the inflationary prospects - although the boost to output would be larger in later years.

6. Similar remarks apply to the other main plankof the TUC's programme - selective and temporary import controls. While these would - if effective - give a further boost to output and employment, they would also exacerbate inflationary pressures - both directly, since imported goods prices subject to quotas would tend to go up - and indirectly by protecting domestic producers and their employees from international competition.

7. Despite these remarks, the TUC's presentation of their results has improved compared to last year, which may show some pay-off to the labours involved in the NEDC paper and the Model Manual:

(i) The results are shown for four years instead of just year 1, and they emphasise that results for the first two years are more reliable than those for years 3 and 4.

(ii) They emphasise the difference between assuming an accommodating and a non-accommodating monetary policy, and the role of judgement in producing the results.

(iii) They acknowledge - and attempt to meet - some of the criticisms of their approach - effects of higher borrowing on the PSBR and money supply, and hence on inflation.

8. There are obviously points of detail and of their analysis which we would dispute, in particular:

(i) Some of the jobs estimates on the manpower and training strategy are probably optimistic.

(ii) The retention of exchange controls is not, as we seem to repeat continually, compatible with a belief that the Government should have done something to keep the £ more sensibly valued.

Richard Gleed

R GLEED
MP1

TUC Budget representations

1. Does Chancellor agree with the representations?

Will study and fully consider TUC's views. All representations play a useful part in putting together a Budget, and views of national organisations like the TUC are particularly important. Share concern of TUC over level of unemployment and desire to see improvement in economic performance. Does not guarantee we agree over the means to those ends.

2. Will Chancellor be seeing TUC to discuss their Budget recommendation?

Have not up to present (close on 3 February) had a request from them for a meeting.

3. Size of TUC proposals

TUC proposes £10 billion gross package, involving additional PSBR cost, on their estimates, of £6½ billion. These are very large sums. Would not want to jeopardise gains made by our prudent fiscal policies.

4. But TUC programme run through Treasury computer produces output and employment growth with only modest rise in inflation - What's wrong with that?

Testing packages on the Treasury model does not mean results definitive. Projections are never more plausible than assumptions fed in. Model cannot accurately assess effect of major changes in policy, predict confidence effects, or foresee success - or failure - of a National Economic Assessment.

5. Participative planning

Best way to prosperity is to allow market forces to operate and not to inhibit decision-making with controls and centralised directions. Government policy to promote employee commitment is through wider share ownership and profit-making.

6. National Economic Assessment

Wage restraint is of critical importance. But TUC reiterate reliance on a vague NEA without clarifying how it would work or could be made to stick. Past experience of incomes policies and social contracts does not inspire confidence.

7. A National Investment Bank

Problem of funding not one of a lack of sufficient funds but lack of profitable investment opportunities. Steps were taken to meet the financing gaps identified by the Wilson Committee (eg setting up Loan Guarantee Scheme, lauch of zero coupon bonds). It is central plank of Government policy to increase the profitability of investment.

8. Increase public sector investment

/TUC's plans for 1983-84 first instalment of £20 billion over five years programme./

Immediate problem not to make more funds available but to get local authorities and nationalised industries to spend the capital provision open to them. Capital expenditure in 1983-84 now planned (1983 PEWP) to be some 12 per cent higher than estimated outturn for 1982-83. (PM wrote to LAs and NIs in November explaining Government's concern at extent of underspending, and changes are being made in the capital allocation procedures for local authorities to combat underspending in future.)

9. Increase housing programme?

/Major part of proposed public sector investment 1983-84 is £1.4billion for home building and renovation./

No case for such an addition: it will add to public spending, pressure on interest rates and inflation.

Local authorities have not spent as much as they could in 1982-83. But we have made provision for significant growth in 1983-84: gross housing capital investment can increase by 12% and local authority spending by 20%.

The private sector is the key to recovery in house building and it is doing well: new starts in 1982 were up by 20% over 1981. The Government is concentrating on repair and improvement: higher rates of improvement grants are available; and we have allowed local authorities to spend without limit on improvement grants in both 1982-83 and 1983-84.

10. Regional Development?

/TUC propose £850 million in 1983-84 including employment premium./

Regional economic policy instruments have been under review by officials of Departments concerned. Minister now considering their report. No decisions yet taken.

11. True Scale of Unemployment

/TUC add 3.3 million unemployed (old series) 0.6 million unregistered unemployed, 0.4 million on special measures to give job shortage of 4.3 million./

Specious to include those on special measures who are not unemployed. Unregistered unemployed can only be estimated; different definitions and methods will yield different results. Claimant figures are best indications of trend.

12. 'Cost' of unemployment

/Effect of measures on PSBR would be mitigated by savings on benefits to tax revenue from employment growth and spending from lower unemployment./

Effects of changes in unemployment on public finances will vary widely according to underlying circumstances - eg world trade changes, UK competitiveness, level of UK earnings etc. Not therefore sensible to talk about cost of unemployment. Payments of UB and SB to registered unemployed currently expected to total about £5 billion in 1982-83. Comparable figures for total of taxes and NIC not collected cannot be given. No basis exists for estimating what the level of earnings and tax receipts would be if all the unemployed were working.

13. Shorter work-time?

If reductions in working time are to reduce unemployment there must also be a corresponding reduction in incomes. If weekly pay remains constant while hours are reduced, unit labour costs are forced up, competitiveness worsens and output and employment suffer.

14. Training and employment measures

Government planning to spend £1½ billion in cash in 1982-83 and £2 billion in 1983-84 on special employment and training measures. This shows their concern to alleviate the impact of unemployment on the most vulnerable.

15. Wage cuts not route to increasing employment?

/Economic Review paras 3.1-6 ~~3 January 6~~ 7

On the contrary. More modest wage increases - not necessarily wage cuts - along with improved productivity provide only route to lasting improvements in competitiveness and to recapture of lost markets

16. 'Productivity miracle' illusory?

/Economic Review paragraph 3.9 7

Certainly not right to call it a 'miracle' but performance impressive, well in excess of what could have been expected at this point in the economic cycle. Output per head in manufacturing is 13 per cent higher than at the end of 1980.

17. Selective Import Controls would assist economic reconstruction?

/The TUC is calling for import controls on sectors and products which will play a key role in economic reconstruction or which will be subject to serious problems of adjustment to new market conditions. 7

No. The UK Government is looking for an expansion of world trade, not a contraction. Protectionism only reduces competition, which raises prices and limits the choice to the consumer.

18. <u>But wouldn't import controls help to reduce unemployment?</u>

No. Protectionist measures only lead to retaliation by other countries. The UK economy is particularly vulnerable to this. One third of our output is exported. We cannot afford to have other countries putting up barrier against our goods and services.

19. <u>Doesn't the growth in imports show that there is a one-way traffic in trade?</u>

On the contrary, although imports have risen in recent years, so have exports. Non-oil exports held up in 1982 despite falling world trade. In December the monthly value of UK exports topped £5 billion for the first time. As a result the current account is performing very well - about £4½ billion in surplus for 1982.

20. <u>Is the UK alone in trying to keep markets open?</u>

No, we could not act as the sole defenders of an open trading system. Instead we are working with our partners in the EC and GATT. Together we can respond in a co-ordinated way to unfair competition.

21. <u>So what can be done to safeguard British producers against the dumping of subsidised imports?</u>

The UK has the right to take selective action where British producers are subject to unfair competition. Under international agreements the EC and GATT can counter by imposing specific duties with the aim of getting the countries responsible to abandon such practices.

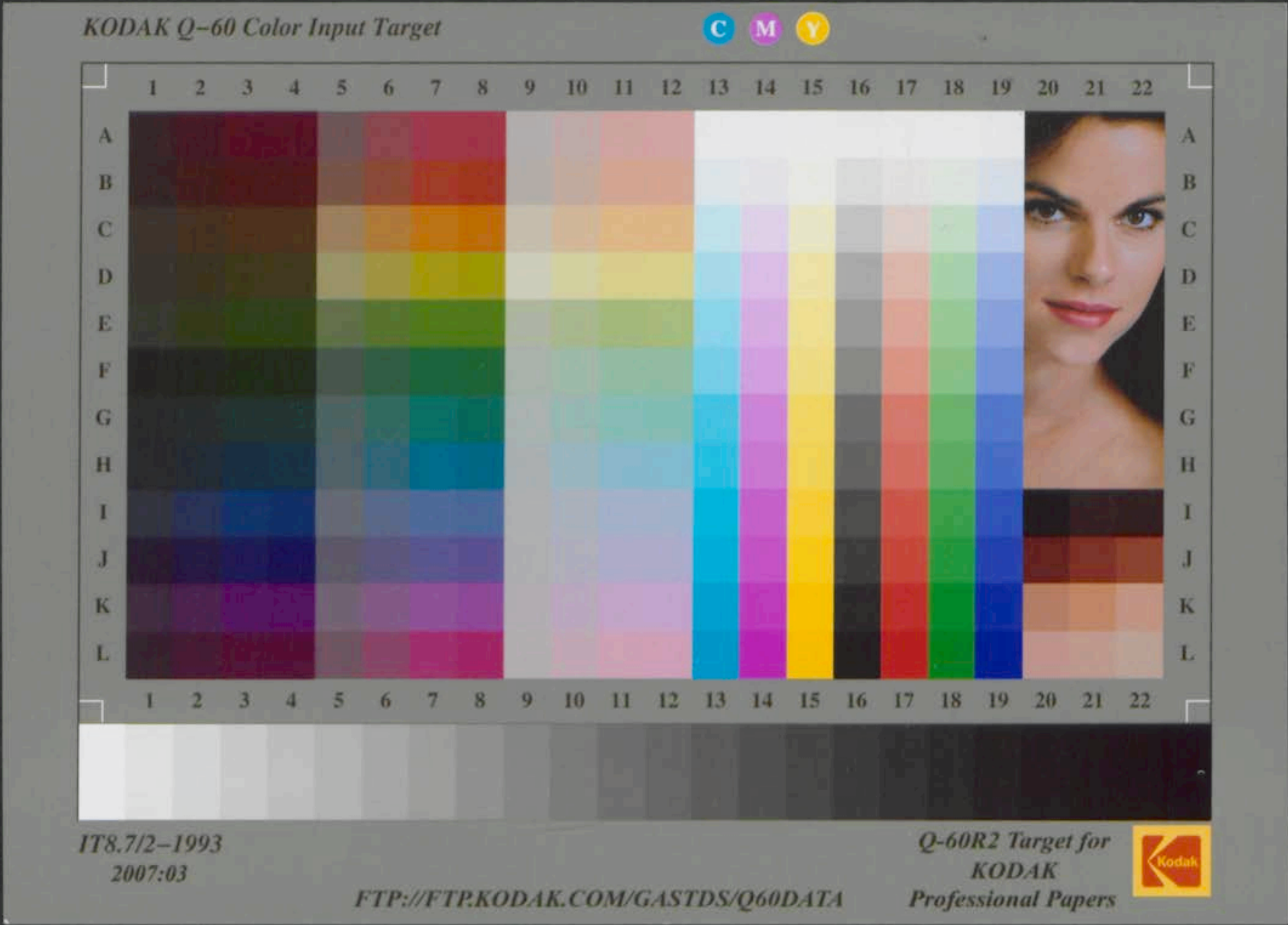
PART 9 ends:-

Sparrow to PM (Qa06238) 31/1

PART 10 begins:-

~~[illegible]~~ HMT note 3/2

END



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