STARTS 22-02-83
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SECRET

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PO -CH /GH/0009

PART A

BUDGET DEBATE 1983

DD 25 years NA 83 15/7/94

PO -CH /GH/0009
PART A

cc Mr Ridley
Mr French

bf 11/3

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

22 February 1983

JR
Pl. [illegible] RH.

C.
Are your B Specials producing something for you?
[illegible] 11/iii

Yes. R.H.
[illegible]

The Rt Hon M Jopling MP
Government Chief Whip
12 Downing Street
LONDON SW1

Dear Michael

Thank you very much for your letter of 16th February, enclosing a copy of the Motion on Economic Policy to be debated at the Central Council at 2.15 pm on Saturday, 26th March.

I confirm that I shall be very pleased to accept the invitation to reply to the debate.

Love

Geoffrey

GEOFFREY HOWE

1983
BUDGET
DEBATE.
PT.A

CONFIDENTIAL

JOK
JKR

FROM: ROBIN HARRIS
11 March 1983

CHANCELLOR'S MORNING MEETING

270th Meeting

Note for the Record

Present:
Chancellor
Chief Secretary
Economic Secretary
Mr Goodlad MP
Mr Ridley
Mr Harris

1. Budget Debate

During the budget debate, it was agreed that the Financial Secretary would wind up on Wednesday, 16th March, and the Economic Secretary on Thursday, 17th March. Divisions would be asked to put forward to the relevant Private Offices for inclusion in these speeches matters essential to have on the record, for the Finance and Economic Secretaries to consider.

2. Conveyancing Charges

The Chancellor observed that he had received letters about conveyancing charges. He noted that the Treasury must be considered to have a legitimate interest in this matter.

3. Opticians' Monopoly

The Chancellor asked for a note from officials on the current position on investigation and reform of the opticians' monopoly.

4. Departmental Sponsorship of Pharmaceuticals

The Chancellor asked the Chief Secretary to continue to support Mr Jenkin in his exchanges with Mr Fowler on the proposed change in departmental sponsorship of pharmaceuticals.

5. Darlington By-Election

The Chancellor would decline to appear on the late night ITN programme covering the Darlington by-election result.

AK pp.

ROBIN HARRIS

Circulation:

Chancellor
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir D Wass
Sir A Rawlinson
Mr Burns

Sir L Airey
Mr A Fraser

Mr Ridley
Mr Harris

DEPARTMENTAL PLANNING UNIT
H.M. CUSTOMS AND EXCISE Rm 404M
KING'S BEAM HOUSE, MARK LANE
LONDON EC3R 7HE
01-626 1515 Ext 2106

BUDGET CONFIDENTIAL

From: D J Howard
10 March 1983

PS/Economic Secretary

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
Mr Moore
Mr Kemp
Mr Griffiths

ECONOMIC SECRETARY'S SPEECH IN BUDGET DEBATES

We spoke about your note of 1 March, sent separately, to Mr Knox, Mr Freedman and Mrs Strachan, requesting building blocks for the Economic Secretary's speech next week.

The only announcement we have to offer is in relation to VAT annual accounting, assuming that this were to be dealt with separately from PAYE. I attach a draft which builds on the piece drafted earlier by the Financial Secretary.

We suggest that any speaking note on freeports would best be drafted on Wednesday next, in the light of reactions to the Budget announcement. We may also be able to offer something on Viva Gas if the judgment is received in time.

D J HOWARD

Internal circulation:

CPS	Mr Freedman	Mr Collings
Mr Hawken	Mrs Strachan	Mr Battle
Mr Knox	Mr Godfrey	Mr Smith

BUDGET CONFIDENTIAL

On VAT, I have asked Customs and Excise to seek the views of small registered businesses and their associations as to whether they would welcome switching from the present quarterly payment arrangements to a system of annual accounting and payment for VAT. This would not obviate the need to keep proper records. But it would mean that calculations of tax liability would only have to be done once instead of four times a year. This change would be helpful to the cash flow of the businesses concerned, though not alas to the Exchequer! But it would mean that they would have to accumulate the necessary funds and carry out rather longer calculations by the VAT year end. In addition, such a scheme could not be optional and the allocation of annual tax periods would have to be made by Customs and Excise. Because of these necessary constraints, the balance of advantage is not quite so clear as might appear at first glance and the Government are therefore prepared to consider this possibility only if a large majority of those concerned are in favour.

BUDGET CONFIDENTIAL

FROM: A M W BATTISHILL
INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE
10 March 1983

PS/FINANCIAL SECRETARY

FINANCIAL SECRETARY'S SPEECH DURING BUDGET DEBATE

1. I attach a possible draft section (mostly the work of Mr Battersby) for the Financial Secretary's speech in the Budget Debates dealing with the Business Expansion Scheme. As you asked, this tries to put it in the context of its development from the Business Start-up Scheme.

2. Looking at the remaining small firms measures, only the averaging proposal for capital allowances for very small workshops and the small companies corporation tax rate changes might be worth inclusion. If the Financial Secretary would like some sentences on these they can be quickly provided.

A M W BATTISHILL

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cc ~~PS~~/Chancellor of the Exchequer
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Kemp
Mr Moore
Mr Monck
Mr R I G Allen
Mr Robson
Mr Turnbull
Mr G Smith
Mr Ridley
Mr French
Mr Harris
Mr Green
Mr Battishill
Mr Prescott
Mr Northend
Mr Battersby
PS/IR

CONTRIBUTION TO FINANCIAL SECRETARY'S SPEECH

BUSINESS EXPANSION SCHEME

1. My Right Hon Friend announced in his Budget Statement a further package of measures to help small businesses. This is the fourth successive year in which this Government has brought forward such measures. It demonstrates the continuing vital importance we attach to the role of small businesses as the engine for growth and new jobs.

2. Of all these measures, the Business Start-up Scheme, introduced in 1981, has been described as the most important. This is surely right. The scheme is without equal anywhere. It offers outside investors uniquely generous tax incentives to put new equity capital into new companies. Individuals who invest up to £20,000 a year in qualifying start-ups can claim relief at their full marginal rates of income tax. The relief matches the importance we attach to a healthy small firms sector.

3. Investors have understandably taken a little time to come to terms with the scheme. But all the signs are that it is gathering momentum and we intend now to build on this success. As the Chancellor announced, we have decided on major extensions to the scheme. We are converting it from a Business Start-up Scheme into a Business Expansion Scheme. Full details of the changes will be in the Finance Bill. But I should like to explain briefly the main improvements we now propose.

4. First, the life of the scheme. The present scheme is due to run to April 1984. We have been urged to extend this. We intend to do so. The wider scheme will take effect from 6 April this year and will run to April 1987.

5. Second, coverage. We thought it right initially to give priority to investment in business start-ups. It is in the creation of brand-new companies where there is often greatest difficulty in raising risk capital on reasonable terms. But many existing unquoted companies do not have access to the capital markets and may have to rely heavily, sometimes too heavily, on loan capital. The growth of these businesses is also vital. So in respect of qualifying shares issued after 6 April next we intend the scheme should apply to investment in a large number of existing unquoted trading companies not just those carrying on a new trade.

6. Third, we intend to broaden the relief. The annual amount which a person can invest with tax relief under the scheme will be doubled, from £20,000 to £40,000 a year. We shall remove the restriction limiting relief to no more than 50% of a company's issued ordinary share capital. And we shall enable people to claim relief more quickly than at present.

7. The Finance Bill will contain other useful relaxations in the present rules which are designed to improve the scheme and encourage a wider take-up.

8. These changes will make a good scheme even better. Its main purpose is to encourage a greater supply of new equity capital for small and medium-sized companies from people who are not otherwise connected with them. It remains a scheme for outside investors. The relief is only for new and genuinely additional full risk equity capital which remains in a company for at least 5 years.

9. I am confident this wider scheme will be welcomed. It builds on the experience we have gained through the Business Start-up Scheme. It takes that scheme an important step further, and demonstrates our determination to see a healthy and thriving small firms sector.

CONFIDENTIAL

From : R R MARTIN

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

11 March 1983

PRIVATE SECRETARY TO THE FINANCIAL SECRETARY

FINANCIAL SECRETARY'S BUDGET DEBATE SPEECH

I attach some draft paragraphs on employee shareholding, the last three of which were contributed by Mr Gray.

RM

R R MARTIN

cc PS/Chancellor of the Exchequer
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Kemp
Mr Moore
Mr Robson
Mr Ridley
Mr French
Mr Blythe
Mr Crawley
Mr Stewart
Mr Gray
Mrs Ayling
Mr Martin

I should like also to comment briefly on the measures to encourage employee shareholding which my rt hon and learned Friend announced in his Statement yesterday.

The Government is whole-heartedly in favour of the principle that employees should be encouraged to take a stake in the enterprise they work for. They are after all the most important component of any firm. So it is only fair that each person's contribution to the success of his organisation should be matched by a share of the rewards. Employees then have a direct incentive to increase efficiency - as a matter of enlightened self-interest. And that is good for society as a whole.

We have already taken substantial steps to encourage employee shareholding in a number of different ways.

Our privatisation programme has opened up the chance of true financial participation for thousands of employees for whom it did not exist before. In every case we have made it an integral part of our moves away from State control to ensure that the employees are encouraged to take a stake in their own firm, on favourable terms. Over 90,000 have done so.

In other areas, the new Employment Act requires companies with over 250 employees - with effect from 1 January this year - to make an annual statement about their arrangements for employee involvement. And the provisions in the 1981 Companies Act for a company to purchase its own shares - with the associated tax provisions - should facilitate employee share schemes in smaller companies.

On the tax front, we have already reshaped and made more generous the reliefs for profit sharing schemes; we introduced in 1980 a separate relief for savings-related share option schemes, open to employees at all levels in a company; and last year we added a further relief, allowing the income tax charge on share options exercised outside these savings-related schemes to be paid by instalments.

It is these three reliefs on which my rt hon and learned Friend proposes to build further. First, profit sharing. Companies will now be able to reward employees under profit sharing schemes up to an annual level of 10 per cent of the employee's earnings - subject to an overall ceiling of £5000. Second, the £50 upper limit for monthly contributions under savings-related share option schemes - set at that level in 1980 - will be raised to £75. Third, the instalment period for share options exercised outside these schemes will be extended from three to five years.

Our aim is to make these reliefs more attractive and more flexible for companies - while reinforcing the main thrust of the "approved" schemes, that they should be open to employees at all levels. As some hon Members opposite will be aware, the profit sharing reliefs since their introduction in 1978 have always allowed companies to allocate shares in proportion to the individual employee's earnings. We are maintaining this principle. At the same time we shall ensure that employees at all levels in the company continue genuinely and in practice to derive benefit from these schemes. Our raising of the existing profit sharing limit in no way implies a disproportionate benefit for the selected few, to the exclusion of other employees.

We also very much welcome the increasing trend of employees uniting to effect an employee buy-out and so participate in and run a business together. The most spectacular, and so far highly successful, venture of this sort was the National Freight Company employee buy-out.

It has however been represented to us that the absence of tax relief for interest on borrowing could make it difficult for employees to afford to take on loan commitments to purchase their shares, and so achieve a successful buy-out. Giving relief for borrowing for share buying generally by employees would in our view go much too far, but we did feel that there was a case to be met here, in terms of encouraging the initial buy-out, to help get the venture off the ground.

So, subject to confining relief to shares bought no later than a specified period after the buy-out and to setting a limit on the proportion of shares held by any individual employee that can qualify, we propose to allow tax relief for interest paid on loans taken out by employees to buy shares in a company which is substantially employee controlled. I hope this will prove a worthwhile step in smoothing the path for these employee ventures.

BUDGET SECRET

FROM: I R SPENCE
11 MARCH 1983

INLAND REVENUE
POLICY DIVISION
SOMERSET HOUSE

2

D

1. MR BLYTHE

2. PS/FINANCIAL SECRETARY

FINANCIAL SECRETARY'S SPEECH IN BUDGET DEBATE - MR G P SMITH'S DRAFT FOR BLOCK IV (TAX BURDEN)

We will be letting you have some detailed drafting points on the personal taxation side. But could I make, in advance, one general point about the way "tax burden" questions are handled in the Budget debates.

It seems to me that in talking about the personal "tax burden" it is important that Ministers should distinguish between income tax and the combined tax and NIC burden. Tax and NIC are different. Ministers have hitherto emphasised the fact (eg in last year's Budget debates). I think it is important that they should keep the distinction clear in this year's Budget debates.

As a matter of presentation, on income tax alone the Government have a good story to tell:-

(a) we can point to improvements for everyone in 1983/84 compared with 1982/83;

---

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Kemp
Mr Moore
Mr Robson
Mr Monck
Mr R I G Allen
Mr Ridley
Mr French
Mr Harris

Sir Lawrence Airey
Mr Isaac
Mr Painter
Mr Blythe
Mr Calder
Mr Haigh
Mr Kuczys
Mr Spence

and (b) we can point to improvements over 1978/79 for most people (eg lower average rates ("tax burden") for the great majority of married men, and higher tax thresholds in real terms).

If tax and NIC are taken together the picture is much less favourable:

(a) some people have a higher tax and NIC burden than in 1982/83;

(b) the great majority have a higher tax and NIC burden than in 1978/79.

The Opposition will want to lump tax and NIC together as much as possible, so as to take the gloss off this year's threshold increases and find the most advantageous point for criticising the Government's track record. But there is no reason for us to accept this as the framework for debate. Of course we will have to face out the "tax and NIC combined" comparisons, and explain whu NICs have gone up. But we surely need to emphasise the income tax only part of the story, so as to set the debate in perspective (and, of course, emphasise the positive side of the Budget, and of the Government's track record).

(I R SPENCE)

PERSONAL

FROM: C D HARRISON
DATE: 11 MARCH 1983

PRINCIPAL PRIVATE SECRETARY

cc PS/Financial Secretary
Mr Kemp

SPEECHES BY ECONOMIC SECRETARY AND FINANCIAL SECRETARY IN BUDGET DEBATES

The Economic Secretary has asked me to let you know that he has spoken with the Financial Secretary about who should speak when in the Budget debates. It would suit them both very nicely if the Financial Secretary were to wind up on Wednesday 16 March, and the Economic Secretary to wind up on Thursday 17 March. I understand, however, that the Minister of State (R) is wanting to have a slot. Perhaps you could let us know fairly soon how we should proceed.

CDH

C D HARRISON

		Day 1	Day 2	Day 3	Day 4
1982	Open:	CST (Shore)	Fowler (John)	Jenkin (Orme)	
	Wind:	FST (Cook) (Budget general)	EST (Straw) (Social services)	Chancellor (Sheldon) (Industry / Employment)	
1981	Open:	CST (Shore)	Jenkin (Soc. Serv.) (Rooker)	Prior (Hefter)	
	Wind:	FST (Cook) (N L) (General)	MST (C) (Rees) (Straw) (Social services)	Chancellor (Sheldon) (Employment / Industry)	Subjects ?

FROM: E P KEMP
2 March 1983

J.H.
Pl construct a list of
a) subjects
b) openers/winders,
for the last 2 yrs.
JPL

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Mr Moore
Mr Hall
Mr Salveson
Mr Norgrove

MINISTERS' APPEARANCE DURING THE BUDGET DEBATES

Mr Harrison's minute of 1 March, of which you had a copy, commissioned building blocks for the Economic Secretary's speech during the Budget debates. We also, of course, have in hand the Budget Speech itself and the Chief Secretary's speech on the Wednesday. Other Treasury Ministers may also be speaking.

2. All this has prompted Mr Moore to suggest that we should think whether there ought to be some kind of arrangement for allocating out, so to speak, Budget topics, minor announcements, etc as between the various Treasury Ministers (and indeed other Ministers) speaking during the debates following the Budget Speech itself. But before we can take this thinking any further, we would really need to know what the plans are for Treasury Ministers involvement. I appreciate that this may not be settled yet, not least because I understand that in part it may be in the hands of the Opposition. But it would be very tidy if we could know as soon as possible what the arrangements the Government Ministers speaking during the Budget debates are, so that we can broadly consider what sort of topics might most satisfactorily be handled by which Ministers.

3. Can you please give us any guidance?

EPK

E P KEMP

BUDGET SECRET

D

FROM: G P SMITH
DATE: 11 MARCH 1983

MR DONNELLY

cc: PS/Chancellor 12/2
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Mr Kemp
Mr Moore
Mr Robson
Mr Monck
Mr R I G Allen
Mr Ridley
Mr French
Mr Harris

PS/IR

FINANCIAL SECRETARY'S SPEECH IN BUDGET DEBATE

Your minute of 3 March. I attach a draft of Block IV on the balance of taxation. I also attach (not for publication) revised tables showing personal and business taxation comparing 1978-79 with 1982-83 and 1983-84, together with some comment.

G.P.S.

G P SMITH

DRAFT

BLOCK IV TAX BURDEN

Since this Government came into office, taxes have risen in relation to GDP by some 5 percentage points - leaving aside the very rapid increase in tax revenues from the North Sea. This increase, regrettable though it is, has been due to the overriding need to finance [increased] public expenditure while ensuring that inflationary pressures were squeezed out of the economy.

2. During our first years of office these inflationary pressures were formidable. Wages rose by almost 60 per cent between 1978 and 1981. Together with an appreciating exchange rate, this resulted in a 50 per cent loss of international cost competitiveness; an intolerable burden on industry facing deepening world recession.

3. These factors have influenced the Government's decisions about both the level of taxation and the way extra taxation has been raised. There have been significant differences between taxation on persons and taxation on business.

4. Personal taxes as a whole (including NIC) have risen [by 12 % in real terms] since 1978-79 and were a higher proportion of income for all except those who were paying absurdly high marginal rates of income tax when we

came into office. [No excuse is needed for reducing these very high rates - they were a nonsense - they raised little revenue and were a standing invitation to find ways round the rules]. For families on average earnings the extra burden amounted in 1982-3 to about 3 per cent of earnings. [The biggest increase came in the 1981 Budget when the Chancellor was unable to increase allowances and increased most specific duties by about twice the rate of inflation - then running at about 15 per cent]. These facts have been acknowledged many times: the Opposition (and recently the SDP) keep rediscovering them but they are less ready to acknowledge that average take-home pay rose in real terms in spite of the higher tax burden.

5. [Inflationary pressures are now less than they were and with public expenditure under firm control] this year's Budget will mean lower tax burdens for most families in 1983-84 even though the cost of providing benefits under National Insurance has meant a rise in contributions. The lower paid are among the biggest gainers. On plausible assumptions about earnings and prices, people will be better off in 1983-84 than they are now [though for most taxes will still be higher as a percentage of income than in 1978-79].

6. On the business side the picture has been very different. Excluding the North Sea, the income of industrial and commercial companies - those most exposed

to the world recession and the loss of UK competitiveness - fell in real terms by something like a third between 1978 and 1981. The real pre-tax rate of return on capital fell from nearly 8 per cent to 3 or 4 per cent. There has been some recovery in the financial position of companies since then. But it was from a very low base. Profitability remains lower than in 1978-79.

7. During these difficult years however, the tax burden on industry has been reduced. The main factor has been the reduction in NIS from 3½ per cent when we came into office, to 1 per cent from next August. This reduction is worth about £2bn a year to private business and has helped directly to improve cost competitiveness. Companies have also been helped by the arrangements for stock relief introduced in 1981 and next year by the 2 point reduction in the small companies rate of corporation tax.

8. Of course there have been offsetting factors. Industry has shared in the increased cost of financing National Insurance benefits (though employers contributions have risen much less than those of employees), and the local authorities have continued to impose higher rates (which cost business over half as much as NIC and NIS combined).

9. Taking all these changes into account, business in 1983-4 will pay something like £1 billion less than it would have paid under the last Labour Government's tax regime.

10. The shift in the balance of taxation I have described has given valuable help to industry during a very difficult period. But of course we cannot solve our underlying economic problems by such means. Changing the balance of taxation is not a lasting remedy for low productivity and lack of competitiveness. In the long run, high taxation - either on persons or business - is bad for both. It remains our intention to reduce it.

Actual Taxation

(£billion)	1978-79 actual	(%)	1982-83 actual	(%)	1983-84 actual	(%)
Persons	41.2	(76)	75.8	(79)	80.9	(79)
Businesses (exclg North Sea)	13.3	(24)	20.3	(21)	21.4	(21)
	54.5		96.1		102.3	

Taxation in Real Terms
(deflated by GDP (mp) deflator)

(£ billion, 82-3 prices)	1978-79	1982-83	1983-84
Persons	67.6	75.8	76.8
Businesses (exclg North Sea)	21.8	20.3	20.3
	89.4	96.1	97.1

Comparison with 78-79 indexed system
(at 82-83 prices)

(£billion)	1982-83	1983-84
Persons	+ 9.9	9.7
Businesses (exclg North Sea)	- 0.8	-1.1
	+ 9.1	+8.6

Comments on Tables

1. The split between business and personal taxes is inevitably broad brush and to some extent arbitrary. For example we have assumed that VAT is paid by persons via higher prices (rather than by business via reduced profits or employees via lower wages). In the longer run the distinction between personal and business taxes becomes blurred because of tax shifting.

2. The fall in the business share of taxes between 1978-79 and the later years appears largely due to the relative decline in business activity. It does not give a meaningful measure of cuts in business taxation.

3. The comparison with the indexed 1978-79 base gives a better measure of 'genuine' tax cuts and increases (but the calculations here are complex). Personal taxation has been increased - due to higher indirect taxes, NICs and local rates. These increases outweigh the cuts in income tax. Business has gained from cuts in NIS (and to a lesser extent CT) but increases in NIC and LA rates offset about half of this.

RESTRICTED

FROM: J O KERR
DATE: 11 March 1983

MR KEMP

cc: PS/Chief Secretary
PS/ Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Mr Moore
Mr Hall
Mr Salveson
Mr Norgrove

BUDGET DEBATE

Your minute of 2 March.

2. The Chancellor has now considered the question of speakers in the Budget debate. Assuming that the topics chosen are:-

a. General Budget measures

b. Social Security

c. Employment/Industry -

which would be in accordance with the recent precedents and not unlikely given the content of the Budget, he envisages that the line-up might be:-

a. [16 March] Chief Secretary to open, Financial Secretary to wind.

b. [17 March] Mr Fowler to open; the Economic Secretary to wind.

c. [21 March] Mr Tebbit or Mr Jenkin to open; Chancellor to wind.

J O KERR

C. Speakers in the Budget Debate.

It would be good to reach preliminary decisions.

2. The Precedents are :—

	Day 1	Day 2	Day 3
'81	CST/Shore	Jenkin/Rooker	Prior/Heffer
	FST/Cook	MST R / Straw	C/x/Sheldon
NL	(General)	(Soc. Serv)	(Empl/Industry)
'82	CST/Shore	Fowler/John	Jenkin/Orme
	FST/Cook	EST/Straw	C/x/Sheldon
	(General)	(Soc. serv)	(Ind/Empl)

3. The betting must be that the Opposition will want a day on social services and one on unemployment.

4. I've had bids from MST (R), and N. Lawson. I can't see how to accomodate either, ~~unless neither~~ without wounding FST — or Jenkin/Tebbit.

5. The line up might be :—

Day 1	Day 2	Day 3
CST	Fowler	? Jenkin/Tebbit

CONFIDENTIAL

FROM: C D HARRISON
DATE: 1 MARCH 1983

MR D J L MOORE
MR MONCK
MR FREEDMAN)
MR KNOX) C&E
MRS STRACHAN)

cc PS/Chancellor
PS/Chief Secretary
Mr Kemp Mr Broadbent
PS/C&E

ECONOMIC SECRETARY'S SPEECH IN BUDGET DEBATES

We do not yet know on which day the Economic Secretary will be speaking in the debates following the Budget Speech. But I should be grateful if you could begin to put thought to "building blocks" containing points which the Economic Secretary should include in his speech. I should be grateful if at this stage the building blocks could be confined to those points which the Economic Secretary definitely ought to announce, unless there are particular themes which it is thought "highly desirable" that he should cover. He has told me that last year he had too much material; in the time available when winding up, he found it extremely difficult to get through all the building blocks which had been prepared as well as replying to the debate.

2. On particular points: firstly, it may be opportune to say a few words about freeports - although we shall need to see nearer the time. Secondly, Mr Monck may wish to consider if there are any words on monetary policy which the Economic Secretary ought to try to include.

3. I should be grateful if contributions could reach this office by lunch time on Thursday 10 March, if possible.

CDH

C D HARRISON

RESTRICTED

PW

FROM: J O KERR
DATE: 11 March 1983

MR KEMP

cc: PS/Chief Secretary
PS/ Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Mr Moore
Mr Hall
Mr Salveson
Mr Norgrove

BUDGET DEBATE

Your minute of 2 March.

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b. /17 March/ Mr Fowler to open; the Economic Secretary to wind.

c. /21 March/ Mr Tebbit or Mr Jenkin to open; Chancellor to wind.

JOK

J O KERR

RESTRICTED

FROM: J O KERR
DATE: 11 March 1983

MR KEMP

cc: PS/Chief Secretary
PS/ Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Mr Moore
Mr Hall
Mr Salveson
Mr Norgrove
Sir Anthony Rawlinson
Mr Monger

BUDGET DEBATE

Your minute of 2 March.

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b. /17 March/ Mr Fowler to open; the Economic Secretary to wind.

c. /21 March/ Mr Tebbit or Mr Jenkin to open; Chancellor to wind.

J O KERR

BUDGET CONFIDENTIAL

FROM: M E DONNELLY
DATE: 15 March 1983

MR TURNBULL

cc PS/Chancellor
Mr Middleton
Mr Monck
Mr Robson
Mr Willetts
Mr Crawley) IR
Mr Stewart)

FINANCIAL SECRETARY'S BUDGET DEBATE SPEECH: CORPORATE BONDS

The Financial Secretary was grateful for your note of 11 March covering a draft passage for his speech dealing with corporate bonds.

As the Financial Secretary is winding up he has recast this material slightly on the attached lines. I would be grateful for any further comments you may have by close on Tuesday 15 March.

MED

M E DONNELLY

CORPORATE BONDS

1. Increased range of borrowing instruments

2. Encourage long term capital for industry

3. Borrow more from the markets and less from banks.
   We now have three options

First there is the conventional full coupon issue which has always been available. The only modification here is increased flexibility in the terms. It will be possible for such stocks to be issued at a discount of up to ½ per cent a year up to a maximum of 15 per cent with that discount being subject to capital gains tax in the hands of the investor. Although it will not be deductible by the company, the discount can be used to allow the yield to be varied on successive issues of a particular stock.

Secondly, as originally announced in the Chancellor's Statement last June companies are permitted to issue indexed stock. I would like to make it plain, that indexed bonds can be issued in two forms which I will call the capital route and the income route. Under the capital route, the bond is structured so that the indexation constitutes a capital uplift of the principal. The borrowing company will not be able to claim a deduction for this uplift against its profits for corporation tax purposes, but the investor will be subject only to capital

gains tax, which given the indexation provisions introduced last year will frequently mean little or no liability. Under the income route, the bond is structured so that the indexation generates additional sums of interest. These can be rolled up year by year and paid out with the capital on redemption. Under such an arrangement, the interest will be deductible for the borrower and subject to income tax in the hands of the lender. Interest actually paid, will under either route be treated as at present.

The third category is zero or deep discounted bonds which were the subject of the recent consultative document. Many of the responses asked us to abandon the concept of the symmetry - the principle that the discount should be treated for tax purposes in the same way in the hands both of the borrowers and the investors. This concept is not an obscure piece of theology, but a simple matter of common sense. It takes little imagination to see how departure from symmetry would enable a company to both borrow and lend the same amount, at great cost to the Revenue. However, another asymmetrical proposal attracted quite extensive support. The discount

would be treated as an income item for borrower and lender. The borrower would be allowed to deduct the discount as it accrued - on a compound basis as is the case in the US,- but the lender would pay income tax on the accrued discount only when the bond was sold or redeemed. Any further gain or loss he made, as a result of a general shift in interest rates for example, would be treated as a capital item. This proposal represents an attractive compromise. We have no hang up over symmetry: there is a degree of asymmetry in timing, but the scope for arbitrage is limited. Companies get relief as the discount accrues giving a cash flow benefit, while lenders pay tax only after they have received funds from disposing of the bond. We propose therefore to introduce legislation in the Finance Bill to provide for taxation in this way.

We continue to examine additional ways of helping. Full details will be laid, together with the clauses for the Finance Bill, in due course.

DEPARTMENTAL PLANNING UNIT
H.M. CUSTOMS AND EXCISE Rm 404M
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D

From: D J Howard
15 March 1983

PS/Economic Secretary

cc PS/Chancellor
Mr Moore
Mr Griffiths

BUDGET DEBATE: ECONOMIC SECRETARY'S SPEECH

I attach defensive briefing dealing with (a) VAT on charities and (b) VAT on sales of works of art etc from stately homes.

We propose to be in touch tomorrow to see whether the Economic Secretary would like any further briefing or draft speech material on freeports. If further contributions on other Customs and Excise matters are required, I should be glad to co-ordinate.

D J HOWARD

Internal circulation:

CPS
Mr Knox
Mrs Strachan
Mr Porter
Mr Taylor
Mr Battle
Mr Smith

WHAT ARE THE OBJECTIONS TO GIVING VAT RELIEF TO CHARITIES?

There are several problems - they can be summarised as method, cost, administration and definition.

Method: Ordinary zero-rating would not work. The only feasible scheme would be to reimburse charities, outside the normal VAT system, for the VAT they spend on non-business activities.

Cost: The cost is not known because there are no reliable statistics on how charities spend their money. But it would be substantial - certainly tens of millions of pounds. We have had to consider whether this is the most effective way of helping charities.

Administration: A refund scheme for all charities would be expensive to administer because of the large numbers involved. The exact number of charities which might claim refunds is not known, but our best estimate is that it would be at least 100,000. Many extra civil servants would be needed. VAT refunds would be an inefficient way of channelling help to charities.

Definition: A limited scheme for refunds only to certain types of charity or only to large charities would not work. The pressures for extension would be too great. But a relief to all charities would be random and indiscriminate depending only on charitable status (which can be controversial) and each charity's pattern of spending. Many charities would benefit which receive no current public support at all.

WHY NOT ZERO-RATE CHARITIES?

This is simply not on. We could not zero-rate what charities do because VAT is a tax on supplies made in the course of business and most of what charities do is not business. Zero-rating supplies to charities would be immensely complicated for suppliers and almost impossible to control against fraud. Any major extension of zero-rating would also breach our Community obligations.

DIRECT TAX CONCESSIONS HAVE BEEN EXTENDED TO ALL CHARITIES, WHY NOT VAT RELIEF TOO?

Most direct tax reliefs to charities have a value determined by voluntary giving. It is right that donations to all charities should receive the same tax treatment. But VAT relief could be unrelated to voluntary support. It would benefit many bodies with very narrow or controversial aims and would add intolerably to the anomalies that sometimes occur in the definition of what is and what is not a charity. Pressures would mount for VAT relief for bodies which are not charities.

NO MORE THAN 10,000 CHARITIES WOULD SEEK REFUNDS

The figure of 10,000 has been widely quoted. It is said to be based on the number of registered charities with income over £1,000 a year which submit accounts to the Charity Commission.

So it excludes small charities; it excludes charities which have not submitted accounts or are not required to; and it excludes tens of thousands of charities which are not registered with the Charity Commission at all, such as churches, and all charities in Scotland and Northern Ireland. I do not think it is a reliable estimate of the number of active charities.

HOW IS THE GOVERNMENT'S ESTIMATE OF 100,000 ARRIVED AT?

Inland Revenue have records for about 200,000 charities. Some 130,000 of these are currently active. It seems likely therefore that at least 100,000 charities are active enough to put in claims for VAT refunds.

WHAT HAS THIS GOVERNMENT DONE FOR CHARITIES?

Every one of my RHF's Budgets has contained measures to help charities. We have:-

- abolished stamp duty for transfers to charities;
- exempted charities from development land tax;
- exempted charitable bequests of whatever value from CTT;

- reduced the minimum period for covenanted gifts from 7 years to 4;

- introduced higher rate tax relief for covenanted gifts, and increased the ceiling to £6,000 a year.

I should be surprised if the benefit of these reliefs to charities which depend on voluntary support did not on average exceed the benefit they might have had from VAT relief.

In addition the special VAT reliefs on medical equipment and aids for the disabled have been greatly extended.

Direct Government grants to charities have also been increased in real terms.

THE "1972 COMMITMENT" HAS NOT BEEN HONOURED

There was never any open-ended commitment to VAT relief. The then Chancellor promised to consider some means of additional help if any charities could show that they were seriously disadvantaged after all the tax changes made in the 1972 Finance Bill. In fact, taking account of further direct tax concessions made in the following year, charities in general benefited from the tax changes.

POSITION OF LOCAL AUTHORITIES

The refund of VAT to local authorities under Section 15 of the Finance Act 1972 is one of the ways in which local authority spending is financed by central government. It is taken into account in calculating the rate support grant so local authorities are no better off as a result

"CONTRACTING OUT" REFUNDS TO NHS BODIES

There has been a good deal of misunderstanding about this. It is not a VAT relief for private contractors to the NHS. They must continue to charge

VAT as at present. But Health Authorities will be able to claim refunds of the VAT charged to them on certain services. It removes a possible disincentive to Health Authorities making cost-effective use of outside contractors. It amounts to an additional method of financing bodies which are already financed by central government, while the net fiscal effect is neutral. Only about 20 NHS bodies are affected so the administrative costs are negligible.

[Note: DHSS has pointed out that it is not quite true to say that the relative position of hospitals and charities is unchanged. The Health Authorities are actually getting additional funding because there will be no claw-back from their Vote].

OTHER EC COUNTRIES PROVIDE VAT REFUNDS TO CHARITIES

I am not aware that any Member States compensate charities for VAT on their non-business purchases.

THIS GOVERNMENT HAS REDUCED THE LEVEL OF DIRECT GRANTS TO CHARITIES

Direct grants to charities have been increased in real terms. In 1981/82 Government Departments provided grants totalling £140 million - a 16% increase in cash terms over the previous year, and a 5% increase in real terms. In addition to this substantial help is channelled to charities through other Government funded bodies such as the Arts Council and the Manpower Services Commission.

Of course the level of grants to individual charities will fluctuate because much of it is related to specific projects.

DEFENSIVE BRIEFING FOR ECONOMIC SECRETARY ON SALES OF WORKS OF ART ETC FROM STATELY HOMES

1. Why has the Chancellor not taken any action to relieve the sales of works of art etc from stately homes from VAT? The Chancellor is still considering the representations he has received on this subject. If the Chancellor decides to grant any relief, it would not require a Finance Bill provision, so that it could be done at any time.

2. Why should VAT be chargeable on the disposal of items which have been in the private ownership of a family for generations? Opening a stately home to the public for a charge is a business activity for VAT purposes. Any item which is on display to the public is being exploited for the purpose of that business and ~~are~~ is therefore an asset~~s~~ of that business. That means that their disposal is normally liable to VAT in accordance with the VAT legislation, as is the disposal of assets of a business generally.

3. Is it not illogical in the case of capital tax exempt private treaty sales and acceptances in lieu of capital taxes that the state should on the one hand encourage them by direct tax concessions and on the other discourage them by the imposition of VAT? It must be borne in mind that VAT is a broad-based tax, and as such is not a suitable instrument for fine-tuning to reflect every aspect of the Government's non-fiscal policy. However, the Chancellor is fully aware of the strength of feeling on this issue, and will bear all the arguments in mind in reaching his decision.

4. On what amount is VAT chargeable in the case of capital tax exempt private treaty sales and acceptances in lieu of capital taxes? Customs and Excise have modified their ruling on the value on which VAT is chargeable. They now accept that VAT should be accounted for only on the amount of cash received, in the case of a private treaty sale, or the amount put to the satisfaction of other capital tax debts in the case of an acceptance in lieu. These amounts include the douceur, but do not include the value of the capital tax exemptions on the object itself (which had been included in the value for VAT purposes under Customs and Excise's original ruling - though no case had arisen where VAT was actually accounted for on that basis).

5. VAT is chargeable on sales of goods in the United Kingdom, but exports are zero-rated. The effect of VAT is therefore to cancel out the 'douceur' which is offered to encourage capital tax exempt disposals. Will this encourage the export of works of art, etc? There is no reason to suppose that the charging of VAT on sales of works of art etc in the United Kingdom would necessarily encourage exports. Although an overseas buyer would not have to pay UK VAT, he would normally have to pay VAT or some other form of taxation in the country to which the goods are exported and also bear higher transport and insurance costs than a UK buyer. He would therefore be expected to offer less than the VAT-inclusive open market value. Where the vendor receives a douceur on top of the open-market value, it is unlikely therefore that he would be better off by selling the item abroad. [Though there are some overseas buyers who are prepared to offer so much more than the normal open-market value that this comparison does not hold, but the effect of VAT in these cases is irrelevant, as there would be a considerable incentive to sell for export even without VAT.]

6. Is it not indefensible that a collection [such as the one at Kedleston Hall] should be broken up and parts exported because of VAT? I cannot comment about the affairs of individual taxpayers. However, the charge to VAT is not as widely drawn as is feared, and there are many circumstances where the charge to VAT may be quite properly avoided. It should not be assumed therefore in any particular case that a charge to VAT would necessarily arise.

7. In what circumstances would VAT not be chargeable on the disposal of works of art etc from stately homes? The arrangements surrounding the ownership of houses and their contents are very varied, so it is not possible to give an exhaustive list. However, examples of cases where VAT is not chargeable include the following:

- the owner may not be registered for VAT because his total business turnover is under the registration threshold;
- the owner of the contents may not be the person who is running the business of opening the house to the public;

- if items which have been on display for a charge are removed for at least 1 year either for free loan to a museum or to private quarters they would no longer be seen as business assets; or
- if the items have been on view purely incidentally to the business activity.

If you are asked for detailed information, we suggest that you offer to write.

MR DONNELLY

FROM: A TURNBULL
15 March 1983

D

cc PS/Chancellor
Mr Middleton
Mr Monck
Mr Robson
Mr Willetts
Mr Crawley) IR
Mr Stewart)

FINANCIAL SECRETARY'S SPEECH: CORPORATE BONDS

I have a few comments on the note you have prepared.

(i) The "we now have" on the first page should be "companies will have".

(ii) First para page 2 redraft last sentence "... the company, it will have greater scope to use the discount as a way of varying the yield on successive ...".

(iii) Page three, first para. I think the reference here is to the coupon interest. As drafted it is ambiguous as it could include supplementary interest.

(iv) Page 3, second para, last sentence. I would prefer "However, a proposal incorporating a more limited degree of asymmetry attracted ..."

(v) Page 4, first line, insert "still" after "would" and open next sentence with "However, the borrower".

(vi) I would prefer to delete "we have no hang up over asymmetry", after all we are still defending symmetry in its larger role.

(vii) The opening sentence of the last paragraph sounds a bit bald. I suggest something like "Our aim has been to lengthen the menu from which companies and

lenders can choose, making it easier for them to find an instrument which most suits their needs, and we will continue to examine ways in which this can be done."

A TURNBULL

BUDGET SECRET

D

FROM: M E DONNELLY
DATE: 15 March 1983

MR G P SMITH

cc PS/Chancellor
PS/Chief Secretary
PS/Economic Secretary
PS/Minister of State (R)
Sir D Wass
Mr Kemp
Mr Moore
Mr Monck
Mr R I G Allen
Mr Robson
Mr Ridley
Mr Harris
Mr Kuczys) IR
Mr Spence)
PS/IR

FINANCIAL SECRETARY'S SPEECH IN BUDGET DEBATE: BURDEN OF TAXATION

The Financial Secretary was most grateful for your note of 11 March, and the subsequent comments on it.

As he is winding up the debate he has produced some notes on the basis of your draft, dealing with this topic. I would be grateful if you could provide the missing figures by close on Tuesday 15 March if possible.

MED

M E DONNELLY

BURDEN OF TAXATION

Personal Allowances

- nothing gives me more pleasure than increase of 8½ per cent over indexation.

Nonetheless compared 1978-79-post 1983 Budget:

1) thresholds are [ ]

2) net of tax pay, for those staying on average earnings through the period [ ]

3) percentage paid in tax, for those on average earnings, [ ]

If you add NIC

NIC not a tax - necessary increases to pay for estimates that:

1) Pensions up 75 per cent by November 1983
   Prices up 70 per cent by November 1983.

2) High level of unemployment and restoration of 5 per cent abatement.

Including NIC figures for change since 1978-79 become:

1) Net of tax pay, for those on average earnings [ ]

2) percentage paid in tax, for those on average earnings [ ]

Compare with the burdens on industry

In 78/79 Persons paid 16% of the Total tax bill.

Business paid 24% (less N Sea Oil)

The figures for 83/84 are 19%
21%

As the Chancellor said, that represents £3bn switch from Industry to persons.

Arguments why that was right

- pressure in House
- cope with High Exchange rate.
- need to save and create jobs.
- profits down from 8% to 3or4%

CT yield down

NIS cuts

NIC increases limited for business

[But Rates - LAs have increased burden]

Government Spending under control now but still high.

If Inflation was to be squeezed out - lower PSBR's - there was no other way.

Party opposite want to place more of the burden on higher income groups. We have done so on the CTT front, - I regret. To go back to 1974 CTT rates would cost [£].

To go back to 78/79 Income Tax higher rates would only bring in £[ ]. Preferable to give the relief on earnings rather than on what is inherited.

And that is only worth [x]% extra on the allowances. We do not believe in forcing our executives and managers abroad. Hard to recruit from abroad even now. Lo se more jobs through lo sing good managers.

"You cannot make the poor richer by making the rich poorer".

I would like to look at these figures another way. The House will see that in 83/84 we will spend £[   ]bn on Social Security.

<u>Equally</u> the House will agree that we can't increase taxes on industry.

<u>Nor</u> do they prefer spending cuts.
The only way to get rid of the poverty trap is to increase thresholds.
Yet to do so is expensive. [1950 thresholds= $\frac{2}{3}$ av. earnings. 1982 thresholds = $\frac{1}{3}$ av. earnings] To go back to 1950 levels of thresholds would cost £[   ] bn.

Perhaps the House will see the value of cutting spending - so that allowances can continue to be raised.

As production and growth increase - more resources will enable us to do so.

Meanwhile essential to hold spending.

RhG for Stepney Pre budget Economic Statement

Increase social spending by £2bn a year. The list of measures set out by B. John, [ ] strangely enough at Darlington. I Quote: "It will also dramatically reduce the poverty trap" It won't - £2bn more taxes to pay it, make it £4bn worse. Total increase of £12bn in PSBR.

Even the Alliance falls into this trap.

More moderate proposals - £3bn.

Can't be sure - job splitt_ing Scottish Leadership. Jenkins - negative PSBR.

which to believe? Old or Young Pretender?

Quote rhg for Stockton

"You could say that the Social Democrats slightly harsher. I have a tough approach attidutde to politics. I don't think that you can soft soap everything. On the other hand I think the Liberals are gentler. There is room for both. If you put them together you have a terrible blancmange".

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Ref. No: FIN(83)2
15.3.83

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THE BUDGET

Members may find the following Brief useful for the Debate on the Government's Budget.

Conservative Research Department,
32 Smith Square,
London SW1
Tel. 222 9000

Enquiries on this brief to:
Katharine Marsh or Dominic Hobson
x 2512 x 2511

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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 2¼% overshoot of benefits arising in the last up-rating will not be fully recovered, and a substantial part of the overpayment 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.

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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 comp e titiveness 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]

Base	1983/4 Indexed	1983/4 Unindexed	Full Year Indexed	Full Year 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 <u>increase</u> the personal tax burden, through both income tax and national insurance in order to shelter industry from tax increases.

<u>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</u>.

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 second successive year reduces average rates of income tax for all taxpayers.

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

2. Tax and NIC Changes on Incomes (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 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:

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

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

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

NB Changes in National Insurance Contributions not 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 more:

- 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. Secondhand Bonds

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 out of income tax into capital gains tax net, thereby avoiding proper charge.

10. Child Benefit and One-Parent Benefit

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. One-parent benefit 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. INDIRECT TAXES

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. Included 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 ~~F~~ 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/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 last two 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;

no

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. Now 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/construction in 1983-84 of over £10bn, 10% increase on previous year's outturn.

on

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.

Estimated revenue cost of package is £~~11~~ 100m 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. Small Companies Corporation Tax Rate

- Lower limit more than re-valorised this year and limit doubled 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. VAT Registration and Deregistration. Thresholds raised from £17,000 to £18,000.

70. Loan Guarantee Scheme. 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. Measures to encourage Industrial Finance. 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 revival of the corporate bond market. This is receiving further direct encouragement in severals ways:

- Deep discount stock. New tax regime following removal of embargo in June 1982, and consultative document from Inland Revenue. Borrowers will get relief against income annually for accrued discount; 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.

FROM: R H AARONSON
DATE: 16 MARCH 1983

Emp

MR GIEVE

cc: PS/Chancellor
PS/Financial Secretary
PS/Econ. Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Mr Moore
Mr R I G Allen
Mr M Hall
Mr G P Smith
Ms Holman

BUDGET DEBATE

You asked for a breakdown of the £9bn increase in personal taxes (in 1982-3), above what their yield would have been if 1978-9 tax rates and real values of thresholds had been maintained. This is shown in the attached background note, which accompanied the Martin O'Neill PQ.

2. The £9bn figure did not take account of the fact that certain social security benefits came into tax in July 1982. If that figure is included the income tax reduction becomes £0.4bn rather than £0.8bn, and the total tax increase £10bn.

3. The figures will not look much better in 1983-4. The Budget reductions in income tax will tend to reduce the total, but benefits will be subject to tax for the whole year instead of a part year and NICs will be up because of increases in the rate.

4. You thought the Chief Secretary might want to quote a figure excluding domestic rates and NICs. There are obvious dangers: the Opposition may argue that what has happened to local government rates is partly due to central government policies, and even if NIC is not strictly a tax it still feels like one when deducted from pay packets.

R.H. Aaronson

R H AARONSON

MR MARTIN O'NEILL

BACKGROUND NOTE

1. Taxes on persons have been defined here as income tax, employees' national insurance contributions, VAT, Customs & Excise duties, car tax, vehicle excise duty and domestic rates.

2. The details of the figures given in the answer are:-

£billion	1978/79 actual	1982/3 actual	1982/3 (indexed 78/79 system)	Difference
Income tax	20.2	31.5	32.3	-0.8
VAT, car tax & C&E duties	13.8	28.2	22.3	+5.9
Employees' NICs	4.1	9.0	6.2	+2.8
VED	1.1	1.9	1.9	0
Domestic rates	2.5	5.5	4.1	+1.5
	41.7	76.1	66.8	+9.4

3. The difference between the actual and hypothetical yield for VAT etc is due to the change in VAT rates in 1979, and to over-revalorisation of most specific duties. The increase in NICs is due to increases in the rates of contribution and over-indexation of flat-rate contributions and limits. The reduction in income tax is relatively small, since the 1979 cut in the basic and higher rates of tax has been largely offset by the abolition of the reduced rate band, and the fall in the real value of allowances and thresholds.

4. The £9.4bn difference could be interpreted as the excess personal taxation in 1982/83 compared to maintaining the 1978/79 system in real terms. However, it has been derived in a mechanistic

BACKGROUND NOTE (contd)

fashion by applying the 1978/79 tax system, indexed, to 1982/3 levels of activity etc. This can only be a hypothetical exercise since if taxes had been so much lower (12½%) this would have had effects on eg prices, the PSBR, borrowing, so that the economy would not have been at the levels of activity etc that actually occurred, and on which the estimate is based.

NOTES FOR SUPPLEMENTARIES/

C

FROM: J O KERR

DATE: 16 March 1983

MR KEMP

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Monger
Mr Moore
Mr Hall
Mr Salveson
Mr Norgrove

BUDGET DEBATE

My minute of 11 March.

2. The topics for debate, and the line-up of Government speakers, are as envisaged, with Mr Jenkin speaking on Monday. The Opposition speakers too are now known; and the complete line-up is therefore as follows:-

<u>16 March</u>	Mr Shore and the Chief Secretary to open; Mr Orme and the Financial Secretary to wind.
<u>17 March</u>	Mr John and Mr Fowler to open; Mrs Dunwoody and the Economic Secretary to wind.
<u>21 March</u>	Mr Rees and Mr Jenkin to open; Mr Healey and the Chancellor to wind.

JOK.

J O KERR

C. So far, all I've done is to ask Mr <u>Lavelle</u> to prepare a ten minute (<u>quiet</u>) world bit
Mr <u>Renton</u> to think of punchy points, jibes, one-liners

I do think it would be good <u>tomorrow morning</u> to commission some more chunks, when you've reflected on the shape you want. [signature]

BUDGET SECRET

Annex: Proposals in the FSBR but not the speech

(a) to alter the law in relation to benefits in kind of directors and employees from loans;

(b) to enable Trustee Savings Banks to be treated for tax purposes as bodies corporate;

(c) to extend the relief for the incidental costs of obtaining loan finance;

(d) to exclude from charge oil won which the participator uses for production purposes in another field;

(e) to correct certain technical defects in the PRT provisions;

(f) to extend the [CGT] private residence relief to gains to a person required by the terms of his trade to live in other accommodation;

(g) to amend the [CGT] rules relating to the value at which assets are deemed to be acquired from certain non-resident trusts;

(h) to extend the period over which [DLT] tax on deemed disposals can be paid by instalments ...;

(i) to extend the period over which [CTT] tax may be paid by instalments ...;

(j) to remove the special rule under which persons becoming domiciled the in Channel Islands [CTT] ...;

(k) to clarify rules about incidence of CTT on death;

(l) to amend the [CTT] provisions relating to settled property.

FROM: R M PERFECT
17 March 1983

1. MR PERETZ
2. PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Economic Secretary
PS/Minister of State (C)
PS/Minister of State (R)
Sir D Wass
Mr Littler
Mr Middleton
Mr Lavelle
Mr R I G Allen
Mr Hall
Mr Vernon

BUDGET DEBATE: CAPITAL OUTFLOWS

Following Mr Shore's claim on TV last night that £1 billion a month is leaving the country you may like some additional material to supplement the Budget briefing.

2. It is not clear what figures Mr Shore has in mind but he may be referring to UK private investment overseas (direct and portfolio) which totalled £10 billion in 1982. In the first half of 1979, immediately before exchange controls were first relaxed and then abolished, overseas investment was running at an annual rate of £6 billion a year.

3. But perhaps the main points to make are:

(i) Net capital outflows simply reflect the current account surplus.

(ii) It is a nonsense to regard overseas investment as a flow of money out of the country. Some of it is financed from unremitted profits. Much is financed by borrowing foreign currency. The rest involves UK investors buying foreign currency; which means finding someone else who wants to make an investment in sterling to buy it from. There is thus no net "drain" of funds out of the country. So stopping these flows won't help finance Mr Shore's inflationary ideas.

(iii) Overseas investment will provide valuable overseas earnings after North Sea production has peaked.

4. I attach fuller notes on exchange controls and outflows together with the most recent figures for overseas investment and other capital flows.

R.M. Perfect.

R M PERFECT

EXCHANGE CONTROLS

Factual

Exchange controls restricted transactions between residents and non-residents. They were introduced at the beginning of the Second World War to make gold and foreign currency available for the war effort. They were retained in the post war years when there was a need to defend a fixed exchange rate despite recurring current account deficits. The growth in trade flows and capital markets made exchange controls ineffective and the easing of the balance of payments constraint as North Sea oil was developed made them irrelevant. They were abolished in October 1979.

Points to make: Positive

(i) Exchange controls have little effect in the face of strong market movements. They did not control leads and lags on payments for imports and exports (one month's movement in payments on goods alone now totals around £10bn). And exchange controls did not prevent non-residents from switching funds between sterling and other currencies.

(ii) With modern communications and increased interdependence between countries no exchange control regime acceptable in a democracy can prevent movement out of an internationally traded currency like sterling.

(iii) Experience in 1967 and 1976 shows that exchange controls have little or no use in the face of strong market pressures. The only defence against speculative flows is to maintain confidence by pursuing the right monetary and fiscal policies.

Defensive

(v) Abolition has led to huge outflows. The net capital outflows in recent years simply reflect - as a matter of arithmetic - the large current account surplus. Just as a country in deficit has to borrow abroad, a country in surplus improves its international balance sheet. Our balance between overseas assets and liabilities is in a better state than it has been for years - and this will provide a useful source of net revenue from overseas for the future.

(vi) Capital outflows mean lower investment at home. [See (v)]. Abolition of exchange control has had no direct effect on net capital flow. But it may have meant larger UK investment abroad matched by higher investment in the UK - or a lower level of withdrawal of funds - by overseas investors. Much of our investment abroad increases our access to overseas markets and exports, encouraging increased investment at home also.

(vii) Economy vulnerable because short term inflows offsetting long term outflows. There was nothing in the exchange controls operated by the previous Government to stop such inflows.

(viii) Why retain the Exchange Control Act 1947 on the statute book. We are required by the European Communities Council Directive of 21 March 1972 to be able to act, where necessary, on capital flows without further enabling measures.

INVESTMENT AND OTHER CAPITAL TRANSACTIONS[1] ~~CONFIDENTIAL~~ INFORMATION

TABLE 8

Not seasonally adjusted

£ million

		Overseas investment in: UK public sector	Overseas investment in: UK private sector	UK private investment overseas	Official long-term capital	Trade credit2	Foreign currency borrowing or lending abroad by UK banks3,5	Exchange reserves in sterling4: British government stocks	Exchange reserves in sterling4: Banking and money market liabilities, etc 5	Other external banking and money market liabilities in sterling5	External sterling lending by UK banks5,6	Other external borrowing or lending7	Other transactions	Total investment and other capital transactions
1971		+103	+912	-800	-274	-233	+471	-55	+656	+709	+39	+144	+66	+1,790
1972		+113	+659	-1,402	-254	-211	+471	+65	+222	-91	-241	+146	-161	-684
1973		+156	+1,341	-1,760	-255	-203	+535	-74	+87	-7	+35	+339	-176	+166
1974		+180	+2,024	-1,145	-267	-722	-295	-124	+1,534	+148	+53	+351	-120	+1,594
1975		-13	+1,527	-1,367	-291	-518	+253	+7	-622	+549	+96	+316	+200	+137
1976		+179	+1,912	-2,269	-161	-992	-106	+12	-1,413	+256	-350	+121	-198	-3,009
1977		+1,432	+2,967	-2,334	-303	-355	+364	+6	-16	+1,481	+58	+813	+56	+4,169
1978		-97	+2,005	-4,634	-336	-631	-433	-113	-	+293	-504	+106	+51	-4,293
1979		+902	+3,459	-6,555	-401	-795	+1,623	+247	+509	+2,580	+205	+541	-68	-2,247
1980		+589	+4,654	-8,204	-91	-1,170	+2,054	+945	+317	+2,558	-2,500	-766	-217	-1,831
1981		+188	+3,168	-10,657	-336	-817	+1,471	+267	-118	+2,607	-2,944	-39	+80	-7,082
1982		+327	+3,317	-10,003	-344	-1,451	+4,700	-32	+440	+4,164	-3,213	+954	+502	-639
1974	1	+22	+830	-358	-53	-125	-61	+68	+164	-53	+1	+100	-21	+514
	2	+95	+404	-101	-44	-273	+56	-190	+421	+155	+104	+57	-	+685
	3	+4	+471	-195	-23	-127	-346	-67	+622	+61	-2	+102	+3	+500
	4	+58	+319	-491	-167	-197	+56	+65	+327	-15	-50	+92	-102	-105
1975	1	+36	+305	-378	-72	-208	-62	+6	+222	+19	+46	+77	+108	+99
	2	-3	+207	-528	-39	-177	+772	-7	-296	+286	-241	+54	+62	+90
	3	-57	+580	-108	-30	+137	-15	-67	-313	+1	+35	+82	+11	+256
	4	+11	+435	-353	-150	-270	-442	+75	-235	+243	+256	+103	+19	-308
1976	1	+1	+591	-598	-37	-355	+94	-10	-72	+6	-245	+147	-79	-557
	2	+15	+377	-560	-18	-284	-86	-13	-908	-11	-223	+74	-118	-1,755
	3	+61	+458	-547	-28	-35	-272	-19	-330	+212	-124	-29	-8	-661
	4	+102	+486	-564	-78	-318	+158	+54	-103	+49	+242	-71	+7	-36
1977	1	+353	+927	-566	-23	-136	+419	-163	+345	+199	+166	+141	-55	+1,607
	2	+443	+831	-772	-19	-60	-706	-4	-394	+350	-110	+381	+56	-4
	3	+252	+727	-499	-30	+91	+187	+31	+43	+323	-23	+216	-47	+1,271
	4	+384	+482	-497	-231	-250	+464	+142	-10	+609	+25	+75	+102	+1,295
1978	1	-55	+869	-897	-23	-169	+128	-33	+176	-62	-292	+160	+21	-177
	2	-40	+335	-814	-8	-280	-931	-20	-211	-152	-65	+39	-76	-2,224
	3	-21	+352	-1,189	-66	-126	+343	-34	+43	+159	-82	-15	+185	-451
	4	+19	+449	-1,734	-239	-56	+27	-26	-8	+348	-65	-78	-79	-1,441
1979	1	+245	+351	-1,516	-78	-320	+1,002	-130	+268	+470	+103	+75	+77	+547
	2	+78	+1,281	-1,441	-35	-243	-385	+5	+92	-358	+204	+12	+159	+855
	3	+429	+923	-1,950	-66	+154	+671	+206	+194	+450	-101	-254	-348	+308
	4	+150	+904	-1,648	-222	-386	-435	+166	-45	+1,302	-1	+708	+44	+537
1980	1	-18	+1,429	-2,139	+10	-328	+767	+45	+455	+256	-324	-508	-188	-543
	2	+656	+937	-1,977	-13	-166	+230	+448	-94	+983	-563	-71	-87	+283
	3	+55	+987	-1,818	-2	-404	-593	+437	-80	+824	-668	-21	-42	-139
	4	-104	+1,301	-2,270	-86	-272	+464	+15	+36	+495	-945	-166	+100	-1,432
1981	1	+82	+348	-3,020	-128	-12	-426	-95	+187	-301	-1,229	+244	-130	-3,878
	2	-156	+1,262	-2,429	-111	-166	-750	+152	+21	+902	-433	-588	+382	-1,914
	3	-11	+757	-2,216	-5	-58	+58	+95	+49	+1,015	-795	-104	+56	-1,160
	4	+273	+801	-3,022	-92	-581	+2,589	+115	-375	+389	-486	+487	+228	-130
1982	1	-58	+1,084	-3,042	-211	-246	+1,656	-167	+512	+1,119	-1,097	+354	-239	-335
	2	-104	+775	-2,325	-17	-219	+541	+82	-294	+1,488	+207	+34	-38	+130
	3	+723	+551	-2,520	-2	-343	+1,264	-228	+478	+1,034	-1,341	+4	+161	-719
	4	+266	+907	-2,116	-114	-643	+1,239	+281	-256	+523	-982	+562	+616	-285

1. Assets: increase-/decrease+. Liabilities: increase+/decrease-. Excluding official financing.
2. Excluding trade credit between 'related' firms, after deducting advance and progress payments to suppliers. Net credit extended by UK merchants on third country trade is included within export credit.
3. Excluding changes in levels resulting from changes in sterling valuation: see notes on pages 45 and 51 of 'UK Balance of Payments 1982 Edition'.
4. Sterling reserves of overseas countries and international organisations, other than the IMF, as reported by banks, etc. in the UK.
5. Prior to 1982 includes transactions by 'other financial institutions'. For 1982 onwards these data relate only to transactions reported by UK monetary sector institutions. Transactions by 'other financial institutions' (for which levels data are included within Tables 15, 16 and 17) are included within 'other external borrowing or lending'.
6. Excluding credit for UK exports.
7. From 1982 onwards includes transactions by 'other financial institutions' (see footnote 5). The estimate included for the latest quarter excludes a substantial part of the private sector borrowing from and lending to banks etc., overseas.

OVERSEAS INVESTMENT IN UNITED KINGDOM [1] ~~CONFIDENTIAL UN~~ [illegible]ON

TABLE 9

		Not seasonally adjusted, £ million: Direct 2			Portfolio									
										Net issues abroad4				
		Unremitted profits	Other	Total	Investment by oil companies	Investment in UK company securities	British government stocks3	British government foreign currency bonds	Local authorities securities	Public corporations	Local authorities	Total	Miscellaneous investment	Total overseas investment in UK
1976		+541	+259	+799	+819	+259	+116	-	+14	+49	-	+438	[illegible]	+2,091
1977		+837	+459	+1,326	+1,131	+421	+979	+395	+28	+30	-	+1,853	[illegible]	+4,399
1978		+720	+572	+1,292	+665	+12	-3	-	+4	-93	+5	-85	[illegible]	+1,905
1979		+1,297	+521	+1,818	+1,215	+351	+929	-	+41	-6	-62	+1,253	+75	+4,361
1980		+838	+1,738	+2,576	+1,714	+264	+571	-	+19	-1	-	+853	+100	+5,243
1981		+1,027	-153	+874	+1,904	+320	+201	-	-	-13	-	+508	+70	+3,355
1982		+1,175	+21	+1,196	+1,876	+95	+502	-115	-5	-55	-	+422	+150	+3,644
1979	1	+174	+40	+214	+91	+41	+236	-	+13	-4	-	+286	+5	+596
	2	+407	+231	+638	+544	+89	+67	-	+12	-1	-	+167	+10	+1,359
	3	+290	+208	+498	+293	+97	+421	-	+8	-	-	+526	+35	+1,352
	4	+426	+42	+468	+287	+124	+205	-	+8	-1	-62	+274	+25	+1,054
1980	1	+398	+443	+841	+479	+79	-28	-	+11	-1	-	+61	+30	+1,411
	2	+255	+172	+427	+460	+40	+646	-	+10	-	-	+696	+10	+1,593
	3	+142	+249	+391	+496	+80	+53	-	+2	-	-	+135	+20	+1,042
	4	+43	+874	+917	+279	+65	-100	-	-4	-	-	-39	+40	+1,197
1981	1	+217	-505	-291	+579	-35	+89	-	+1	-8	-	+117	+25	+430
	2	+221	+519	+740	+407	+100	-157	-	+2	-1	-	-56	+15	+1,106
	3	+373	-375	-2	+634	+110	-6	-	-2	-3	-	+99	+15	+746
	4	+216	+211	+427	+284	+75	+275	-	-1	-1	-	+348	+15	+1,074
1982	1	+451	+175	+626	+403	-10	-48	-	-6	-4	-	-68	+65	+1,026
	2	+275	-179	+96	+674	-20	+11	-115	-	-	-	-124	+25	+671
	3	+267	-100	+167	+374	-20	+222	-	+1	-	-	+203	+30	+774
	4	+182	+125	+307	+425	+145	+317	-	-	-51	-	+411	+30	+1,173

1. Net of disinvestment. Liabilities increase+/decrease-.
2. Excluding the transactions of oil companies.
3. Excluding investments by central monetary institutions and international organisations
4. Excluding official financing

UK PRIVATE INVESTMENT OVERSEAS [1]

TABLE 10

		Not seasonally adjusted, £ million: Direct 2					
		Unremitted profits	Other	Total	Oil companies' and other miscellanous investment	Portfolio	Total
1976		-1,454	-691	-2,145	-214	+90	-2,269
1977		-1,292	-593	-1,885	-461	+12	-2,334
1978		-1,259	-1,481	-2,740	-821	-1,073	-4,634
1979		-1,636	-1,152	-2,788	-2,858	-909	-6,555
1980		-1,646	-1,845	-3,491	-1,566	-3,147	-8,204
1981		-2,184	-2,973	-5,157	-1,380	-4,150	-10,687
1982		-1,542	-1,522	-3,064	-1,139	-5,800	-10,003
1979	1	-335	-219	-555	-711	-250	-1,516
	2	-354	-594	-948	-451	-42	-1,441
	3	-501	-71	-572	-1,077	-301	-1,950
	4	-445	-268	-713	-619	-316	-1,648
1980	1	-520	-530	-1,050	-563	-526	-2,139
	2	-404	-925	-1,329	-327	-321	-1,977
	3	-388	-117	-505	-233	-1,080	-1,818
	4	-334	-273	-607	-443	-1,220	-2,270
1981	1	-587	-639	-1,226	-434	-1,360	-3,020
	2	-520	-551	-1,071	-368	-990	-2,429
	3	-605	-587	-1,192	-294	-730	-2,216
	4	-472	-1,196	-1,668	-284	-1,070	-3,022
1982	1	-494	-623	-1,117	-295	-1,630	-3,042
	2	-526	-326	-852	-183	-1,290	-2,325
	3	-327	-515	-842	-338	-1,340	-2,520
	4	-195	-58	-253	-323	-1,540	-2,116

1. Net of disinvestment. Assets increase-/decrease+.
2. Excluding the transactions of oil companies but including investment by a number of public corporations

FROM: R G LAVELLE

DATE: 17 March 1983

MR KERR

cc: Mr Littler o/r
Mr Unwin
Mr Carey
Mr Odling-Smee
Mr Bottrill o/r
Mr Peretz
Mr Graham
Mr Atkinson

I've shortened

But is it much wrong? I can't, in a quick look, see a easy selection

BUDGET DEBATE: CHANCELLOR'S WIND-UP

You asked me yesterday if I could produce ten minutes worth about the world which might occupy the middle section of the Chancellor's wind-up speech next Monday.

2. I attach a rough piece to meet your deadline (my enthusiasm modified by today's Frank Johnson piece). I have not been able to clear it with others, but since it contains little new this may not matter very much. However they could let you or me know of any textual changes or additions they feel desirable.

3. If this is the sort of thing you had in mind, you will also doubtless say if you would like help in its refinement.

R G LAVELLE

DRAFT

It is customary that the Budget statement which inaugurates our debate should itself begin with a review of the world economic prospect. This is much more than a convention. The global outlook to a major extent conditions our affairs. I might add that to an increasing extent this is becoming true nowadays for every major country in the world, even for the United States.

2. We have a major interest in the evolution of a coherent and constructive global economic strategy: one that is consistent, and also one that successfully tackles abroad the same problems we are tackling at home.

3. And in fact this is a matter in which there is a remarkable consensus within the international community. This is not to say that the period of recession, from which we are now emerging, has been free from disagreement or indeed drama. But this debate has been less about the broad strategy that should be followed, than how best to manage it. To a significant extent that debate has therefore been to do with the roles, in a period of adjustment, of countries, of international institutions and of commercial banks. It has been concerned with techniques of adjustment, not the objectives of adjustment.

4. And understandably any such debate analyses the past: why we got where we are. That analysis of course bears not

don't say that

only on the roles of different performers, but on the strategy followed by the international community.]

5. The goal we share today is sustained non-inflationary growth. The consensus is for prudent monetary policies and for control of budgetary deficits: to reduce inflation and real interest rates and provide a durable basis for employment. It is for greater stability of exchange rates.

6. The Bretton Woods system provided a basis for stability through the disciplines it imposed. It was eroded as inflation built up in many countries. And this process gathered momentum with the disposition of many countries after the first oil shock to print their way out of trouble. It is this process which the international community decided could not persist, but must be reined back.

7. [One of the major legacies from this period was the great size of nominal external debt of the non-oil developing countries. [The real rate of growth of this debt in the decade since 1973 was in fact lower than the rate of increase of 12 per cent seen during the '60s. The economies concerned have grown so that relatively the rate of increase is still less.] Worth noting that The ratio of outstanding debt to exports has shown remarkably little change over the last decade. While some of the major borrowers have faced problems, and are still facing them, they are countries with great underlying strengths in terms of resources: which is why they were able to borrow in the first place. But while we do well to see

not essential

these issues in perspective, there is no doubt that they represent a matter for major concern. These countries have had to cope with contracting markets for exports and until a few months ago high interest rates. The resulting high current account deficits could up to a point be financed through the capital markets but that process has also run

NP into some difficulties. 8 I have dwelt for a moment on the emergence of the global strategy we are following now because it is that historical insight which provides the answer to the calls that have are been made from time to time in this debate for some form of global reflation. They are made at a time when the worst of the problems of the world economy have begun to abate. Inflation in the industrial countries was the lowest in 1982 in a decade. Real GNP is expected to resume growth in 1983. This, combined with the adjustment programmes being implemented, can be expected to result in a pick up of developing country exports and a lowering of their current account deficits. It is true that the rate of recovery projected is a moderate one and that for non-oil developing countries will be much lower than experienced in say the late '60s. But the experience of the 1970s argues for caution. The average inflation rate in the industrial world is still higher than what our economies were used to living with comfortably in the '50s and '60s. A premature and too rapid expansion would reignite inflation and only lead us before long into another recession.

9. Even amongst the industrial countries, performance is also still mixed. Those countries which have been able to achieve success in the control of deficits and money supply

and consequently interest rates and inflation are expected to grow more rapidly this year. Lower real interest rates and the effects of lower inflation on real wealth will stimulate private expenditure. There is no need for these countries to go further and respond to demands for a deliberate relaxation of policy. This would merely rekindle inflationary expectations and jeopardise the successes from which real and sustainable growth of demand is now being created.

10. I have spoken of the global achievement in reduced inflation and interest rate levels. For the world as a whole these gains will be reinforced by the recent weakening in oil prices. But it may be worth looking back over the past months not only at the strategic gains but the operation of the monetary system during the period of difficulties over debt. There are five points I would make here.

~~11.~~ First, the international community has shown itself able to undertake major rescue operations for countries in difficulty in short order. These operations have characteristically involved the Bank for International Settlements which is in turn backed by a number of Central Banks. But governments have been involved as well.

~~12.~~ Second~~ly~~, the emergency operations have in ~~most cases~~ nearly every case ~~now~~ given way to adjustment programmes worked out by the International Monetary Fund. ~~The design and negotiation of~~

RHG (Leeds East)

these arrangements ~~is not always a matter~~, As ~~the Honourable~~

Knows better than any of us, ~~the design~~ designing and agreeing on such programmes

~~Gentleman opposite will know, free from stress and difficulty.~~

is a tricky business. He knows, because he had ~~to~~ one imposed on him in 1976. But he

~~It may be that in some cases the programmes will need to be~~

also knows that Fund advice, however unpalatable, makes sense.

~~revised from time to time. Nevertheless the path forward has been mapped out.~~

13. Thirdly, ~~in the negotiation of these arrangements~~ a major new development ~~has been the role of~~ Since his time is that the Fund ~~in~~ have ~~acquired a role now~~ have developed contacts ~~establishing contact and exchange of information~~ with commercial banks. The Fund are now ~~cases~~ in a position ~~in order~~ to encourage them to play an appropriate continuing part and thus help ~~to~~ ensure the viability of ~~the~~ debtor countries' adjustment programmes. The resources thus mobilised have helped ~~to~~ cope with ~~the~~ strains on the system.

14. Fourthly, recent months have seen a further impetus in the arrangements for exchange of information between commercial banks and for their effective supervision. As Lord Richardson has said:

> "There is no inherent reason why it should be easier to obtain identity of views among the supervisors of national banking systems which have evolved differently than among negotiators on questions of commercial, military or political co-operation."

~~Nevertheless~~ work ~~continues to improve~~ on improving the coverage and content of such supervision continues.

15. ~~Fifthly~~ I, the international community has managed to reach agreement on a substantial replenishment of the Funds resources ~~for the IMF. This is achieved in part by a major increase~~ — (i) a major increase in the credit lines available under the General Arrangement to Borrow, (ii) making these credit lines available ~~and their availability~~ to non-members, (iii) ~~and partly~~ a 50 per cent increase in the size of the Fund itself; ~~In~~ (iv) ~~addition it has been agreed that member countries will take steps to arrange for implementation of these changes~~ agreement that this increase should take effect by the end of this year. // Effectively, all this means, taking account of the acceleration of the decision process itself that had occurred, that funds ~~will be~~ available to help with the international adjustment process will have been effectively doubled, and the process completed some two years earlier than previously expected.

// This was the result of many midnight meetings — but I believe that ~~This was~~ the game was well worth the candle, ...

16. This is a considerable achievement since in the past two years there has been a major increase in demand on Fund resources - both its so-called "ordinary resources" based on the quotas subscribed by members, and its borrowed resources. Fund lending rose to record levels in 1981 with net commitments of over SDR 12 billion. At present there are over 25 stand-by arrangements and nine agreements for extended financing, together totalling nearly SDR 25 billion.

? take up to 3 (5 as typed)

17. In evidence to the Treasury Committee earlier this year I set out the broad strategy which, as Chairman of the IMF Interim Committee, I believed we would need to follow over the months ahead. I said that the dual aim was so to manage the recovery that it is sustained without rekindling inflation

and so jeopardising the stability of the international financial system; and at the same time to ensure that those countries with particularly severe debt problems are restored to economic health. If we can achieve these objectives the prosperity of the '80s will be built on sound foundations.

to para 3.

18. I would like to comment on three particular points lying behind those broad aims.

Different tack

You could jump straight from here to 22.

19. Firstly, I believe that there is scope for achieving greater convergence in the economic and financial policies of the major industrial countries. In international discussion the UK has suggested that there is a particular responsibility to maintain the internal and external value of their currencies resting with those countries whose currencies make up the SDR: United States, Japan, France, Germany and ourselves. This has been accepted by those countries themselves. Those countries also are agreed on the general strategy which should inform their domestic policies. At the same time some problems remain. Although there are shared objectives in moderation of monetary growth, rates of increase have varied sharply between countries, leaving aside the problems of interpretation of figures in some cases. There are also differences in the degree of success in reducing Budget deficits. The latter may explain why interest rates have remained historically high relative to inflation levels. Differences in the timing of adjustment to lower inflation can contribute to sharp movements in exchange rates, which of course strengthens the need to co-ordinate policy in the major countries.

? ask of 'Physician heal thyself' – look at £.

EMS typical example

20. What I am suggesting is that in addition to the broad agreement on convergence it is desirable that further progress

be made in the detailed application of policies particularly amongst the major countries. This would in turn open the way for greater exchange rate stability. Clearly it is possible to be over ambitious in these areas. It is not sensible to ignore the domestic and institutional realities that determine the timing of national decisions. This in itself suggests that one way forward would be to have some fuller medium term framework for international discussion.

My second point is this.
21. /The process of working through the adjustment process has set up tensions which have in some cases expressed themselves in a growth in protectionist pressures. This can of course be one by-product of distortions in exchange rates following from discrepancies in the mix of national policies. One crucial element in the strategy for recovery is to avoid protectionism. Increased restrictions on trade can only impoverish us all. There is already close co-ordination between the international institutions involved in this area, notably the IMF and the GATT, and it may be that these arrangements could usefully be reinforced.

B/4

22. At the same time, ~~and this is my third point, we~~ must ~~undoubtedly~~ expect continuing pressures on the resources and the imagination of the IMF in superintending the adjustment process. The extent of the transitional problems wh~~ich still face the international community~~ has given rise to ~~numbers of~~ proposals ~~, of greater or less ingenuity, involving~~ for wholesale refinancing ~~of~~ debt. Such proposals must ~~always~~ carefully be considered

(4)

confess ~~suspicious~~ chary of

on their merits. But ~~I must say that I am distrustful~~ of

those
pro~~posals~~ which involve blanket solutions, major institutional

changes
dev~~elopments~~ which would take years to implement, or ~~proposals~~

the governments taking best
~~to substitute~~ Government decisions ~~for those better~~ made in

the market-place,

23. There are sometimes calls for a new Bretton Woods. It is a common feature of such calls that the role of new institutions or the objectives of a conference are left undefined. This can be convenient in rhetorical terms. But it makes no more sense than getting into a taxi without a destination in view.

24. Our present institutional arrangements have accommodated great changes in economic strength among nations. It is inflation and monopoly that have been the main forces damaging performance. But the solution to problems such as the recent

we have seen
currency ~~and~~ instability is a durably lower level of inflation

and interest rates ~~and~~ greater convergence of economic policies, and

is not new institutions: it

(B)

25 [There to ~~inflation~~ Domestic scene thro the inflation link. ? Pick up text at Section 8 of Kemp, boiled down]

26. Then Kemp Sections 2 + 3.

27 Then Harris

MONDAY WIND-UP: CHUNKS

SHORE KNOCKING COPY

RH. writing

1. ANY COUNTRY WHERE TRIED + SUCCEEDED:
   LIST THOSE WHO SO DONE, + FOLLOWED
   BY SLUMP / U-TURN → B. RUSEK
2. INCOMES POLICY OR NOT? (MEET THE PRESS)
   → HIS PROGRAM FOR "(MIN LIMITS" ON N.I.S

S.D.P KNOCKING COPY

RH writing

→ KING OVER THE WATER

PENSIONS UPRATING

D.S. writing

- AFFIRM VIRTUES
- COUNTER-ATTACK: [illegible]

BUDGET VIRTUES (INCL EARLIER BUDGETS)

PKemp co-ordinating

1. WHY GOOD FOR JOBS
2. WHY GOOD FOR BUSINESS (IOD, CBI etc?)
3. WHY GOOD FOR FAMILIES
   - LIV. STDS / TAX BURDEN
   - [illegible] ALLCE

D.S. writing

4. SOCIAL RECORD

THE RECOVERY

RIGA/Kemp writing.

EXPORTS
PRODUCTIVITY
MANUF. GROWTH
INVESTMENT
CONSTRUCTION / HOUSING [illegible], PROSPECTS

C.

No need for you to consider these points — what NOT has passed on. But you might like to glance at the draft

MWP

FROM: E P KEMP
18 March 1983

PS/CHANCELLOR OF THE EXCHEQUER

cc Mr Lovell
Mr Allen
Mr Peretz (with copy of draft)
Mr Norgrove

JW

BUDGET DEBATE MONDAY - SECRETARY OF STATE FOR INDUSTRY

Just a couple of points on the draft (curiously signed "Stephen Sherbourne") which has been sent round today of Mr Jenkin's speech for Monday.

2. On page 4 there is a curious phrase "We are now controlling the value of the pound more effectively than at any time for 13 years". I take it that Mr Jenkin thinks he referring to "the value of the pound in your pocket"- ie inflation. But it looks as though we have an exchange rate policy.

3. In the same sort of area, at the top of page 5 the figure needs checking; more important it looks as though Mr Jenkin wants a depreciated pound.

4. Further on in page 5 I am not sure quite what a Secretary of State for Industry can usefully say about the Chancellor and the IMF Interim Committee. We shall see.// 4a. On page 9 there is a reference to a net increase in the number of new businesses in the UK. My recollection is that we are a bit nervous about this sort of statistic. Perhaps more importantly, is this the moment to rebutt Mr Shore's remarks in Wednesday's debate (Hansard, top of Col.248) about the "highest figure recorded since the war of company liquidations".

I have. (I got a piece from Lovell, which was good, and Adam passed it on)

5. Going back towards the start of the Speech, Mr Jenkin needs to be a bit careful about his arguments about demand. As he says, the Chancellor dealt with this in the Budget Speech. We do not (unless we are going for a very high risk strategy) want to let Mr Healey when he winds up have some ammunition for an argument which says that the personal tax cuts in the Budget will go straight into imports, through creating additional demand.

6. Indeed this leads me to suggest, though perhaps it is not totally our business, that Mr Jenkin could say a lot more about "Buy British". I would have thought he could.

NOT helpful

7. Finally, one should remark that there is a marginal political risk in referring to Marks and Spencer. Certainly what Mr Jenkin proposes to say is fine. But also it is Marks and Spencer who gave their name to the now notorious tax avoidance doge in relation to expensive property made available to directors which the Chancellor in the Budget said he was going to deal with. If anyone in the Opposition was on their toes reference to Marks and Spencer here could be an opportunity for a horse laugh or even an evil intervention.

8. I am not sure where and if so how it is intended that these sorts of comments should be conveyed to DOI. May I leave it to you?

EPK.

E P KEMP

IMMEDIATE

RESTRICTED

PWP

FROM: ADAM RIDLEY
18 March 1983

A.5 Speeches

CHANCELLOR

YOUR BUDGET DEBATE SPEECH

In preparing your building-blocks for the wind-up there are one or two points and bits of material which might be of some use which I am submitting with this note.

2. These are:

(1) A version of Block B of the Budget Speech which you felt at the time might be useful for your wind-up. NB This was an Adam version, not cleared – or liked – by officials. And I, for different reasons, advise v. strongly against using it.

(2) A short extract from pp.4 and 5 of Mr Fowler's NHS speech of March 10, which has a useful passage about the increase in health care, expressed in terms people can understand rather than the impersonal gibberish of constant prices.

(3) A little note of mine of March 9 which sets out useful chapter and verse as to the extent to which industrial sentiment here is better than in the EC. [There may be a slight update to be done on the figures].

3. In addition, I would warmly commend to you the material in Section B of the CRD brief for the Budget...

AR

A N RIDLEY

C.

(2) might be worth bringing in.

(1) definitely is not

JNC

~~BUDGET: CONFIDENTIAL~~

Restricted

BLOCK B

It was clear well before 1979 that Britain's long term decline in the world economy called for new policies from the Government, and a change of attitude in the country. In my first Budget I stressed the principles that were [fundamental if we were to succeed] [essential to success]: better incentives, greater freedom of choice, a smaller more efficient public sector, realism about pay, and, at the same time, squeezing inflation out of the economy.

Even in June 1979 the task before us seemed much more difficult than it had only months before. Inflation, money growth, public spending and pay had all accelerated very sharply indeed in early 1979, to a degree which only became clear after the election. But worse was still to come. In July, only weeks after the Budget came the first sharp and unforeseen rise in oil prices, which was to be repeated before the end of the year. This both added still more to inflationary pressures, knocked the world economy seriously off balance, and was the trigger for fierce upward pressure on the exchange rate.

Horse laugh

Horse laugh

Horse laugh

[This is an unsayable paragraph! "Worse still to come" will bring the House down] JW

These extra and unforeseeable problems rendered even more essential speedy and far-reaching changes in attitudes in all parts of society. For the same reasons a long-term programme of recovery was all the more essential. For a considerable period there were widespread but groundless doubts as to whether the Government would stick to its course. At the same time and partly for that very reason many, particularly wage bargainers, continued to pursue the kind of absurd and unrealistic objectives, for pay

Horse laugh

particularly, which had been crippling our industrial progress for so long.

A firm monetary policy, reinforced in 1980 by the announcement of the MTFS (and by the autumn measures of both 1979 and 1980) meant that the outside world increasingly came to believe, as they should have from the start, that Government intended to stick to its course. While that was increasingly being perceived, management, freed from years of controls, at last reasserted its role and as millions of employees rediscovered what common sense had always told them.

Shouts of "They'd be out of jobs"

By spring 1981 the trough of the economic cycle was past, inflation was falling fast, and public finances were under firm control. Confidence and output increased as we predicted only to be gravely if temporarily set back in the autumn by the No. unprecedented rise in US and worldwide interest rates. By the spring of 1982 things were again looking much better within the UK. But for the second year running external circumstances deteriorated. Contrary to all reasonable expectation, the world economy went into stagnation and decline, rather than recovering, as had universally been forecasted till that moment.

too alibi-ish.

GDP in Britain grew by ~~only ½%~~ during the year (1982/3) instead of by the 2% projected at 1982 Budget time. While domestic demand expanded sharply in real terms (contrary to popular belief), overseas demand actually fell. Even with a remarkable ½% growth in our manufactured exports, market share - from 7¼% to about 7¾% of world trade - a marked recovery was out of the question.

Opposition cheers and laughter

BUDGET: CONFIDENTIAL
-Restricted

Exceptional progress in our public finances during 1982 happily made it possible for us to reinforce the economy with the major measures announced last Autumn. As the recent CBI Survey shows, the forces of recovery are once again on the move for the third year running.

It is entirely understandable that ... impatience at the fitful and patchy path of output and the recovery should be great. What is less well understood is that the course of our economy in the last two years has been remarkably good relative to what is happening overseas.

While GDP has grown a little here, and industrial productivity remained flat, it has fallen by [2%] in OECD.

[continue with Block C]

It is possible to quote figures of the money spent on the health service or of the doctors and nurses employed. All those figures have increased over the last four years. But the most important measure is the number of patients being treated. And here the trend is encouraging. According to the latest figures which are now available a comparison between 1978 and 1981 shows that in 1981:

FOWLER 149/83

- the National Health Service was treating half a million more hospital in-patient and day cases than in 1978;

- and that the number of out-patient and accident and emergency attendances had risen by 1½ million.

15oz

FROM: E P KEMP
18 March 1983

CHANCELLOR OF THE EXCHEQUER

cc PS/Chief Secretary
Mr Moore
Mr Allen
Mr Hall
Mrs Lomax
Mr Shields
Mr Mercer
Mr Martin
Mr Norgrove
Mr Ridley
Mr Harris

BUDGET DEBATE - MONDAY 21 MARCH

I attach some Blocks for your winding up speech next Monday, on the lines indicated to me yesterday by Mr Kerr.

2. No doubt you will let us know what further material is needed.

E P KEMP

BUDGET DEBATE MONDAY 21 MARCH

BUILDING BLOCKS FOR WINDING UP SPEECH

Note

1. Budget(s) good for jobs

2. Budget(s) good for industry

3. Budget(s) good for family

4. Enterprise, small firms, measures

5. Unemployment measures

6. Social Security Records and Achievements

7. Pensions uprating - historic v forecast method

8. Inflation and Jobs

9. Bull points on the recovery

10. New GDP figures

11. February RPI and inflation outlook

BUDGET(S) GOOD FOR JOBS NOTE 1

1. Whole thrust of this Budget, and of previous Budgets, is to restore the health of the economy on sustainable basis. Only way to provide real new jobs. Said in first Budget that entirely fresh approach needed to reverse years of economic decline. Cannot be turned round over night.

2. But overall, working on these deep-seated problems. Medium Term Financial Strategy published, money supply and borrowing well under control. Inflation and interest rates down, so economic framework is paying off.

3. Measures to help the so-called "supply side". Such measures included in every single Budget. Help for enterprise, small firms. (Note 4).

4. Downward trends in pay. Not sort of mechanical pay control which previous Governments have tried and found wanting, but based on genuine recognition by all that high pay settlements threaten jobs. Settlements now coming through lower, should be helped by tax cuts in this and last Budget.

5. Limit to what Government can do. But Government taking such steps as it can to restore health to industry, through giving appropriate macro-economic framework - and, extremely important, sticking to it - and removing inhibitions and suffocations where possible. Result - business and industry responding. Productivity up. New industries growing. Markets being recaptured.

6. Does not show up quickly in the jobless totals. But only sure way to go. Draw attention to Red Book. Growth in the range 2 to $2\frac{1}{2}$ per cent, if sustained for a period and accompanied by no major shifts in financial pressures on employers, could start to increase the total number of jobs available. Of course jobs are being created all the time, but up to now the creation of new jobs has been less than loss of the old ones. Could soon start to get net growth in new jobs. Does not necessarily mean unemployment comes down one for one, because of demographic factors; new entrants to job market exceeding people leaving. But must be the way to go, and the signs are there.

7. Meanwhile Government not ignoring those who are affected by this transition - this loss of jobs in the old industries of the past and creation of jobs in new industries in the future. Over £2 billion now spent per annum on Special Employment Measures and the like. And in this latest Budget have taken yet more steps in this direction (Note 5).

BUDGET(S) GOOD FOR BUSINESSES AND INDUSTRY NOTE 2

1. Businesses are the source of jobs. Important to encourage and sustain them. This is what this and every other Budget has done. And done it for all businesses, big and small - but special emphasis on small and new because that is where a lot of the growth of the future comes from.

2. Over this Parliament so far Government has reduced tax on jobs introduced and then increased by the Opposition, from 3.5 per cent to 1 per cent. Combined total employer NIC/NIS rate gone down from 13.5 pe cent to 11.45 per cent, worth around £1¾ billion per annum to businesses. Contrast Opposition who between 1975-76 and 1979-80 put up total employer NIC/NIS rate from 8.5 per cent to 13.5 per cent, an increase in the burdens on business of around £4 billion per annum.

3. Further wide variety of measures put in hand to help businesses (see Note 4). In this Budget, packages for small firms and innovation worth over £300 million. Similar moves in previous Budgets - in 1982, measures for construction, enterprise, innovation and energy costs. In 1981, help with fuel prices and improved stock relief, a major enterprise package - Business Start-Up and Loan Guarantee Schemes. In 1980 small company rate of Corporation Tax down from 42 to 40 per cent and in this Budget reduced again to 38 per cent. Also in 1980 another major enterprise package including announcement of enterprise zones.

4. Also non-fiscal measures to help; prudent economic policies encapsulated in MTFS, downward pressures on monetary and fiscal ranges and hence on inflation and interest rates. Also controls gone; pay control, dividend control, price control, exchange control, hire purchase control, ODP control, planning procedures eased. Public expenditure brought under control, lower and more effective Civil Service, privatisation to increase efficiency and consumer choice.

5. This Budget alone coupled with Autumn 1982 measures worth around £1¼ billion per annum to businesses. Budget welcomed by CBI and IOD.

BUDGET(S) GOOD FOR THE FAMILY NOTE 3

1. All Budgets have had the family in mind. If not directly through help, then indirectly because only by restoring prosperity and recovery on a sustainable basis can we improve the standards of individual family life. And reverse is true; people are the engine of growth, and without people businesses get nowhere.

2. The basic rate of income tax reduced from 33 to 30 per cent and higher rates also reduced. On thresholds, this last Budget increased them by 8½ percentage points or more than 2½ times the amount required just to compensate for inflation. In 1982 they were increased by 2 per cent more than required for inflation. In 1981, no increase at all possible because industry had to come first; increases in 1982 and 1983 are the reward for that. Overall over the life time of this Parliament tax allowances have gone up by 6 per cent in real terms.

3. Many other social security improvements (see Note 6).

4. In all these areas - tax allowances, child support, pensions, benefits and FIS - Government have increased levels in real terms since 1979. (allowances 6 per cent, CB 12 per cent, pensions 7 per cent, short-term benefits ½ per cent, FIS 12 per cent). And same goes for spending on the National Health Service (7½ per cent).

5. Of course employees' NIC up, and offsets part of benefit of tax cuts to workers (Note : pensioners do not pay NIC).

6. But combined employee/employer rate not up very differently from under previous Government; between 1975-86 and 1979-80 went from 14 per cent to 16.5 per cent or 2.5 per cent; from 1979-80 to 1983-84 went from 16.5 per cent to 19.45 per cent, or 2.95 per cent. Must not begrudge this: everyone wants more and better benefits for pensioners and other beneficiaries. Price the working population have to pay to help support those less fortunate than themselves. Cannot argue on the one hand for more and better benefits and then on the other grumble about the NIC bill when it is presented.

7. Nor apologise for the way Government has laid burden on employee rather than employer. Essential need was to bring down industry's costs. Actions in 1980-81 meant that industry is around £800 million pa better off than would otherwise be the case. True, working individuals paid this. But a necessary part of the total price to be paid for starting to restore industry's health and prosperity, and thus jobs.

8. But, notwithstanding, real take home pay higher on average in 1983-84 than in 1978-79 at all earnings levels (using Government Actuary's assumption about earnings).

SMALL FIRMS ETC NOTE 4

1. More than 15 measures to help enterprise and small firms in this year's Budget, taking total to about 100 since 1979.

2. Help small firms find finance, like the Business Start-Up Scheme, its greatly expanded successor, the Business Expansion Scheme, and the Loan Guarantee Scheme, now with a ceiling for lending of £600 million.

3. Let firms keep more of their profits for investment, like the changes in "small companies" Corporation Tax, where the rate is now 4 percentage points lower than when we took office, the lower limit double the level and the upper limit nearly six times higher.

4. Directly assist small companies to invest, like the reopened Small Engineering Firms Investment Scheme, which will help firms in the West Midlands and elsewhere acquire the modern equipment they need to compete.

5. Help firms find suitable premises, like the increase in the Industrial Buildings Allowance to 75 per cent and the 100 per cent allowances provided by the Small Workshops Scheme.

6. Help employees acquire a stake in their companies - as a result of action in successive Budgets there are now over 550 profit-sharing and share option schemes compared with less than 30 in May 1979, and now we have provided a new tax relief to assist employee buy-outs.

7. Cut the weight of bureaucracy on firms, in the Enterprise Zones and the new freeports experiment.

8. In total, the measures to assist enterprise and small firms introduced since 1979 have a full year revenue cost of the order of £500 million. Action of relevance to jobs - a quarter of workforce (over 6 million people) work in small firms: their job prospects have been protected and enhanced by these measures. Small firms which have been helped to start and expand will provide many of the jobs of the future (cf Marks and Spencer Penny Bazaar and Mr Morris' bicycle shop).

1. In 1983-84 planning to spend over £2 billion on special employment and training measures, almost four times as much as in 1978-79.

2. New or expanded measures announced in the Budget build on a whole series of new initiatives which this Government has taken over the last four years.

3. These initiatives have a common purpose - not simply to protect those hit hardest by the recession (though this they certainly do); but also to help people help themselves and to improve the flexibility and the adaptability of the economy.

4. Obvious example is the Enterprise Allowance. The £54 million we are making available for the nationwide extension of this scheme should enable around 25,000 unemployed people to set themselves up in business. And if the experience of the 2000 or so businesses set up under the existing pilot schemes is anything to go by, many of these new enterprises will themselves generate extra employment.

5. Also encouragement of more flexible working patterns. An efficient labour market is one that can respond rapidly to new demands. Job Splitting Subsidy launched earlier this year gives employers and employees the chance - if they wish - to re-arrange the way in which the organise their work. The part-time Job Release Scheme, announced in the Budget, is a further development of this idea. It extends people's freedom of choice by allowing them to make a gradual transition from full time employment to retirement. At the same time provides jobs for around 40,000 people who would otherwise have been without them.

6. New Community Programme also combines full and part time work. Within the next year should reach its target of 130,000 places for the long-term unemployed, more than four times as many as the former Community Enterprise Programme.

7. Main priority young people. In the Youth Training Scheme about to embark on a comprehensive and ambitious reform; a reform which previous Governments talked about but failed to implement. Scheme will give high quality training to around 450,000 young people a year. Huge stride towards the sort of provision for vocational training which some of our competitors have enjoyed for many years.

8. But young peoples' employment prospects do not depend solely on acquiring the skills which will be needed in the future, important though this is. They depend also on realistic wage levels. Here too we have acted. The Young Workers Scheme is aimed at helping youngsters - often unwilling victims of short-sighted wage bargaining - to price themselves back into jobs.

9. [See also Social Security Block].

Government's record on social security. NOTE 6

Government has attached high priority to needs of elderly, to family, to sick and disabled and to widows. Long list of achievements in this area.

[See attached list]

For instance, we have more than fulfilled our pledge to full price protection of the pension.

We are encouraging thrift through raising the supplementary benefit capital disregard and adding the disregard for life assurance relief. This will be of particular help to the old, who have worked hard to put savings by.

Child benefit will be at its highest ever level in real terms - a direct benefit to mothers.

We have ended the invalidity trap, and extended the long term rate of supplementary benefit to those over 60.

We have increased mobility allowance in real terms, and taken it out of tax.

We have increased war widows' pensions, and taken them out of tax. We have introduc and extended, the widows' bereavement allowance.

We have increased spending on the National Health Service by 7½% in real terms.

And we have done all this and at the same time have been able to raise tax thresholds in real terms by 6% - compared with the Labour Government who decreased them by 20%.

LIST OF GOVERNMENT ACHIEVEMENTS SINCE 1979

Elderly

* Better than price protection for pensions and other long term benefits eg supplementary pension, attendance allowance. [Nov 78 - Nov 82 RPI = 61%, pension = 68%; Nov 78 - Nov 83 (estimated) RPI = 70%, pension = 75%.

* More help with heating cost for low income households. Heating addition now paid automatically to supplementary pension recipients over age 70. One and a half million pensioner households qualify.

* Increase in main capital limit and single payment limit for supp ben. [Main limit = £2000 in 1980, £2500 in 1982, £3,000 in 1983. Single payment limit = £300 in 1980, £500 in 1983].

* Introduction of separate limit for life assurance policies for supp ben. [£1,500, ie half main disregard].

* Christmas Bonus - statutory entitlement; Labour by contrast, withheld it in 1975 and 1976 [but bonus not increased, so possibly dangerous to use].

Sick and Disabled

* Real increase in Mobility Allowance - and taken out of tax. [Mobility Allowance up by 83%, if RPI to Nov 83 = 70%.]

* Ended invalidity trap.

* Have boosted therapeutic earnings limit twice.

Widows

* War widows' pensions and allowances made completely tax-free [1979 Budget]. Introduction of (1980) and extension of (1983) widows' bereavement allowance.

Families

* Child support overall up by 12% in real terms since came to office. Real improvements in one-parent benefit and 10 per cent increase in take-up

achieved (from 60 per cent to 70 per cent).

* Real improvement in FIS since 1979 of 12%.

* Child benefit boosted to £6.50 in November 1983 - highest ever level. [£6.45 needed to retain April 1979 level].

Unemployed

* Restored 5% abatement of unemployment benefit (UB). (Thus UB and Supplementary Benefit both price protected).

* Brought UB into tax (justice between those in and out of work).

* Improvements in Supplementary Benefit scheme - higher children's scale rates, higher capital disregards, more help with heating costs.

* Long-term rate of Supplementary Benefit extended to all unemployed over age 60.

War Pensioners

* Better than price protection for all war pensions and war widows pensions.

* Introduced war pensioners mobility scheme.

Virtues of the historic method NOTE 7

Make no apology for returning to the historic method. Provides certainty and stability.

Forecast method invention of the Opposition. Not surprising that has real disadvantages. Confusing for all concerned - confusion compounded by Opposition's talk of 'clawback' - irresponsible statements leading pensioners to fear they would have to give back part of last year's benefit increase - Inexcusably alarmist.

Historic method asked for by pensioners' organisations themselves. End to overshoot and shortfall, adjustments, compensation, all the rest of the jargon.

Opposition themselves admitted advantages of historic method.

- Brian O'Malley, 1974

'the historic method is in the end the fairest method. 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 December 1974 col. 191]

And of course that's just what the Labour Government did. They saved £500 million - £1 billion in today's prices - by an uprating 6 percentage points lower than it would otherwise have been. At a time when inflation was running at over 20% because of the Labour Government's profligacy, they chose to take it out on the pensioner.

[Note; if uprating had been based on prices between March 75 and March 76, would have been 21%. Uprating actually 15%, based on forecast movement of prices/earnings between November 75 and November 1976. Effect was to miss out inflation between March and November 1975 - the famous 'missing months].

NOTE 8

INFLATION AND JOBS

1. In my Budget Speech I said that lower inflation will lead to higher real demand and output, provided we hold to the Medium Term Financial Strategy. This is not just theory, it has already started to happen. Lower inflation is an important reason why we can look forward to a period of real recovery. A recovery born of success in controlling inflation. Not a shortlived boost bought by irresponsible and unsustainable policies, that would put at risk all we have won so far.

2. Lower inflation - not profligate fiscal policies - lies behind the revival in domestic demand - growing by $2\frac{1}{2}$ per cent per year in real terms in the past year, with as good or better in prospec for 1983. It has helped consumer confidence. Recently, as inflation has come down, people have had less need to save just to repair the ravages of higher prices - and the share of income saved has fallen from nearly 16 per cent in the second half of 1980 to about 10 per cent in 1982. Consumer spending is rising (3 per cent during 1982) - and it is now up to British Industry to translate that demand into higher output and jobs.

3. Lower inflation has allowed us to have lower interest rates and still meet our monetary targets. And lower inflation and lower interest rates have put industry in a better position to meet rising demand. Each 1 per centage point fall in interest rates means £300m boost for companies over a full year. And lower inflation has helped keep down other costs. [It has helped to bring commonsense back into wage bargaining.] Since last autumn wage settlements have been running 1-2 per cent below their level in

the previous wage round. We need to do still better. But people are beginning to understand that the only way to secure rising living standards and more jobs is to make industry more competitive.

4. Lower inflation and lower interest rates have helped home buyers too. The 5 per cent fall in the mortgage rate since November 1981 was the equivalent of a pay rise of about 10 per cent for the average family on a mortgage. And that has helped the construction industry - output up 6 per cent on a year earlier in the last quarter of 1982, with housing starts up more than 13 per cent in the latest three month period.

5. We shall see more of the benefits of lower inflation and lower interest rates over the coming year. Lower inflation has allowed us to reduce the cash plans for public expenditure (- which means lower taxes -) and still leave room for a real increase in what those plans will buy, compared with 1982-83. Above all, we shall see the benefit in more output and, in time, in more jobs. Business confidence is improving /_CBI February Trends Enquiry_7 and so is company profitability. Investment rose by 3½ per cent last year, and we can look for a further real increase this year. Our success on inflation is the best assurance that this recovery - unlike so many in the past - will not be aborted by soaring prices and interest rates. The stability that low inflation brings is essential if we are to make real improvements in economic performance. And only that will produce the extra jobs we all want to see.

BULL POINTS ON THE RECOVERY NOTE 9

- Real domestic demand in the fourth quarter of 1982 was 4½ per cent higher than in the second quarter of 1981.

- Retail sales in the three months to February were about 5 per cent up on a year earlier.

- GDP on the output measure - the best indicator of short-term movements - increased ½ per cent between the two halves of 1982, and in the fourth quarter was 2 per cent higher than in spring 1981.

- Industrial output in the 3 months to January was 2-2½ per cent above its spring 1981 level. Though this mainly reflected higher North Sea output, activity in other sectors has also been increasing - eg consumer goods, parts of engineering.

- Manufacturing production increased by 1 per cent between November and December 1982, and 2½ per cent between December and January.

- Manufacturing productivity (output per head) rose 14½ per cent between 1980 Q4 and the three months to January 1983.

- Construction output rose 1½ per cent between third and fourth quarters of 1982 and is 6 per cent up on a year earlier. Within the total, new private housing construction in the fourth quarter of 1982 was 33 per cent up ona year earlier. New construction orders in 1982 Q4 were 8 per cent up on a year earlier.

- Steel production in the 3 months to February was over 14 per cent up on the previous three.

- Car production in the 3 months to February was 8½ per cent up on the previous three.

- CBI Industrial Trends Enquiry (February) results encouraging, in particular sharp swing in net balance of firms expecting manufacturing output to increase - biggest positive swing since January 1981. Order books - particularly export order books - have also improved substantially. Much smaller proportion of firms believes stocks are excessive.

- Engineering order books were 7 per cent up in the 3 months to November on previous three.

- Total housing starts rose by over 13 per cent in the three months to January compared with previous three.

- All four of the CSO's cyclical indicators moved upwards between January and February, and point to a continuing upswing in the business cycle.

NEW GDP FIGURES

NOTE 10

On these latest figures, published today, output in the fourth quarter of last year was over 2 percentage points higher than at the cyclical trough in the second quarter of 1981. This reflects, in particular, higher North Sea output, but also increased activity in sectors such as construction and distribution. Manufacturing output has also been rising in recent months - by 1 per cent in December and 2½ per cent in January - reflecting higher activity in industries such as consumer goods and parts of engineering.

IF ASKED why the figures have changed so much from those published in the FSBR. This reflects new information, not available to the Treasury at the time the FSBR was prepared. Nevertheless, the changes are quite small in relation to the uncertainties surrounding the construction of the quarterly National Accounts. And I would have thought that the House would welcome the fact that output is somewhat higher than was previously thought.

IF PRESSED about the implications for the short-term forecast. Compared with the FSBR, output is likely to be higher throughout the forecast period - that is, until the first half of 1984. But the projected growth rates of GDP shown in the FSBR - 2 per cent between 1982 and 1983, rising to 2½ per cent in the year to the first half of 1984 - are not significantly affected.

THE FEBRUARY RPI AND THE INFLATION OUTLOOK NOTE 11

The 12-monthly RPI inflation rate increased slightly in February - from 4.9 per cent to 5.3 per cent. But this is nothing to be alarmed about; indeed, some increase had been widely expected. In fact, the rise in prices between January and February was very modest - only 0.4 percentage points - and the rise in the 12-monthly rate arose because, between January and February 1982, the index barely moved at all. The February figure is fully consistent with the inflation path projected in the FSBR. [IF PRESSED: and is consistent with an inflation rate "in the region of 4 per cent" in May.]

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Margaret O'Mara

We spoke

Mr Kemp
Mr Lowe
Mr Chivers
Mr Allen

N. 18.3.

With the Compliments of the

Private Secretary to the
Secretary of State for
Industry

Caroline Varley
PS/SOS.(I)
18/3/83

CS 248

SECOND DRAFT

SPEECH BY SECRETARY OF STATE IN BUDGET DEBATE :

MONDAY 21 MARCH 1983

I begin by welcoming to the Debate the Rt Hon Gentleman, the Member for Leeds South, in his role as overlord. My understanding is that he was elevated to this role so that he would not steal the thunder of his Rt Honourable Friends who speak for Industry and Employment. Not that there is much thunder to be stolen from them. He is, I suppose the Shadow Ministers' Shadow - a role he has performed brilliantly. So effectively, I think, that until today he has not been allowed to speak in any economic debate.

The Labour Opposition sometimes appear puzzled by their low and falling level of popular support in the country. For the reason why, they need look no further than their complete failure to understand what in the past went wrong with the British economy and how it needs to be put right. Their whole case rests upon one fallacious proposition : that there has been too little demand in the British economy, that this is the sole cause of the recession and unemployment; and that the answer is to scatter money from somewhere or other all over the country so that all our problems just melt away. As we hae seen in the past, ~~what happens~~ under this kind of confetti monetary policy is that WHAT MELTS AWAY ~~it~~ is the value of the pound, ~~which melts away~~.

Last week the Rt Hon Gentleman, the Leader of the Opposition, talked about hyper-unemployment. He might have added that its cause is hyper-inflation, which this Government inherited from the Labour Government.

From the way Hon Members opposite talk, you would never think that unemployment had doubled under the last Labour Government; that for years, well before this Government came to office, imports IN MANY areas were gaining greater market share at the expense of British producers.

In his Budget Statement, my Rt Hon Friend, the Chancellor, gave the ~~lies~~ LIE to the argument that there has been a chronic and declining level of demand. Domestic demand in Britain has been growing since the Spring of 1981 in real terms at almost 3 per cent a year. And ~~that~~ this is a stronger growth of demand than in most other industrial countries.

All too often this demand has been satisfied by imported goods rather than by home-produced goods. The critical question is why.

IN THE PAST,
~~But elsewhere~~, British industrial recovery has been like an obstacle race - trying to overcome ~~obstructive~~ working practices, THE monopoly power of State-owned industries and unions; barriers to enterprise and profit; and ~~all too often~~ the failure of SOME management to adapt and innovate.

The Labour Opposition should be aware of some of these problems because they helped to create them. It is Labour Governments since the war who have been responsible for massive nationalisation; for giving sweeping powers to the trade unions; for deliberately discouraging enterprise and denegrating profit.

This is why this Budget is a budget for enterprise, for innovation and for the small firm. I noticed that the Rt Hon Gentleman, the Member for Stepney and Poplar, sneered at the measures in this Budget for innovation and small firms. He described them as "marginal". Perhaps he would care to tell the Chairman of Marks and Spencer that the establishment of that famous penny bazaar in Leeds a century ago was marginal. Marginal? It has now grown into one of the most successful companies in Britain, providing jobs, wealth and exports. And with a buy British policy where British is best.

Of course, it didn't happen overnight. But thank goodness it happened. If the schemes produce just one Marks and Spencer it will be a major, not a marginal, boost to Britain.

Sustainable recovery depends on British industry being able to supply the customer with what he or she wants. Price is crucial. One of the best ways we have been able to help industry has been to bring inflation down from over 20 per cent to 5 per cent. We are now controlling the value of the pound more effectively than at any time for thirteen years.

Interest rates are down per cent since the autumn of 1981. That helps the company sector by £ million a year.

Then there are the cuts this Government has made in the National Insurance Surcharge, the tax on jobs introduced and then increased by the last Labour-Government. This will help private business by nearly £2 billion in a full year. In the interests of decency, I hope that the Rt Honourable Gentleman will keep his head down on this subject. It was the Labour Government, of which he was a senior member, which introduced NIS and put the rate up to 3½ per cent. It is this Government which has brought the rate down to 1 per cent. He should-remember that.

Industry will also benefit from the fall in the exchange rate. There have been estimates that company income in a full year could benefit by as much as £4 or £5 billion.

And there is the stimulus to industry which lower oil prices will generate through increased world output and trade.

PASSAGE ON CHANCELLOR/IMF INTERIM COMMITTEE TO COME.

Taken together, these developments give a very substantial boost to companies. Outside forecasters confirm that a substantial improvement in the financial position of the company sector is underway. Phillips and Drew, as well as the London Business School, forecast a 15 to 20 per cent rise in profits in 1983 on top of a rise of about 10 per cent in 1982.

In his speech on Wednesday, the Rt Hon Member for Salford West, tried to develop the argument that the recession has led to a loss of capacity which will hamper industrial recovery. But the huge rise in the number of foreign-made cars on our roads was not because British companies lacked the capacity to produce the cars. It was because British customers preferred the price, style, design and reliability of foreign cars. The demand was there. British companies were just not competitive enough.

It is in fact this growth of imports which has forced motor manufacturers to replace outdated plant with much more efficient capacity. [Reference to visit to Cowley?] This is ~~ow~~ now leading to improved competitiveness, and increased output and employment.

Recovery depends on the greatest natural resouce that Britain has - its people. It is people who start companies, who build them up, who win orders, create wealth for the community and provide jobs. It is people who do this. The job for government is to make it possible for it to happen.

Last year the Government launched the Enterprise Allowance Scheme as an experiment in five areas. We made it easier for unemployed people to start a new businesses by making available an allowance of £40 a week for one year to offset their loss of unemployment benefit. The response was ~~to~~ so encouraging that from August 1 to the end of March 1984 we are making enterprise allowances available throughout the whole of the country.

The evidence in these pilot areas - which will now be multiplied nationally - is that, not only did people set up their own business, but they also provided work for others. An engineering firm in Scotland, started by 3 people, now employs 3 other skilled workers and an apprentice. A building trade wholesaler in Kent now-

employs 2 people. And an insulation firm in Coventry employs 7 people. Enterprise is alive and kicking.

We are also making it easier for employees of a company to buy the business for which they work - sometimes known as a management or employee buy-out. The interest payments on loans taken out to buy the shares will qualify for tax relief.

This has sometimes happened when a firm has found itself in difficulties or where people are made redundant. But it is now widely recognised that many businesses which are part of large groups of companies would be run more successfully if they were hived off into independent companies. There are many examples of where a buy-out has encouraged greater motivation among the employees and produced improved results.

Armalloy Ltd, for instance, in the West Midlands, is a new foundry started by three managers made redundant. They now employ 25 people and have an expected turnover in their first year of £1½ million.

Of enormous value also is the extension of the Business Start-up Scheme into the Business Expansion Scheme. From April 6, we are extending the benefits of the original Business Start-up Scheme to established unquoted companies. And we are doubling the maximum investment to qualify for relief in any year from £20,000 to £40,000.

This will help unquoted companies needing capital to raise new equity. It will make it easier for companies with the potential for growth to achieve growth. It is a major step in the direction I want to take - to steer personal tax incentives much more towards private enterprise and productive investment.

Small firms are one of the engines of growth in the economy. The Rt Hon-Member for Stepney and Poplar on Wednesday gave a grudging welcome to our measures for small businesses. He said that he welcomed help for small firms "in principle". I am grateful for that! This Government welcomes them in practice, ~~too~~. Since taking office, this Government has introduced more than 100 measures which help small firms, both established and new. This Government has done more - far more - than any previous government, Labour or Conservative, to help small firms. One of the most important innovations has been the Loan Guarantee Scheme. Since we introduced the Scheme in June 1981, nearly £300 million has been lent to some 9,000 companies, about half of them new businesses and about half of them existing businesses. And manufacturers have taken up about half of the loans issued so far.

We are therefore raising the present sealing of £300 million to £600 million so that the Scheme can run its full three year course. This Scheme is providing and maintaining many thousands of jobs.

The Budget also helps small businesses further by raising the VAT registration threshold; by reducing the small companies rate of corporation tax and by providing 100 per cent tax relief on the conversion of old buildings to small work-shops.

Over the last two years, despite the recession, there has been a growth in the number of companies in the UK. In the two years, 1981 and 1982, there was a net increase in the number of new businesses of around 20,000.

Another engine of growth in the economy is innovation. We have to shift the emphasis away from supporting the casualties of the past to supporting the industries and the products of the future. A week ago, I told the House that assistance to BL, British Shipbuilders and the British Steel Corporation has fallen from £1¾ billion in 1980-81, TO £1½ billion in 1981-82, is forecast to be about £1¼ billion in 1982-83 and under £¾ billion in 1983-84. Meanwhile, we have doubled the amount of Government assistance for new technology and innovation.

For the second year, the Budget contains an innovation package for industry - this time worth £185 million over three years.

Of this, £100 million is being made available to re-open the small engineering firms investment scheme - or SEFIS. This Scheme was launched in March last year to help small engineering firms invest in advanced capital equipment. So great was the demand, that we had to close the scheme after just 8½ weeks despite the topping up with a further £10 million, from within our budget, on top of the original £20 million. Under this scheme, 1400 firms have been made offers of assistance, £10 million has already been paid out to nearly 600 firms, and nearly 60 per cent of the equipment orders will be UK produced. The West Midlands gets twice as much SEFIS support per head of population as the national average.

By re-opening the scheme and allocating £100 million for it, we will be bringing substantial help to the West Midlands in particular and to small engineering firms in general.

I want now to announce a new initiative to encourage greater innovation in the West Midlands. The industries in this area are mainly traditional. It is therefore important for the West Midlands to broaden its industrial base. However, too few firms from the region have been applying for grants for innovation. I am therefore setting up a spoecial team - a Team for Innovation - in the West Midlands- Regional Office of the Department of Industry. Its purpose will be to help and encourage firms in the West Midlands to make the fullest use of all the national schemes of support for industry.

The local CBI recently called for firms in the region to make greater use of the Government's schemes. I hope therefore that they will work in partnership with both my Department and the local Chambers of Commerce to achieve this objective.

I am also asking English Industrial Estates to investigate the industrial property market in the West Midlands and to establish whether there is adequate provision for the needs of new industrial development, including high technology industry and new and small businesses. If necessary, I will ask EIE to undertake development in the West Midlands even though it is not an assisted area. We will make separate financial provision to cover any work by EIE in the West Midlands so it does not affect the level of their programmes elsewhere.

A fundamental part of our industrial strategy is to encourage the industries of the future and to encourage well-established industries to modernise and adopt the new technology. The challenge is "automate or liquidate".

So last May, we launched our Support for Innovation Programme. This brought together all of my Department's assistance for industrial R and D, for increasing awareness of the new technologies and for promoting its application. We raised the maximum grant level from 25 to 33⅓ per cent. As the House knows, the rate is being kept at 33⅓ per cent for a further year beyond May 1983.

We are also extending the Support for Innovation Programme by an innovation-linked investment scheme to which we are allocating £40 million. Up till now, our schemes have helped research and development up to the point of commercial production. The new scheme will support investment designed to "pull through" new products and processes to the market. Projects will be eligible for support under the scheme when development work has been supported by the Department of Industry or would have been eligible for such support. This will fill a gap which will help bring the product from the backroom into the showroom.

We are also allocating £10 million to promote computer-aided production management; which is badly needed in manufacturing industry; and an extra £15 million to the improved software products scheme, to help companies develop and bring to market innovative software products.

We are also strengthening - with an extra £20 million - the various services to make management more aware of the opportunities for improving design and manufacture. Design is crucial. It is the key function in the commercial exploitation of goods. If the top designer had been in the boardroom more often, many British companies would not have lost out to foreign competition. I am therefore much encouraged by the way the design advisory service, set up last year, has generated a demand way above expectations. The manufacturing advisory service has already provided benefits to more than 3000 firms. And we are currently considering a proposal from the Institute of Marketing to help establish a service to give advice on marketing to small and medium-sized firms.

Making management more aware of the opportunities may represent a small, though growing, part of my Department's budget. But if, as I believe, we have got to make the work of my Department more people-oriented - because it is people who create prosperity - then it is crucial and I am giving it higher priority.

Too often, the indusrial policy of successive governments has been shaped by the pressures of the past rather than the opportunities of the future. Painful as it sometimes is, we have got to re-direct our industrial support to those products and proocesses, companies and industries of the future - because that is where the jobs of the future will come.

One of the most encouraging signs for the future is the enthusiasm and skill shown by our young people for the new technology. We are top of the world league in providing micro-computers in our schools. Thanks to this Government's initiative, every secondary school has its own micro and we expect the same to be true soon for our 27,000 primary schools.

We must also look to our universities and polytechnics. Unfortunately, the links between academic research establishments and industries are not as strong in the UK as in several other countries. The untapped potential for transferring technology from the laboratory into the marketplace is considerable.

I have therefore set in hand a programe of consultation to determine how the Department of Industry can promote this transfer of technology. My officials are already embarking on a series of consultations with 24 universities and polytechnics nationwide. I also want to see discussions with industry, research councils and other government departments.

Mr Speaker, the answer to Britain's industrial decline since the second world war is a more competitive, more enterprising and more innovating industry. We are clearing away the obstacles. We are step by step transferring state monopolies from the insulated public sector to the more competitive private sector. "What we lack in Government is entrepreneurial ability." Those are not my words. They are the words, spoken in 1974, of the Rt Hon Member for Bristol South East.

There are now real signs of improvement. Industrial production is up. Housing starts are up. Productivity is up. Consumers expenditure is up. Our exports are worth £150 million a day. Last year, when world trade of manufacturers fell, UK exports of manufactures rose. We increased our share of that world trade.

We are on the right path to sustainable recovery and we must keep on it.

Stephen Sherbourne

17.3.83

CHIEF SECRETARY TO THE TREASURY

FROM: JOHN GIEVE
DATE: 21 March 1983

PRINCIPAL PRIVATE SECRETARY

cc Sir A Rawlinson
Mr Cassell
Mr Kemp
Mr Hart
Mr Kelly
Mr Stibbard
Mr Mountfield

TONIGHT'S DEBATE

The Chief Secretary has slightly amended the draft passage on shortfall which Mr Mountfield submitted this morning.

JG

JOHN GIEVE

Type of passage on shortfall as amended.

~~Can we shorten further the one on the estimates?~~

Deferve.

~~Expansion by Legerdemain~~

That there is some doubt about the method by which I have settled, for the year ahead,

I want next to deal with the ~~accusation that I have cooked the~~ suggestion ~~books again this year - or, to change the metaphor to one favoured by the Sunday Times, that it's all done by mirrors.~~ ~~The argument is that I only arrived at~~ on a PSBR of £8 billion ~~for 1983-84 by reducing~~ the Contingency Reserve and increasing the shortfall. I plead not guilty on both counts.

dangerous language!

in particular an alleged dry undue reduction of

an unjustified £ of

2. First, the Contingency Reserve. For 1982-83 the Reserve was set at £2.4 billion, and for 1983-84 it has been reduced to £1.5 billion. The reason for this is quite simple. 1982-83 was the first year of cash planning and we were deliberately cautious. As things turned out, there were fewer claims on the Reserve than we expected. and, even including the cost of the Falklands campaign, only £1.4 billion out of the £2.4 of it has been required. This was no doubt ~~In part this was~~ the result of falling inflation. ~~In part it may have been the result of closer estimation by managers.~~ So for 1983-84, ~~I took~~ The Chief Secretary and I took the view that we could safely run with a much smaller Reserve. As a matter of record, that decision was taken provisionally in the autumn and the figure of £1.5 billion is in the Autumn Statement. Nothing has happened since then to alter our view, so that figure is retained in the FSBR.

3. The second charge is that I mysteriously invented a new quantity called shortfall, and used it suddenly to reduce the PSBR ~~at a stroke~~. I have even seen it argued that this shortfall neatly matches the amount set aside for Income Tax reductions in the Budget. This accusation too is quite misconceived. All Chancellors have to take a view at Budget time about the extent to which there may be underspending within the plans. In seven out of the last nine Public Expenditure White Papers there has been a general allowance for shortfall, in one form or another. The same is true of the Financial Statement and Budget Report. This shows that the total shortfall ~~in 1982-83~~ in the current year compared with the Plans announced in the 1982 Budget is likely to be £2·2 billion. For 1983-84 the allowance is ~~£ 1.2 billion~~ about a billion less.

4. There is always likely to be some shortfall as managers seek to keep within their cash limits. In addition, it may take

time for the measures we have taken to reduce capital underspending by local authorities and nationalised industries to have their full effect. I am Satisfied, therefore, that the allowances for shortfall and contingencies are justified.

? omit

[5. To be fair to the critics, a general allowance for shortfall was not included in the 1982 White Paper: general shortfall was netted off there against local authority overspend (at the outturn), which happened to be roughly the same figure.]

[6. In some years the provision for underspending has been lumped in with other items like the Contingency Reserve and sales of assets. This year I decided to make the presentation a little clearer and to show the House in more detail how the sums were done. So I had shortfall shown separately in the Autumn Statement and again in the White Paper and the FSBR.]

Include last 2 §§
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