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Part D,

CONFIDENTIAL

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Begins: 1/5/81.
Ends: 29/6/81

PO -CH /GH/0084
PART D

Chancellor's (Howe) Papers:

REPRESENTATIONS ON TAXES
AND INFLATION FOR THE
1981 BUDGET

PO -CH /GH/0084
PART D

Disposal Directions: 25 Years
D Anderson
26/7/95

12/2

1/5/81.

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PS/FINANCIAL SECRETARY

cc - Principal Private Secretary
PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir Douglas Wass
Mr Burns
Mr Ryrie
Mr P Dixon
Mr H P Evans
Mr Unwin
Mr Neuburger
Mr Williams
Mr Ridley
Mr Cropper
Mr Cardona

ECONOMIC OUTLOOK

Mr Unwin has suggested to me that we should attempt to agree a line for Ministers to take on the "bottoming out" of the recession and the prospects for recovery.

2. The great danger here is of appearing too bullish, and placing too many hostages to fortune. It must be remembered that the only direct evidence that the recession has bottomed out is one month's industrial production figures. There is, of course, a good deal of indirect evidence - eg from the CBI's latest Industrial Trends Survey, the increase in private sector housing starts, anecdotal material, etc. At the Chancellor's meeting to discuss first order questions earlier this week, he said that he prefered not to refer to "troughs" or "bottoming out", as these phrases have become somewhat cliche-ridden. There are also dangers in using the word "recession" which is not unambiguous, and easily misunderstood (I heard Sir Geoffrey Rippon say the other night something to the effect: "Of course the recession is not over; it will not be over until unemployment has stopped rising"). If this is ruled out there seem to be two alternatives - a precise reference to recent and prospective movements in output, or vaguer references to the improved business outlook. I would suggest something along the following lines :

- there is growing evidence that the fall in output has come to an end; and/or

- the business outlook (as evidenced, for example, in the April CBI Survey) now appears much more favourable.

3. It should be remembered that any statement about the "improved" or "more favourable" business outlook is only relative to the unfavourable position during the earlier part of the downswing. Indeed, there is still a (small) net balance of firms in the April CBI Survey who see business prospects as deteriorating (and output falling) over the next four months. (I understand, however, that the next FT Survey will show a small net balance who see an improvement in prospects, though this Survey is based on a smaller and narrower sample of industries, some of which - brewing, engineering and paper, for example have not been exposed to the full rigours of the present recession). So caution is needed and it certainly seems best to avoid statments at this stage to the effect that :

- the upturn has come; or (as Sam Brittan claims in today's FT):

- output is growing a good deal faster than at the snail's pace predicted by the Treasury at the time of the Budget.

There is really only the flimsiest of evidence for such views.

4. In countering Mr Shore and others who advocate "reflationary" policies it might be safest to go for a rhetorical approach - eg how can Mr Shore criticise our policies now that there is growing evidence that output has stopped falling, that business confidence has improved, that (in some industries) there are reports of higher productivity, etc, etc, and how can he criticise our policies when his own would mean higher interest rates and/or taxes and undermine any recovery, just as it may have started ?

5. On the question of productivity, it is not easy to substantiate at the aggregate level the reports of claims by various industrialists (fervently reiterated by Sam Brittan in yesterday's FT) that there has been substantial improvements in productivity in many industries during the current downswing (you will recall that businessmen were saying much the same thing in 1971-72 and 1975-76). Indeed, so far as they go, aggregate data suggest that movements in productivity during the current recession have been very similar to those experienced during the previous cycle. But the CSO figures take no account of the speed and depth of the recession. When output falls, there may be fewer opportunities to benefit from economies of scale and from technical progress. The Treasury model equation for employment in manufacturing tries to take account of such factors but has recently overestimated the level of employment (thereby underestimating the level productivity). This suggests that productivity may have been holding up rather better than expected given the present level of output. But until more evidence emerges, I would suggest taking a rather cautious line.

R.A

R I G ALLEN

EB

1 May 1981

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TOBACCO ADVISORY COUNCIL

Glen House, Stag Place, London, SW1E 5AG

From Sir James Wilson, K.B.E., M.C.
Chairman

Telephone: 01-828 2803/2041
Telegrams: TOBCOM LONDON SW1E 5AG

2

1st May, 1981

The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London SW1P 3AG.

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CH/EXCHEQUER
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Dear Chancellor.

My Council have asked me to write to you at once to express their deep concern at the possibility expressed in this morning's papers, and ventilated in some quarters in the House last night, of any further increase in tobacco taxation at the present time. The savage increase already imposed in the Budget of 10th March has presented my industry with serious problems in terms of short time working resulting from the kind of sharp drop in consumption against which, you may recall, our pre-Budget submission had warned you. It is still too early to judge what the full consequences of that earlier increase may be; however, to pile Pelion on Ossa at the present juncture by a further increase would certainly, in our estimation, be disastrously unwise.

This letter merely seeks to let you know at once my Council's deep concern. Early next week, I plan to let you have a fuller paper, setting out in more detail the consequences of the increase in taxation already imposed, and showing how devastatingly dangerous any further impost would be.

Yours sincerely

James Wilson

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cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Mr Unwin
Mrs Gilmore

MR R ALLEN

SHEET OF BULL POINTS FOR TREASURY FIRST ORDER PQ's

The Chancellor had occasion this morning to use your sheet of bull points as a quarry for the radio Programme today.

2. He found it particularly useful.

3. He would be grateful if for the future you would update the note more frequently than is presently done for the purposes of first order PQ's, so that it might serve as a standing note on which Ministers might draw for media interviews. It may be that a fortnightly updating would be appropriate, though there may be particular events which would merit an updating more frequently than this.

R.I.T.

R I TOLKIEN
1 May 1981

Subsequent issues to be broken down into separate pages & side flagged. 6

A KEY POINTS TO STRESS

- Interest rates. Short-term rates below those in US, France and most OECD countries (but no longer Germany).

- Inflation. Despite 1 per cent increase in March due to Budget, 12-monthly increase in RPI remains at about 12½ per cent. And trend is still downwards. One year ago Terry Ward forecast that inflation today would be 25 per cent; Joel Barnett forecast 20 per cent; but Financial Secretary forecast 13 per cent (D. Express, 23 April 1980).

(Civ. svc strike) SANITY PAY

- Earnings/wage settlements. February figures (published 29 April) show underlying earnings rise of ¾ per cent a month since September 1980. For whole economy, average settlements probably running at under 10 per cent.

MANNF + IMO

- Recession. Increasing evidence (including February ¾ per cent rise in industrial production and April CBI Survey) that output may have stopped falling.

- April CBI Industrial Trends Survey. Further evidence of ~~ending of recession and~~ improving business confidence; slackening in expected rate of destocking; 'stabilisation' in company liquidity.

- Housing starts. Private sector starts in January and February substantially up on 1980 H2 levels - about 12,000 compared with 7,000 a month (seasonally adjusted).

- Executive recruitment. Management Services Ltd say executive recruitment in UK is showing first real upswing for three years (14 per cent up in 1981 Q1).

- ICI. Chairman reports (22 April) that recent sales increases and cost-cutting "should result in our being able to report a improvement in profits for the first quarter" (after dismal last returns).

- Spending cuts in other countries. Britain not alone in taking difficult decisions on public spending - eg Sweden, Belgium, Netherlands, USA and Japan also making or planning cuts.

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B RECENT ECONOMIC DEVELOPMENTS

Inflation

(i) 12-monthly increase in RPI rose slightly to 12.6 per cent in March (12.5 per cent in February). Increase in month to April was 1.4 per cent, of which about 1.0 per cent result of Budget measures (further 1 per cent from Budget expected in April). [CONFIDENTIAL: 12-monthly RPI increase expected to fall to about 12 per cent in April].

(ii) Six monthly annualised rate 10.5 per cent (8.2 per cent in February).

(iii) Underlying increase about 11-12 per cent at annual rate over last six months [increase from 10-11 per cent last month due to Budget effects]. This compares with an underlying six monthly rate of about 12% in May 1979; but inflation was then on a clear upward trend.

(iv) 12-monthly increase in TPI 13.4 per cent in March, but in April and subsequent few months figure will be 3-4 per cent higher than 12-monthly increase in RPI (result of Budget failure to index income tax, and higher NI contributions). PQ answer gave forecast increase in TPI in year to 1981 Q4 as 13-13½ per cent, compared with 10 per cent RPI increase.

(v) Wholesale output prices for manufactures rose 1¼ per cent in March, but 12-monthly increase fell slightly (for twelfth consecutive month) to 10½ per cent. Three-quarters of March increase due to Budget effects. Input prices for manufacturing increased by 1½ per cent in March, mainly reflecting higher sterling oil prices following depreciation of sterling against the dollar. Input prices have risen 8½ per cent in last 12 months.

Exchange Rates

With a strong dollar and the recovery of the Deutschemark, the sterling exchange rate has eased slightly. Opening rates 29 April showed drop of 7 per cent in effective rate, and 11½ per cent in dollar rate compared to January peaks. (The £ : $ rate was 12-month low, and some recovery may be expected over coming weeks). But these changes relatively small in comparison with 40-50 per cent decline in competitiveness over last 2 years.

Money Supply

Although recent figures for £M3 growth have been good (last 4 month's increase all less than 1 per cent), Ministers are advised to be cautious. Seasonal adjustment factors are currently being revised and this is likely to make growth in immediate past look less favourable.

Interest Rates

UK short-term rates well below OECD average :

	3-month Euro-currency rate (latest April)
UK	12.25
US	16.50
Japan	7.50
France	13.25
Germany	12.00
OECD	14.02

Earnings

February's earnings figures were published late (29 April) because of the Civil Service dispute. 12-monthly increase in whole economy earnings 16.4 per cent in February (compared with 18.6 per cent in January); increase adjusted for temporary factors is about 15½ per cent. Underlying increase since September about ¾ per cent a month, compared with $1\frac{3}{4}$ per cent in period January-July 1980. CBI pay databank continue to show a sharp moderation in level of settlements. Since October, settlements in manufacturing have been running at an average of 8-9 per cent compared with 16-17 per cent last spring. For whole economy, average level of pay settlements is probably running at less than 10 per cent.

Unemployment

Total UK unemployment (including school leavers) rose above 2.5 million in April and is now 10.4 per cent. But underlying increase in unemployment is clearly slowing down. April increase of 65,000 compares with 81,000 pm in first quarter and 115,000 pm in 1980 Q4.

Other indicators point to slowing down in deterioration in the labour market: lower declines in manufacturing employment, bottoming out of overtime, declining flow onto the register, a levelling off in number of vacancies.

Balance of Trade

No new figures are available because of the Civil Service dispute.

Industrial Production

All industries index rose by $\frac{3}{4}$ per cent in February, and manufacturing output by 1 per cent. February manufacturing output no lower than last December. Risky to put too much weight on one month's figures - but encouraging, particularly when taken with other indicators.

Productivity

Many business sources generate anecdotal evidence of a step improvement in productivity of the order of 10-20 per cent. Whilst this can be used and cited as evidence of how some firms are coping, it should be remembered that :

(a) such improvements do not yet show up in aggregate data; productivity performance may not be greatly different from earlier recessions;

(b) businessmen were saying much the same thing in 1971-72 and 1975-6.

Company Finances

Figures for industrial and commercial companies' appropriation accounts (published 21 April) show substantial improvement in financial position in second half of 1980. Companies had virtually eliminated their financial deficit and achieved net repayments in 1980 Q4. But this reflects in the main exceptionally large scale destocking.

Recession Bottoming out ?

A number of clear signs suggest that the recession is bottoming out and that we may be close to the trough. Any output recovery likely to be very slow.

(i) CBI and FT surveys of business opinion and prospects have pointed to improved optimism for several months now (CBI indicators have a good historical track record). Latest CBI survey (published on 28 April) confirms this view - more optimism; expected slowdown in destocking, improved corporate liquidity position. Anecdotal evidence of renewed business, activity and confidence (eg see Sunday Times feature on W. Midlands, 19 April). Stock market 'boom' could be misleading indicator (eg comment in FT that 'recovery' could now be over-discounted).

(ii) CSO leading indicators have since end 1979 for longer leading indicators, and more recently for shorter leading indicators, been pointing to the trough being reached in the spring. Coincident indicator levelled out last November; February rise suggests we may already have reached trough. [But this may prove to be false dawn as more information becomes available].

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(iii) Latest outside forecasts for NIESR, LBS, and Phillips and Drew assess the fall in output to end at some point during 1981. CBI see output falling slightly to the start of 1982. [But note: only CBI and P & D are full post Budget forecasts. LBS, and NIESR submitted post Budget simulations to TCSC].

(iv) Treasury Budget forecasts consistent with fall in output ending in the spring, with the prospect of some [slight] recovery between the first and second halves of 1981.

(v) Housing starts: Private sector housing starts in January and February substantially up on 1980 H2 levels; about 12,000 compared with 7,000 per month (seasonally adjusted). The Housebuilders' Federation are reported to be optimistic about prospects for 1981.

(iv) Labour market: Recent developments are consistent with the recession bottoming out (see above). The increase in unemployment has moderated this year and vacancies have stabilised since the end of last year.

Deflationary Impact of Budget

Some people have suggested that Ministers have been making inconsistent statements on the deflationary impact of the Budget. The fullest treatment of the subject was given in FST's IFS speech (23 March). He stressed that while Budget could have "some very modest contractionary effect" in the short-term, it was much more important to look further ahead and see the Budget in the context of the MTFS ie as part of medium-term strategy to reduce inflation and create conditions for sustainable growth. Other Ministerial statements have taken a very similar line (see summary at attachment C); there is no inconsistency of approach. The fault lies in the interpretors.

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Spending cuts in other countries

Britain is not the only country having to make difficult decisions on public spending :

- In Sweden, Denmark and the Netherlands measures have been taken or proposed to reduce the index-linked uprating of pensions and/or social security benefits.

- In Belgium the Government is aiming to reduce the planned growth of health service expenditure (including a cut in the number of available hospital beds) and to increase some charges for health care.

- In the Netherlands, planned expenditure by the Ministry for Social affairs has been cut by 6 per cent in 1981 (eligibility for disablement benefit, family allowances and unemployment benefits has been reduced).

- The new US Administration plans to spend less on health in 1982 than in 1981 (in cash terms).

- Japan reported to be cutting back on welfare programmes.

C 13

Ministerial statements on deflationary impact of Budget

"His (Mr Jack Straw's) condemnation of the Budget is based on the false premiss that it is massively deflationary ..... I do not think that it can remotely be described as deflationary to adopt policies leading to a PSBR of £10½ billion."
[Chief Secretary, Budget Debate, 11 March, Hansard col 920]

"This brings me to ..... the charge made by the Opposition that the Budget is deflationary. I maintain that it is not a deflationary Budget, although it is certainly an anti-inflationary Budget."
[Financial Secretary, Budget Debate, 11 March, Hansard col 978]

"Both sides [public expenditure and taxation] have to be looked at ..... this certainly affects the balance between the public and private sector, but it certainly does not mean that the Budget is in any sense deflationary."
[Financial Secretar, interview on BBC radio 4, 12 March]

"The current underlying rate of inflation is within the new monetary target, so that judged by that yard-stick there is no reason whatever to characterise this year's Budget as contractionary."
[Financial Secretary, speaking to journalists, 12 March]

"It is wrong to suggest - as some have argued today - that the Budget is too deflationary. It is important to consider the overall fiscal stance and to consider both sides of the account."
[Chancellor, Budget Debate, 16 March, Hansard col 97]

"I believe that this misunderstanding [that the Budget is deflationary] comes about through looking at the Budget alone, rather than taking it as part of the Government's whole policy, including its expenditure response to the recession."
[Chief Secretar, Huddersfield, 20 March]

"That is also why those who described the Budget as "deflationary" misunderstand the basic objectives of the strategy."
[Chief Secretary, Finance Bill Debate, 13 April, Hansard col 35]

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'In the short term, there may be some very modest contractionary effect [of the Budget]. But the more important point is that, taking full account of the Budget, we expect output to be on a rising trend during 1981-82."
[Financial Secretary, IFS Speech, 23 April]

(PA) 4

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10 DOWNING STREET

From the Private Secretary

5 May,1981

You wrote to the Prime Minister and the Chancellor of the Exchequer on 6 April about VAT repayments delayed because of industrial action by computer (data processing) staff at the Customs and Excise computer centre in Southend. I have been asked to reply.

I regret that, because of this strike, Customs and Excise are unable at present to make repayments of value added tax. The size of the operation, about 10,000 repayment claims a day received in random order, rules out any question of making the repayments manually, even on a selective basis. Nor is there any valid means of distinguishing between claims in order, for example, to deal separately with claims from a particular class of trader or those where hardship exists. Once the industrial action is over, Customs and Excise will do all they can to see that repayments are resumed as quickly as possible.

However, although VAT is distinct from income tax and national insurance contributions collected under pay-as-you-earn arrangements, Collectors of Taxes will have regard to difficulties facing businesses because repayments of VAT are being delayed. They will not take precipitate action to collect pay-as-you-earn payments falling due where there is a genuine temporary difficulty about paying in cases of this kind.

You also ask why VAT has to be levied on machinery which is sold only to registered businesses who can reclaim the tax. It has in fact been suggested previously that VAT should not be charged on transactions between registered traders, and, in 1978, a joint working party, comprising the Consultative Committee of Accountancy Bodies, the CBI, the Retail Consortium, the Federation of Wholesale and Industrial Distributors, and Customs and Excise, was set up to consider the question in depth. However, the conclusion of all the trade bodies represented on the working party was that the balance of advantage lay in retaining the present system, and in the light of that finding the Government could not comtemplate introducing such arrangements, which would not, in any case, be permissible under the European Community regulations.

I am sorry that I cannot be more helpful.

S L Thornton, Esq

PWJ 5

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FINANCIAL SECRETARY

c.c. Principal Private Secretary
PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir Douglas Wass
Mr. Ryrie
Mr. P. Dixon
Mr. H. P. Evans
Mr. Unwin
Mr. R. I. G. Allen
Mr. Williams
Mr. Ridley
Mr. Cropper
Mr. Cardona

W is counsel

ECONOMIC OUTLOOK

I agree with Mr. Allen's suggestion that we should be cautious about claims of a recovery.

2. There are now many tentative signs that output has stopped falling much as we have been expecting in recent forecasts. There has been a major shift in press coverage and this has been noted generally. My impression is that this increased confidence has been the result of changes in the market place. However, many critics are all too ready to argue that it has been inspired by Ministerial statements. It would now be easy for the Treasury to overplay its hand and claim more of an upturn than eventually occurs. Any faltering of recovery would then receive undue attention. This would only distract from the principle that an end to falling output does not depend on government 'reflation'. If recovery emerges more rapidly than we have forecast there will be plenty of others who will carry the story. Our response should now be low-keyed.

(TERRY BURNS)
6th May, 1981.

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PS/FINANCIAL SECRETARY

cc PS/Chancellor — 12/2
PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Mr Burns
Mr Ryrie
Mr Unwin
Mr H P Evans
Mrs Gilmore
Mr Williams
Mr Ridley
Mr Cropper
Mr Cardona

ECONOMIC OUTLOOK

We spoke. Further to the Chancellor's comments (summarised in Mr Tolkien's minute of 6 May), could I suggest the following standard passage for insertion into letters for the Financial Secretary's signature, etc :

> "It is encouraging to note the growing signs from [recent movements in industrial production], business surveys, labour market trends, private sector housing starts, and other sources, that output may have stopped falling. The business outlook also appears to be more favourable. There are many reported recent examples of new businesses being set up and new initiatives being taken, as well as of the weeding out of damaging restrictive practices, and in some companies substantial improvements in productivity. All these changes augur well for the future."

2. The reference to the industrial production figures has been put in square brackets, pending publication of the March figures on 19 May.

RA

R I G ALLEN

EB

7 May 1981

6
18

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Mr Burns
Mr Ryrie
Mr Dixon
Mr H P Evans
Mr Unwin
Mr Neuburger
Mr Williams
Mr Ridley
Mr Cropper
Mr Cardona
Mr R Allen

PS/FINANCIAL SECRETARY

ECONOMIC OUTLOOK

The Chancellor has seen Mr Allen's minute of 1 May about what line Ministers should take on the "bottoming out" of the recession and the prospects for recovery.

2. The Chancellor thinks that we should take the line suggested by Mr Allen at the end of his second paragraph, save that the business outlook should be described as appearing to be more favourable rather than much more favourable. He agrees that statements to the effect that the upturn has come or that output is growing a good deal faster than was predicted by the Treasury in the FSBR should be avoided.

R.I.T.

R I TOLKIEN
6 May 1981

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TOBACCO ADVISORY COUNCIL

Glen House, Stag Place, London, SW1E 5AG

27975

From Sir James Wilson, K.B.E., M.C.
Chairman

Telephone: 01-828 2803/2041
Telegrams: TOBCOM LONDON SW1E 5AG

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6th May, 1981

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The Rt. Hon. Sir Geoffrey Howe, QC, MP,
Chancellor of the Exchequer,
H.M. Treasury,
Parliament Street,
London SW1P 3AG.

Dear Chancellor,

In my letter to you dated 1st May, I undertook to let you have some fuller information early this week indicating the consequences so far of the increases in taxation imposed in your March Budget; though it is still too early to judge the full impact of those tax changes upon the tobacco industry, it is already clear that the effects have been far reaching. Against such a background, comments in the press and in the House suggesting any further increase at the present time appear to my Council as extremely ill informed.

One should perhaps first look again briefly at the drastic character of the increases already imposed in the March Budget. These changes involved:-

a) A 30% increase in the tax on cigarettes compared with a year earlier, which raised the price of a packet of 20 cigarettes by 14p to 91p (plus 18%).

b) Similar tax increases of 30% on cigars and handrolling tobaccos.

c) A 25% increase in tax on pipe tobaccos.

The immediate effect of these unprecedented increases has been to cause a drop in sales to the distributive trade of approximately 15% since the Budget. U.K. manufacturers have thus been forced to cut production and make adjustments to their labour forces. So far, these steps have involved:-

a) Imperial

Over 5,000 workers laid off for up to two weeks at seven factories (W.D. & H.O. Wills in Bristol, Swindon, Newcastle, and Glasgow; John Player in Nottingham, Stirling, and Ipswich), plus further short time working on cigar production continuing into the summer.

b) Gallaher

Short time working for 6,000 workers over three months at six factories in Manchester, South Wales and Northern Ireland.

The Rt. Hon. Sir Geoffrey Howe, QC, MP. 6th May, 1981

In the case of B.A.T. and Carreras Rothmans, success in exports has so far cushioned the effect in production terms of the drop in U.K. sales; even so, some short time working may be necessary within a month or so, while the Budget increases caused deferment of plans to increase production at Rothmans' Spennymoor factory for which 90 more workers would have been recruited.

Smaller businesses, concerned mainly with the pipe tobacco trade, whose difficulties were explained in our pre-Budget submissions, have found their problems accentuated as a result of the tax increases. The slightly smaller increase in tax on pipe tobaccos makes only a small difference to their problems in a declining market and with severe foreign competition.

It must also be remembered that the March tax increases were imposed on an industry whose products were already substantially over taxed across the board, with duty and value added tax, taken together, accounting for about 70% of consumer expenditure. It is no coincidence that sales of cigarettes have fallen annually since 1973, and that, in 1980, the level of cigarette consumption was 12% below that of seven years ago. The base for future tax revenue was thus already being diminished at an alarming rate before the recent Budget; the latest tax increases, by further increasing the tax proportion of the retail price to 73½% on the most popular cigarette price levels, can only accelerate the process.

Nor are the consequences of the recent budgetary increases confined to the tobacco industry itself. There are serious effects on the wholesale and, in particular, retail trades where smaller businesses of the C.T.N. type may be made unviable, as their stocks at the old prices become exhausted and their profits are affected by other adverse factors e.g. substantially higher rates. Similar 'knock on' effects are suffered too by the transport industry (wholesale and retail distribution) and tobacco ancillary industries (packaging, fibre and board etc.).

It is worth a brief look at the effect of continued high taxation on comparative prices within the E.E.C. The following table of cigarette prices shows that the retail price is unacceptably high as compared with the situation obtaining elsewhere except in Denmark. These figures could almost be interpreted as evidence of discrimination against the British industry and smoker.

	Most popular cigarettes (Sterling equivalent per 20)
Belgium	44p
Denmark	113p
France	27p
German Fed. Rep.	62p
Greece	21p
Italy	31p
Luxemburg	35p
Netherlands	47p
Rep. of Ireland	63p
U.K.	88p to 91p

Over and above the serious consequences indicated above, severe increases in taxation of the type imposed in March have other, perhaps more permanently damaging, effects on the capacity of T.A.C.'s companies to secure employment and produce wealth for Britain. Some of the more important of these factors are:-

a) Effects on Forward Planning

A successful large business, with the responsibility for the employment of many thousands of people, needs to be able accurately to forecast sales trends in order to safeguard employment. It is, of course, possible to make allowances for reasonable adjustments of indirect taxation; the process of business planning, however, becomes much more difficult when Government chooses, for whatever reasons, to make such large changes as were imposed in March. T.A.C.'s companies had been planning some methodical run down in manning levels in consequence of their more efficient operations; now, however, redundancies beyond those originally visualised are undoubtedly more probable.

b) Profitability

A reduced U.K. cigarette market of the kind indicated by the drop in retail sales already referred to must inevitably cause a reduction in overall profits. Tighter competition in a declining market will mean an increasing demand on the reduced resources available; it seems, therefore, possible that there may be a consequent reduction in money available for the research and development which are so vital to the future of the tobacco industry.

There is another, less immediately obvious, but perhaps even more significant factor. It should be remembered that the member companies of T.A.C. are involved in a wide variety of industrial activities other than their tobacco components. However, the profits from their tobacco divisions are an important source of funds, especially in a recessionary climate, for investment in other industrial activities, while these are developed and made profitable. Clearly the tax increases on tobacco products in the recent Budget will make it more difficult for these other activities of T.A.C.'s companies to be maintained or extended, with consequent adverse effects on the whole industrial scene.

For all these reasons, therefore, my Council would deprecate any idea that yet further tax demands on tobacco products are being considered at the present time. Any such action would only exacerbate the severe problems for the tobacco industry and trade following the damaging March increases. Moreover, to heap further taxation upon consumers already highly taxed, and to do so immediately following a massive increase only two months ago, could affect demand so severely as to render any normal recovery of sales, and consequent revenue out turn, extremely uncertain.

The Rt. Hon. Sir Geoffrey Howe, QC, MP. 6th May, 1981

Finally, my Council consider it inequitable that one prosperous and efficient industry in the private sector should be called upon to carry a disproportionate part of present economic burdens. In my Council's view, the Government should make determined efforts to bridge the gap in public expenditure arising from the diesel concession by further restricting current public expenditure - the sum involved (£85 million in 1981/82 and £135 million in a full year) is surely within the scope of economies capable of being achieved without further taxation.

Perhaps, therefore, I may end this letter as it began by stressing again my Council's view that even to contemplate any further increase in tobacco taxation at the present time would be very unwise.

At this stage, less than two months after the unprecedentedly heavy tax increase on cigarettes, neither the Industry nor the Treasury can be sure of the full extent of the drop in consumption and consumer purchases. T.A.C. fears that in the present climate this drop could be more severe and longer lasting than might have been expected from previous patterns following more moderate increases. In this uncertain situation we believe that to contemplate any further increases to tobacco taxation would be most inprudent and put at risk not only future sources of revenue but also permanent jobs in the tobacco industry itself and in its various associated businesses.

By any standards, therefore, the imposition of further tobacco taxation at the present juncture would, in my Council's opinion, be impossible to justify.

Yours sincerely

James Wilson

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PPS. 8

SHEERWOOD CORPORATE SERVICES LIMITED

Directors: Francis A. Singer (*Chairman*) Philip A. Lovegrove (*Managing*) Nicholas A. H. Stacey
Sir Neil Shields MC

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CH/EXCHEQUER
REC. 15 MAY 1981
ACTION Mr Burgner
COPIES TO Mr Monck
Mrs Case
Mr Isaac IR

PERSONAL

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
Chancellor of the Exchequer,
11 Downing Street,
London, S.W.1.

11th May, 1981.

This - as the rest of the letter suggests - overstates our case, I think? But it is what we said.

Dear Geoffrey,

Your letter dated 14th April awaited me on my return from the USA and the notion that even an equity issue by say BL would be part of PSBR finally killed my suggestion of placing participating preference shares of some nationalized industries with the market. May I suggest that PSBR is an obvious misnomer?

Still my idea may be shelved for later use rather than completely discarded. If so, I wanted to suggest a further refinement, namely making such participating preference shares convertible into ordinary shares say, in 3-4 years from issue at par and for a premium of say 25% - 50% within say two years thereafter. This may have special appeal to institutions as they could benefit from a turnaround in the fortunes of a company like British Leyland. It could also be considered a subtle way of privatization, which could avoid it becoming a political issue. In addition, it would strengthen the argument for commercial discipline.

My case rests - at least for the time being. Should you ever wish to reconsider it, possibly under changed circumstances, I shall always be gladly available to further develop it.

As ever
Francis

F. A. Singer

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2k

Chancellor of the Exchequer

cc Financial Secretary
Mr Ryrie
Mr Byatt
Mr Cassell
Mr Sedgwick

NORTH SEA OIL AND GAS

At the first meeting of MISC 56 you agreed to circulate a memorandum on the impact on the UK economy of North Sea oil and gas revenues. This was to be done in consultation with the Secretary of State for Energy. The attached draft has just been sent across to Energy officials. But I wonder if you could bear to glance at it at the same time and let us know whether you think it is on broadly the right lines.

PEM.

P E MIDDLETON
11 May 1981

Enc

NOT SURE IF IT QUITE MATCHES CONTEXT IN WHICH REQUESTED (WHICH I FORGET, IN ABSENCE OF MINUTES): BUT I BELIEVE IT WAS INTENDED TO SHOW (E.G.)

- IT'S ALL HAPPENED
- IT GIVES US NO SCOPE FOR PROTECTING IND FROM HIGH ENERGY PRICES
- NOR FOR UNDER-PRICING ETC GAS, ELEC
- NOR FOR PRODUCING OUR COUNTERPART TO CHEAP FRENCH HYDRO-ELECTRIC, NUCLEAR

I.E. WHY WE ARE — & CAN'T AFFORD TO STOP BEING, BY MEANS OF / DESPITE N. SEA REVENUES — A HIGH ENERGY PRICE COUNTRY

(CAN WE GET IN A SWIPE AT OUR FAILURE TO MAKE THE MOST OF OUR POTENTIALLY CHEAPER COAL?)

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THE ECONOMIC IMPACT OF NORTH SEA OIL AND GAS REVENUES

Introduction

Total tax revenues from North Sea oil and gas amounted to some £3¾ billion in 1980-81. This year they are expected to be around £6 billions. By 1983-84, they might amount to about £8 billion (at current prices). These figures are substantial, but even by 1983-84, North Sea revenues will still account for only about 6 per cent of total general government revenues.

IMPACT OF NORTH SEA OIL

	1979	1980	1981	1982	1983	1984
Output of North Sea Oil (m. tonnes)	78	80	80-95	85-110	85-115	90-120
Direct Contribution of Oil and Gas to GNP (as a % of GNP in that year)	2¼	3	3¾	4	4½	5

	1979-80	1980-81	1981-82	1982-83	1983-84
Total Tax Revenues from North Sea (£ billion)					
(a) current prices	2.3	3¾	6	6¾	7¾
(b) constant 1979-80 prices	2.3	3¼	4½	4¾	5¼

2. In broad terms these tax revenues can be taken as a measure of the potential addition to the nation's income as a result of North Sea oil. But two important points need to be made about this:

3/0/5

First, North Sea oil is not a cheap source of supply. Producing it has a high resource cost. With the present world oil price we are clearly better off with it than if we had no oil. But we are not better off than we would have been without oil but with the oil price where it was at the beginning of the 1970s. North Sea oil has not made Britain better off in any absolute sense. What it has done Some? All?

Net plus or minus?

is to protect our standard of living from the effects of the sharp rise in oil prices that has hit living standards in other industrial countries.

Second, the adjustment to the rising output of North Sea oil and the higher oil price has entailed major structural changes in the economy. In particular, the relative size of the non-oil tradeable goods sector of the economy (notably manufacturing)

Explain?

has to decline in order to accommodate the higher share taken by oil. This need not involve an absolute contraction, but these structural changes, which are associated with a high real exchange rate, have undoubtedly accentuated industry's difficulties in the present recession.

It is important to see the potential benefits of North Sea oil in this fuller perspective.

The Use of the Revenues

3. It is impossible to say exactly how the revenues from the North Sea have been used. For this we would need to know what would have happened to the economy in the absence of North Sea

oil. Both the private and public sectors would have been faced with a significantly different economic environment. In particular, inflation would probably have been even higher, personal living standards have risen less and company profitability been less severely squeezed. In these circumstances persons, companies and the government would almost certainly have made ~~difficult~~ different decisions from those they actually made.

IT'S ALREADY USED:

4. In principle the Government could use North Sea revenues in any of the following ways:

DON'T IMPLY IT'S STILL AVAILABLE TO USE

(i) to reduce other taxes;

(ii) to increase public expenditure;

(iii) to reduce the PSBR, but to keep the monetary targets unchanged - this would reduce interest rates;

(iv) to reduce both the PSBR and the rate of monetary growth. The reduction in inflation this makes possible will directly increase real personal incomes.

5. While the Government's broad economic strategy is independent of the existence of North Sea oil and gas, its monetary and fiscal policies have been framed with knowledge of both the impact of and the opportunities afforded by the North Sea wealth. In other words, the Government has consciously sought to use North Sea revenues in ways that reinforce its overall strategy.

6. Thus, compared with what policies might have been in the absence of North Sea oil, North Sea revenues have in effect been used to reduce other taxes, public sector borrowing and interest

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rates and, selectively, to increase public expenditure. There is little doubt that personal real disposable incomes are higher than they would have been without oil; and that inflation, public borrowing and interest rates are lower. It is also clear that without the oil revenues it would not have been be possible to provide support for industry and employment from public funds on the scale now envisaged. NOR TO MAINTAIN EVEN A SEMBLANCE OF UNSUSTAINABLE EXPANSION OF PUB. SEC PAY, PENSIONS

including the pouring of money down the NCB/NUM, BSC, BL(?) drains. PS

The Exchange Rate

7. The impact of North Sea oil on the economy is felt not only through government revenues, but also through the balance of payments and the exchange rate. A substantial part of sterling's rise in the past three years is attributable to North Sea oil. Industry's competitiveness has suffered, at least in the short run, and this has added to the severe pressures on business profits. But by improving the terms of trade the rise in the exchange rate has increased real incomes and helped in reducing the rate of inflation. The relatively small fall in the nation's real disposable income in 1980, compared with the fall in GDP, can be attributed largely to the impact of North Sea oil, and this played a part in sustaining final expenditure during the recession.

8. The impact of oil on the balance of payments has had other beneficial effects. The strengthening of the current account enabled exchange controls to be abolished, so allowing the private sector to invest overseas and to finance such investment in the cheapest and most profitable way. It has also allowed the foreign

exchange reserves to be rebuilt and the most expensive public sector overseas debt to be repaid. The associated improvements in the UK's net overseas asset position will provide against the day when the oil begins to run down.

Conclusion

9. The revenues from North Sea oil have been, and will continue to be, of undoubted benefit. Compared with what would have happened in the absence of oil - a comparison which cannot be made with any precision - they have helped to reduce taxes, public sector borrowing, monetary growth and interest rates and to finance substantial government support for industry and employment. With its impact on the exchange rate, North Sea oil has helped to bring inflation down, at some cost, however, to industry.

10. The revenues - and hence their potential impact - must, however, be kept in perspective. They are not large by comparison with total government revenues. And they are already committed - our medium-term financial strategy takes full account of them.

AR 11/5.

11/5/81.

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1. MR BOTTRILL
2. CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Sir Douglas Wass
Sir Kenneth Couzens
Mr Ryrie
Mr Middleton
Mr Hancock
Mrs Hedley-Miller
Mr Turnbull
Mr Mercer

MEETING WITH MR ARTHUR BURNS

You are seeing Mr Arthur Burns at 10.30 am on Tuesday 12 May. Mr Burns was Chairman of the Federal Reserve Board from 1970 to 1978. Since then he has taken up a position with the international bank, Lazard Freres, lectures at Georgetown University and more recently was named as one of the twelve eminent figures appointed to advise President Reagan. A personality note is attached at annex A.

2. Mr Burns standing in the financial world and his proximity to President Reagan should make his views on future US developments worth hearing. You might be interested in his opinion of:

(i) the likely responsiveness of the economy to the supply side measures; in particular whether growth will be stimulated by as much as the administration forecasts; and whether inflation will fall as far as anticipated.

(ii) the operation of US monetary policy; has the US experiment with monetary base control led to higher/more volatile rates than necessary? Effect of volatility on inflationary expectations, business confidence? European complaints about effects on EMS currencies?

3. A brief on President Reagan's programme for economic recovery is at annex B. You may like to glance again at an updated version of the brief on US monetary policy, prepared for your meeting with Mr Volcker in February at annex C. A short note on recent US economic developments is at annex D.

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4. Mr Burns will probably want to discuss UK policies. A copy of the aide memoire on the UK economy is at annex E. The main point to get over is that you believe the economy is turning the corner, as evidenced by the improved business climate.

5. He may be particularly interested in monetary matters because of his background. You will be sufficiently familiar with recent monetary developments to answer his enquiries. The latest position is described in Mr Turnbull's for the Prime Minister of 5 May. Although Mr Burns is unlikely to be interested in the muddied waters of the Civil Service Dispute, you will want to reassure him that monetary policy remains broadly on course. The underlying rate of growth of £M3 has been within the target range. He may be interested in the impact on the UK of the recent sharp rise in US interest rates. While the dollar exchange rate has fallen the effective exchange rate has remained stable. The impact appears to have been more dramatic in the gilts market which has witnessed a major fall in prices; over the past 10 days the price of 20 year gilts has fallen by £3, raising the yield from 13.8 per cent to 14.3 per cent. The market appears to have lost hope of an early reduction in interest rates.

6. You will be supported by Mr Bottrill at the meeting.

PM Leahy

P M LEAHY
IG3
11 May 1981

A

Annex A

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Arthur Burns (76) was appointed to a 12 member advisory board to assist President Reagan and Treasury Secretary Donald Regan on economic matters in February 1981. He joined Lazard Freres in September 1978 as a senior adviser on general policy matters, especially those relating to international developments. He holds this position in conjunction with two others based in Washington DC: "distinguished scholar in residence" at the American Enterprise Institute for public policy research, and distinguished professorial lecturer at Georgetown University's School of Business Administration. These academic posts reflect Burns' career before his two terms as FRB Chairman from 1970 to early 1978 where he exerted considerable influence on US economic policy. His economic research, mainly in the fields of macro-economic theory and policy, was largely conducted at the National Bureau of Economic Research, where he served as Director of Research before becoming President and Chairman. From 1953-56 he was Chairman of Eisenhower's Council of Economic Advisers.

B

Annex B 33

THE REAGAN PROGRAMME

1. President Reagan's programme for economic recovery aims through tax cuts, public spending cuts and deregulation to reduce the role of Government and increase incentives to the private sector. The main measures proposed are:

(i) personal tax cuts of 10 per cent in each year 1981 to 1983, starting from July 1981;

(ii) corporate tax concessions via accelerated depreciation allowances; and

(iii) extensive public spending cuts of about ¾ per cent of a re-estimated version of Mr Carter's January budget in FY 1981 (October - September) rising to 6½ per cent in 1982 and 9¾ per cent in 1986.

2. The importance of reducing monetary growth in coming years is also recognised. As is the significant role of expectations in shaping economic behaviour. A balanced budget by FY 1984 is crucially dependent on optimistic projections of GNP and inflation growth based on the economy's assumed response to supply side measures. A marked departure from recent trends is anticipated. Average GNP growth of 4½ per cent between 1982 and 1986 is assumed. Inflation is expected to fall from 13½ per cent in 1980 to 4.2 per cent in 1986.

Tax proposals

Personal income tax proposals are rather more cautious than once thought likely and less concentrated on the upper and of the earnings scale. Nevertheless it is these measures which have attracted Democrat fire not the expenditure cuts. Marginal tax rates are to be reduced by 10 per cent a year from July 1981 for the next three years bringing the present range of rates down from 14 - 70 per cent to 10 - 50 per cent. Incentives will therefore be raised but the fiscal impact this year, even if Congress agrees the measures before the end of the financial year, which seems increasingly unlikely, will be small. In subsequent year the cuts will only partly offset fiscal drag. The revenue cost is much the same as the expenditure saving. Tax and expenditure measures are therefore complementary.

Expenditure cuts

4. Expenditure cuts in the present fiscal year are mcuh less than proposed

in the election campaign but targets for subsequent years are ambitious. Cuts are planned for all areas of the budget except defence spending which is projected to rise from 23.4 per cent of total spending in 1981 to 37.6 per cent in 1986. Federal spending is planned to fall from around 23 per cent of GNP in 1980 to 19 per cent by 1986. Reagan gained a significant victory last week when the House of Representatives overwhelmingly passed the 'Gram-Latta' budget resolution which incorporates all his spending cuts and more. Senate has still to vote but is expected to agree to the resolution. But spending targets may be exceeded when detailed proposals are examined in Committee stage.

The federal deficit

5. Between 1973 and 1980 the federal deficit was on average just under 2 per cent of GNP. Reagan aims to balance the budget in 1984. A deficit of $54.9 billion this year is forecast, 1.9 per cent of GNP, much the same as that bequeathed by Mr Carter. The profile for elimination of the deficit is:

	1980	1981	1982	1983	1984	1985	1986
target balance $b	-59.6	-54.9	-45.0	-22.8	0.5	5.8	28.2
% GNP	- 2.3	- 1.9	- 1.4	- 0.7	-	0.1	0.6

Monetary policy

6. The administration has only published a summary statement of its monetary plan in order to avoid the impression of interfering with the independence of the Fed. But it is aiming to halve the rate of monetary growth by 1986. The Fed has reduced 1981 monetary targets by ½ per cent in each case. The upper limit of M1 - B range is 6 per cent. It is not easy to reconcile this with expected growth in nominal GNP of 12 per cent or so. This implies growth in the velocity of circulation of around 6 per cent, compared to an average of around 3 per cent in the last 20 years. But this increase in velocity was surprisingly achieved in the first quarter of 1981 - albeit US interest rates have risen in the most recent period.

Conclusions

7. Tax and spending proposals seen likely to be passed as a package by Congress although there is still some uncertainty about the tax measures. Nevertheless the imbalance between fiscal and monetary policy is unlikely to be alleviated in the near future. Pressure on interest rates is likely

to continue given the prospect of large budget deficits this year and next and the the possibility of strong economic growth.

C

Annex C 36

US MONETARY POLICY

Techniques and problems

New techniques introduced in October 1979 seek to control growth of monetary aggregates by restricting supply of reserves to the banking system. Not pure monetary base control. Interest rates are not completely free but allowed to fluctuate within wide margins.

2. Techniques applied through open-market operations. Fed buys and sells securities to provide volume of non-borrowed reserves thought consistent with money targets. If money supply moves above target banks need to top up reserves. They are encouraged to use Fed discount window only as a last resort and to look for other sources of funds first. In this way reserve pressure pushes up money market interest rates (the Fed funds rate is the trigger) and so affects bank lending and money supply growth. If money supply fails to come back on course the Fed can squeeze the supply of non-borrowed reserves further.

3. Two main problems in practice: what targets to choose and how to define them; and how to react when relationships between bank reserves and money supply appear to shift.

a. Choice of target

4. Trade-off between Fed's ability to control a given aggregate and influence of that aggregate on overall demand. Monetary base easier to control but weak relationship to overall demand. Broad aggregate such as M2 has more stable relationship but hard to control. Narrower aggregates fall in between.

5. Problems of definition a further complication. US financial system evolving rapidly. Growing availability of new instruments and banking facilities blurring distinction between various forms of money. Fed has opted for flexibility. Family of targets:

MIA - Currency plus demand deposits

MIB - MIA plus other checkable deposits (eg recently authorised "Negotiable Order of Withdrawal" accounts which are interest bearing).

M2 - MIB plus banks' overnight repurchase agreements, savings and small time deposits.

Volcker recently said "No single monetary measure should be emphasised to the exclusion of others, nor should undue weight be placed on short-term changes or small deviations from targets, particularly when those deviations are not consistent from one measure to another."

b. Relationship between bank reserves and money supply

6. Fed nonetheless has problem of distinguishing between self-correcting money supply fluctuations and more fundamental shifts. It periodically sets short-term (1-2 months) targets during the year and manages reserves on day-to-day basis. Procedure designed to avoid unnecessary market disruption (many say it has failed in this): while responding early to serious money supply slippage.

7. One difficulty has been unpredictable relationship between reserves and money stock. Different money stock components have different reserve requirements: some have none at all; many banks have left the Federal Reserve system to avoid requirements. Uniform requirements are being applied to all deposit taking institutions but this will take 8 years.

8. Another difficulty has been Fed's limited ability to achieve reserves targets. Forecasting errors and faulty or erratic management of the discount window have been blamed. Reforms to increase Fed's control over reserves are being considered.

Recent monetary developments

9. Partly for these reasons, new techniques have had teething problems. But Volcker attributed last year's volatility of interest rates and money supply mainly to parallel volatility in the overall economic environment (cf GDP fall in Q2 at 10 per cent, annual rate, rise in Q4 at 5 per cent). This argument now looks weaker since activity in the last half year has been relatively steady.

10. US interest rates (3 month CD rates) rose from 10 per cent in February 1980 to 18 per cent in April, fell to 6 per cent in June, rose to 20 per cent in mid-December fell to 13 per cent in March and are now back up at 18 per cent. Money supply (MIB) fell in the second quarter of last year and grew rapidly for much of the second half. For the year as a whole MIA and MIB grew at the upper end of target ranges ($3\frac{1}{2}$-6% and 4-$6\frac{1}{2}$% respectively); M2 slightly exceeded its 6-9% range. MIB and M2 have been growing near the top of their ranges during the first quarter of 1981 but the picture is distorted because of sharp movements into new interest bearing 'NOW' accounts.

11. Europeans complain about the effects of high and volatile US interest rates on the German mark and other European currencies. Recent increases in official US rates may fuel their arguments. They see US monetary policy as adding to their inflation by weakening their currencies, and to their unemployment by keeping up European interest rates. But they can hardly complain about US determination in fighting inflation.

Prospects

12. All monetary growth targets for 1981 cut by ½%. Early interest rate decline might be limited by several factors:

i. Heavy Treasury financing requirements in the second and third quarters;

ii. The apparent willingness of corporations to issue a considerable volume of bonds following only modest declines in interest rates;

iii. Probable Fed unwillingness (even if economy goes into recession again) to see repeat of rapid interest rate decline of last spring.

iv. Prospect of double figure inflation persisting through most of 1981.

Annex D

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US RECENT ECONOMIC DEVELOPMENTS

GNP growth in Q1 1981 quickened to 6½ per cent (saar) after 3.8 per cent growth in Q4 1980. GNP in 1980 fell by only 0.2 per cent despite the record 9.9 per cent (ar) fall in GNP in the second quarter. Activity is now slowing down, but as, yet there are no signs of the economy slipping into recession.

2. The underlying rate of consumer price inflation slowed down in March, primarily because of moderate energy price rises, after an acceleration at the turn of the year. The year on year rate in March fell to 10.7 per cent. Little further improvement is likely. Wholesale prices are increasing rapidily and earnings growth in the year to March was still over 10½ per cent.

3. The unemployment rate has fallen steadily since October 1980. It is now 7.3 per cent of the civilian labour force compared to 7.6 per cent then.

4. The current account was in approximate balance in 1980 for the first time since 1976. The trade account improved substantially because of better expert performance and a 17 per cent or so reduction in the volume of oil imports, which more than offset higher oil prices. The strength of economic activity and the post-Bali oil price rises have led to a deterioration in Q1 1981.

AIDE MEMOIRE ON THE UK ECONOMY 11 May 1981

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PRESENT SITUATION

G... output estimate fell 1½ per cent in Q4 1980: the average estimate fell 2 per cent between the years 1979 and 1980. Industrial output rose 3/4 per cent in February 1981 but in the three months to February fell 2 per cent. Manufacturing output rose 1 per cent in February and in the latest three months was 3 per cent lower.

Consumers' expenditure rose just under 2 per cent in Q1 1981 reflecting an increase in the volume of retail sales. Volume of exports fell 2 per cent in the three months to February 1981 after being broadly flat since mid-1980. Volume of imports fell 2 per cent in the three months to February 1981 continuing the downward trend though suggesting some slowing down in the rate of decline. Manufacturing investment in 1980 after allowance for leasing is estimated to have fallen 6 per cent compared with 1979. Distributive and service industry investment (excl. shipping) rose 5½ per cent on the same comparison. DI investment intentions survey (conducted in October to December) suggests a fall of 15-20 per cent in manufacturing investment in 1981, with some recovery in 1982; distributive and service industries (excluding shipping) investment expected to be broadly unchanged in 1981 and 1982. Manufacturers' and wholesalers' stocks fell substantially in Q4 1980 to bring the total level of destocking in 1980 to £1.8bn (at 1975 prices). Retail stocks in 1980 fell by about £¾ billion (at 1975 prices).

Unemployment (UK, seasonally adjusted excluding school-leavers) was 2,446,000 (10.1 per cent) at April count, up 65,000 on March. Vacancies stood at 95,000 in April.

Wholesale input prices (fuel and materials) rose 1½ per cent in March to a level 8½ per cent above a year earlier; wholesale output prices ("factory gate") rose 1¼ per cent and are 10½ per cent higher than a year earlier. Year on year RPI increase was 12.6 per cent in March compared to 12.5 per cent in February. Average earnings rose 1 per cent to stand 16.4 per cent higher than a year earlier. RPDI was little changed in Q4 1980 but in 1980 as a whole was 2 per cent higher than 1979. The savings ratio fell 1 per cent to 16 per cent in Q4 1980 but in 1980 as a whole rose 1 per cent to 15 per cent.

PSBR was £12¼ bn (seasonally adjusted) in the first three quarters of 1980-81. CGBR was £13.0bn in the financial year 1980-81.

Latest banks' eligible liabilities figures suggest sterling M3 rose about 2.0 per cent in banking April; the civil servants' strike is estimated to have contributed around 1¼ percentage points to the rise. MLR reduced from 14 per cent to 12 per cent on 10 March.

Visible trade has been in surplus since mid 1980. Estimated current account surplus of £0.6bn in February 1981 followed a surplus of £1.0bn in January. Reserves at end-April $28.1 bn. At the close on 8 May the sterling exchange rate was $2.1155 and the effective rate was 98.9.

CONFIDENTIAL

pmr 11

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cc Financial Secretary
Mr Ryrie
Mr Byatt
Mr Cassell
Mr Sedgwick

12/5/81.

MR MIDDLETON

NORTH SEA OIL AND GAS

In your minute of 11 May you asked the Chancellor for a preliminary steer on the draft paper on the impact on the UK economy of North Sea oil and gas revenues commissioned at MISC 56(81) 1st meeting on 16 April.

2. The Chancellor's main general comment is that he is not sure that the draft fully meets the MISC 56 remit as it stands. The minutes record the discussion as follows:-

> "It was frequently argued that it was indefensible for the United Kingdom to pursue a policy of high price energy in spite of the benefits of North Sea oil and gas. Further consideration should be given to the presentation of the benefits of the econonmy generally, and to industry, of North Sea revenues."

The paper does not directly meet the argument, which was made much of in the discussions of relative energy pricing in the NEDC, that North Sea oil is a natural resource similar to the cheap hydro and nuclear power enjoyed by France and that we should use it as they do to give our industry a competitive advantage and that at the very least we should ensure there was no competitive disadvantage. He feels that the main aims of the paper should be to show the following:-

i. We are already using North Sea revenues to the full - in that sense its all happened, and there is no vast unaccounted for benefit still to come.

/ii. It gives us no

CHANCELLOR OF THE EXCHEQUER

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ii. It gives us no scope for protecting industry from high energy prices.

iii. Nor for under pricing gas and electricity to produce our own counterpart to cheap French hydro-electric and nuclear power.

The main aim therefore should be to show why we are, and cannot afford to stop being, by means of North Sea revenue, a high energy price country. It would be worth getting in a swipe at our failure to make the most of our potentially cheaper coal; this point could usefully be made in dealing with the natural resource argument.

3. The Chancellor had the following particular points on the draft:-

i. Page 2 first paragraph. Has our standard of living been protected from all the effects of the sharp rise in oil prices or only some of them? Should this be regarded as a net plus or minus?

ii. Page 2 second paragraph. Should not the assertion that the relative size of the non-oil tradeable goods sector of the economy has to decline in order to accommodate the higher share taken by oil be explained briefly?

iii. Page 3 second paragraph. The sentence "in principle the Government could use North Sea revenues" gives the wrong flavour, since it implies that those revenues are still there to use. While it is true that the revenues represent an additional resource a better way to express it might be to say "in principle the Government could have decided to use North Sea revenues in any of the following ways."

iv. Page 4 first paragraph. The last sentence might be amended to read "it is also clear that without the oil revenues it

/would not have been

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would not have been possible to provide support and financial assistance for industry and employment from public funds on the scale we have, nor to maintain every aspect of the unsustainable expansion of public sector pay and pensions." Some flavour is needed of recognition that by using North Sea oil to pour public funds into the NCB, the BSC and BL, as well as into pay and pension increases we cannot really afford or sustain, we may not be making the best use of a bad and relatively short-lived resource. In other words North Sea oil has cushioned us from a reality which we would have bumped into long before now without it - in the shape of balance of payments crises etc - but is this really a good thing? Only if we can use the breathing space to sort out our basic industrial problems.

PSJ

P S JENKINS
12 May 1981

12

REES & FRERES
PARLIAMENTARY AGENTS
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YOUR REF:

OUR REF: R.1750/JAD

15th May 1981.

28561

URGENT - BY HAND

Top copy CH/EX for C&AG 15/5

CH/EXCHEQUER

REC.	15 MAY 1981
ACTION	PS/IR
COPIES TO	PS/CST

The Rt. Hon. Sir Geoffrey Howe, Q.C., M.P.,
The Treasury,
Parliament Street,
London,
SW1P 3HE.

Dear Chancellor,

Finance Bill - Clause 34
Association of Independent Industrial Consultants

My firm acts for the above Association which represents independent professional consultants to industry. Their members provide services to a number of essential industries such as the defence, avionics, electronics, micro-processor, computer and petrochemical industries.

The Association and its members are most concerned at the proposals contained in clause 34. Members of the Association are essentially small businesses which your administration has pledged itself to support. However, the effect of the clause as now drafted would have nothing but disastrous results for members of the Association and they trust that you will see your way to proposing amendments to the clause to remove the harmful effects which will otherwise occur.

Members of the Association are a highly mobile and flexible work force capable of undertaking temporary and specialised assignments anywhere in this country or throughout the world. They often travel long distances and are frequently required to stay in hotels and it is only by operating through limited companies that they can afford such expenses.

As a consequence of setting up their own businesses, members are obliged to acquire equipment which is essential to enable them to carry on those businesses. The cost of such equipment is often considerable especially in the field of micro-processors. Being small businesses, the funds available to members of the Association are limited and the 30% deduction proposed by the clause would make severe, if not ruinous, inroads into those funds. The result would be that many new developments now being carried out or contemplated would be stifled and free enterprise would take a turn for the worst.

Many members of the Association have considerable seniority in their particular professional disciplines. If any of those members are forced by the enactment of the clause to become employees of the companies who now use their services, they would not, because of the way British industry is structured, be able to work at their respective disciplines and command the incomes which they now earn. For example, a senior engineer in a company can only increase his salary by giving up his professional career and accepting a post as a manager. Such a move often results in a first class engineer becoming a second rate manager thus causing a double loss to the industry in which he works. If the law is allowed to remain as it now stands, such unfortunate losses are less likely to occur.

Another possible result of the proposed change in the tax law would be that many members of the Association, who frequently travel abroad in the course of their work, would transfer their bases of operation to countries such as Germany, Holland and the U.S.A. who positively encourage people to go it alone as subcontractors. As a result, the services of those members would often be denied to industry here and any tax on their incomes would be paid to those other states.

Apart from their general case that the clause will either sap the initiative of enterprising people or drive them abroad, there are three related points which the Association wishes to make and they are as follows.

1. The deductions are expressed at 30% of any relevant payment but the true rate of deduction is greater because of the effect of V.A.T. As the clause is drafted, the paying company will deduct 30% under the clause whilst the receiving company will pay V.A.T. on that deduction as if it were money received for services rendered so that the true rate of funds withheld will amount to 34.5%.

2. Most members of the Association are registered for V.A.T. purposes. The clause assumes that corporation tax will amount to 30% (plus 4.5% for V.A.T.) of the gross incomes of members of the Association. However, in practice, the true percentage of corporation tax payable is minimal because profits in small businesses are drawn as wages which are subject to PAYE and National Insurance contributions which members will still be required to pay on a monthly basis. In the event, almost the whole of each deduction will be repayable to members of the Association. Thus members will, in effect, be required to make an enforced loan to the Inland Revenue which will not be repayable for at least two years and which will cause severe cash flow problems. What is more, the enforced loan will, if inflation continues at anything like the present rate, deteriorate considerably in value and thus impose an additional tax upon members of the Association.

3. There appear to be no safeguards in the clause to deal with cases where dishonest deducting companies make off with the money which they deduct. Such acts of dishonesty would lead to members of the Association paying their corporation tax several times over.

The Association and its members accept that there may be a number of dishonest people who are evading payment of taxes which are properly due from them. However, the Association does not believe that the dishonesty of a few people provides a reason for imposing massive penalties on their honest and hardworking members who play an important role in generating wealth in this country. They suggest, therefore, that the clause should be amended so that it will still be effective to deal with dishonest persons but, at the same time, allow honest tax payers, such as members of the Association, to continue operating their businesses without being penalised. Accordingly, the Association suggest that the clause should be amended to provide that tax exemption certificates be issued by the Inland Revenue in a manner similar to those issued to members of the construction industry under Part IV of Schedule 12 to the Finance (No.2) Act 1975.

The Association trusts that you will propose amendments to the clause to meet the points made on its behalf but, if not, I am instructed to request that there be a meeting with your officials at which representatives of the Association would

46

provide further information to support their case.

Yours sincerely,

J.A. Durkin.

RESTRICTED

13

pwr 47

FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR

cc Chief Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Mr Burns
Mr Ryrie
Mr Dixon
Mr Evans
Mr Kemp
Mr Allen
Mrs Gilmore
Mr Williams
Mr Ridley
Mr Cropper
Mr Cardona

ECONOMIC OUTLOOK

The Financial Secretary has seen Mr Tolkien's and Mr Burns' minutes to him of 6 May and Mr Allen's of 7 May 1981 about the best line to take on the prospects for recovery.

He has commented that the main need surely is to see to it that the code of ministerial speeches and that of ministers' replies to letters is the same. He finds the gulf between them that has emerged in recent weeks absurd. It may well be that ministers need to avoid over playing the upturn theme, but equally he thinks that those who draft letters for ministerial reply need to avoid underplaying it to the point (usually, of avoiding it altogether). He has agreed with Mr Allen a form of words to be included in future letters for his signature:

> "It is encouraging to note the growing signs from /recent movements in industrial production/, business surveys, labour market trends, private sector housing stocks, and other sources, that output may have stopped falling, and that the business outlook is now more favourable."

This should be kept under review as events unfold.

DLW

D L WILLETTS
15 May 1981

Mr C Williams
Miss Peirson } copy to each.

14

27th May 1981 48

Could you please fill in the blanks in the attached extract for a speech which Mr Carlisle proposes to make on Friday? A reply this evening would be appreciated.
RT 27/v

SECRETARY OF STATE FOR EDUCATION AND SCIENCE

Dear Mr Tolkein,

We spoke about this, and you agreed to fill in the gaps in the attached sentences when you could see them written down.

The sentences are taken from a speech to be given by my Secretary of State to the annual conference of the National Association of Headteachers on Friday 29th. The speech itself is still being typed, but we are hoping to get a final version in ~~the~~ tonight's box, so a response today would be extremely helpful. However, the Secretary of State will not actually leave for the conference until noon tomorrow, so we can live without the figures until then if necessary!

Thankyou for your help

Yours

Chris Ingles

Private Secretary

Last year alone - in a period of world recession - our gross ~~national~~ domestic product dropped by 2 %.(1) At the same time public expenditure rose by 4%. 3% (1)

~~This fall, and the rise in pub exp, in~~

Consequently ~~our~~ public expenditure as share of ~~that~~ gdp ~~spent on our public services*~~ went up ~~by~~ from 41½%. to 44½%

* the figure for public expenditure would be quite acceptable if that for services is not readily available.

(1) fall in average measure of GDP 1980 on 1979 (output measure dropped by around 3 per cent)

2/6/81. 15

80

CHANCELLOR OF THE EXCHEQUER

Views of CST, FST, Ridley pls

c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
PCC
MEG
Miss M P Brown
Mr Riley
Mr Sedgwick
Mr Mowl
Mr Ridley

POLICY ASSUMPTIONS FOR THE SUMMER FORECAST

The summer forecasting exercise is just beginning and as usual I am putting forward for your approval the proposed policy assumptions. These assumptions have been agreed by PCC as a convenient basis for constructing a forecast which reflects current policy.

2. We expect to circulate the completed forecast early in July. It will be built round a central case, but it is hoped to include in the report a description of two or three variants.

3. The forecast is intended primarily to help with the preparation of background and Cabinet papers for the 23 July discussion of public expenditure. It will also provide an updated assessment of the inflation forecast well in advance of the September Cabinet at which the cash factors will be confirmed (or amended); though for this meeting a further update in early September will be possible, building on the summer forecast.

4. The strikes in the Civil Service are affecting the collection of some statistics - such as trade - and are distorting many other statistical series, above all the CGBR and money supply. It is inevitable, even if there were to be a quick return to normal, that the statistics available to the forecasters by the end of this forecasting round will continue to be seriously distorted; in consequence the forecasts will be subject to (even) larger margins of error than usual. The forecast will assume an end to the strikes by the end of July.

/Monetary and fiscal policy

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Monetary and fiscal policy

5. During the current financial year 1981-82 monetary growth will, it is assumed, be at the centre of the £M3 target range of 6-10 per cent. The level of interest rates necessary to achieve this target will be forecast, together with the growth of other monetary aggregates.

6. For subsequent years, it is proposed to assume £M3 growth at the centre of the MTFS ranges; and to forecast the level of interest rates, both short and long, necessary to achieve this. But if the resulting levels of interest rates point to the need for fiscal adjustments as well, the forecasters, on advice from Mr Burns, will assume changes - in either direction as appropriate - in personal income tax. This treatment is proposed to avoid having to make interest rates bear the whole responsibility for achieving monetary targets; and the fiscal adjustment is made on income tax partly because that is the usual assumption and partly because in a forecast designed to help with public expenditure decisions it would not be helpful to assume changes to the existing plans.

7. As usual, the exchange rate will be assumed to float freely, with only short-term intervention by the authorities.

8. On taxation, we assume enactment of the Budget proposals, the only exception being the assumption that the loss of duty on DERV is made up by higher rates of excise duty. For 1982-83 and beyond, we propose to follow the usual approach of full revalorisation of tax allowances, thresholds and specific indirect tax rates (but subject to a possible fiscal adjustment as in paragraph 6).

Pay

9. The Government's direct influence over pay settlements is exercised through its negotiations with its own employees, through the setting of cash limits (including the RSG) and through setting EFLs for public corporations. For this pay round we propose to assume a Civil Service settlement on terms that are close to the present offer and that are within the constraints of cash limits. For future pay rounds, settlements in the public services will be

/forecast

forecast subject to the constraints of the cash factors and of the allocation of the contingency reserve, against the background of the - as ever - very difficult forecasting judgement on the likely level of pay settlements and earnings in the private sector.

Public expenditure

10. The starting point for 1981-82 will be the Cmnd. 8175 figures (including the contingency reserve, plus subsequent decisions) revalued by the 1981-82 cash limit factors and (for 1982-83 and 1983-84) the cash factors agreed by Cabinet as working assumptions for the survey.

Central government expenditure (subject to cash limits), local authority capital expenditure, and nationalised industries

11. It will be assumed that for 1981-82 the cash limits and other control totals such as EFLs hold, except to the extent of allocations from the contingency reserve. For 1982-83 to 1983-84, the cash figures - the illustrative working assumptions - will be assumed to hold, apart from allocations from the contingency reserve and subject to the effect of changes in inflation (see below). Central government pay in particular will be enhanced from the contingency reserve if necessary and the whole of the reserve will be allocated - in line with current claims - to particular programmes and above all to nationalised industries. For 1984-85 and 1985-86, the total of this expenditure will be set equal to the 1983-84 total, increased by a further 5% a year.

12. Nationalised industries will be assumed to stay within their EFLs or, where appropriate, the sum of their EFLs and allocations from the contingency reserve. The latest returns from the industries show very large additional bids for finance in 1982-83 and beyond. It was always expected that a substantial allocation of the contingency reserve would be needed for these industries, but the latest bids go beyond this. It is proposed, for the purposes of the forecast, to assume that these bids can be reduced (mainly through cuts in investment or increases in prices) so that they can be contained within the existing contingency reserve: to assume otherwise, it could be argued, would be to assume a change in policy.

/13. As part

53

13. As part of the transition to cash planning, the Cabinet recently established "illustrative working assumptions" for the cash factors for 1982-83 and beyond, of 7%, 6% and 5%. If by the autumn of this year there were to be a clear shift - either up or down - in the prospects for the rate of inflation, then there is a likelihood that these cash factors will be adjusted. For the purposes of the forecast some assumption needs to be made about the extent of the adjustment. If inflation in 1982-83 and beyond looks like turning out higher than expected in May when the cash factors were first established then it is proposed to assume that the cash factor is increased correspondingly (except that the first ½ or 1% of any excess in 1982-83 would be disregarded). The alternative approach would be to assume less or no change in the cash factors as the inflation forecast changes. The most obvious drawback here is that it could build into the forecast the assumption of a possibly substantial squeeze on the volume of expenditure, and present an unduly favourable picture of public expenditure and the PSBR, i.e. that it would assume the success of what could well be a difficult policy line. For this reason PCC thought that the forecast should be presented on the first basis. If inflation were to turn out higher than allowed for in the cash factors, and the cash factors succeed in restraining cash expenditure, then the result would be a reduction in expenditure and in the PSBR, by comparison with the forecast.

Local authority current expenditure

14. For 1981-82 and subsequent years, forecasting judgements, made in conjunction with other Treasury divisions and DoE, will involve assessment of the extent of local authority overspending, the scale of reaction through the RSG and the pay prospects for local authority employees. A £½ billion grant reduction will be assumed for 1981-82; it is proposed to assume further RSG cuts for future years if overspending seems likely to continue. Although it will be important to identify these overspends, they will not be charged to the contingency reserve.

Demand-determined expenditure

15. Of total central government expenditure - leaving out grants to local authorities - over half is demand-determined and not cash

/limited,

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limited, much of it social security. In all these areas, the projection of public expenditure will be consistent with the economic forecast as it emerges. There will be differences from the White Paper figures, as a result of changes in such factors as unemployment and interest rates. These differences will be identified, and included in the forecast totals of public expenditure but not charged to the contingency reserve.

16. For social security, the forecast will reflect the particular decisions already announced - such as 9% upratings in November 1981 - and the general rules for uprating benefits in line with the forecast increase in prices. It is proposed to assume that national insurance contribution rates are increased in April 1982 in order to bring the income and expenditure of the Fund back into balance: recent estimates suggest that an increase in the joint contribution rate from 17.95% to about 19% will be needed. It is usual to assume that the increase in the contribution rate is split equally between employees and employers.

Conclusion

17. I should be grateful for your early authority to go ahead on the basis of the policy assumptions specified in this minute.

HPE

H P EVANS

2 June 1981

1a

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cc: Mr H P Evans

CHIEF SECRETARY)
FINANCIAL SECRETARY)
MR RIDLEY)

POLICY ASSUMPTIONS FOR THE SUMMER FORECAST

The Chancellor would be grateful for your comments on Mr Evans' submission of 2 June.

JW

A.J. WIGGINS
3rd June 1981

17

56

F.3

CHANCELLOR

Other comments awaited

cc Chief Secretary
Financial Secretary
Mr H P Evans

POLICY ASSUMPTIONS FOR SUMMER FORECAST

Mr Wiggins' minute of 3 June asked for my comments on Mr Evans' minute of the previous day. They are:

(1) I feel that it is particularly important that there should be some variants, as Mr Evans suggests in his paragraph 2. I seem to remember the proposal being made for the last round, but that time or resources prevented any variants being run or, at the least, reported on. This time it would be worth having them accorded higher priority.

(2) The variants I would want examined are:

(a) A low/falling oil price case - [with the major change beginning around the end of this year.] It's started?

(b) A "high wages" case. This would be the formal analysis of the consequences of something like the following events:

NUM win 15% in Nov '81; private sector earnings increases in the '81/82 pay round come out at 11%; NIs at 13%.

(c) A progressive failure to control public spending, with a progressively increasing overshoot of present plans in '81/82, '82/83 and '83/84. How precisely that arises and is dealt with could be most important. I am thinking primarily in terms of volume not cost; and of some attempt being made to stick to the MTFS, PSBR and money supply figures.

(3) Finally a small point. Is it realistic to make any firm assumption about the civil service strikes at this stage? Indeed is it necessary?

AR

ADAM RIDLEY
3 June 1981

·pa 18

57

29022

10 DOWNING STREET

CH/EXCHEQUER

REC.	-3 JUN 1981
ACTION	
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From the Private Secretary

3 June, 1981

You wrote to the Prime Minister on 7 May about the approach adopted by the Inland Revenue to collection of your company's tax arrears.

Mrs Thatcher has asked me to assure you that she fully understands the liquidity problems now facing many businesses. However, she regrets it would not generally be right to see the retention of money due to the Exchequer as an acceptable way of meeting the problem. The commencement of recovery proceedings will be the usual consequence of consistent delays in the payment of tax liabilities properly due under the law.

Mrs Thatcher does not think it would be right to comment about your company's tax arrears whilst legal proceedings are under way. But she hopes that the developments in the company's business which you described in your letter will enable the company to meet its tax arrears without further delay.

W. F. S. RICKETT

D Evers, Esq

19

10, DOWNING STREET,
WHITEHALL S.W.1

With the Private Secretary's Compliments

10 DOWNING STREET

From the Private Secretary

3 June 1981

CH/EXCHEQUER
REC. - 2 JUN 1981
ACTION
COPIES TO

29617

You wrote to the Prime Minister on 4 April enclosing some correspondence about the arrangement for collection of Schedule D tax due from your business.

Mrs. Thatcher is, of course, very much aware of the cash flow problems which many small businesses are facing at the present time, and the Inland Revenue have said that where a business has met with some temporary financial difficulty the Collector of Taxes would normally be prepared to consider allowing a little latitude over payment of its tax liabilities. At the same time, however, it remains the Collector's duty to ensure that as far as possible tax is paid on the due dates, and to that end taxpayers must be expected to arrange their affairs so that their tax bills can be met promptly. I am afraid there can be no question of any general departure from this principle because of the present economic situation.

You acknowledge in your letter that the Schedule D tax due from your business is properly payable in two instalments each year, that is, on 1 January and 1 July. Although the Collector has evidently been accommodating about your requests to settle these liabilities by monthly instalment for some time now, I am sure you will understand that this is not a situation in which he would be justified in allowing to continue indefinitely, and that in seeking recently to obtain payment on the two dates the law lays down, he has been doing no more than his job.

As regards the interest charges which you have been asked to pay, the Inland Revenue have said that whilst it is open to a Collector in certain circumstances to make some concession over payment of tax, he has no such discretion about charging or not charging interest in particular cases. Under the present rules, interest runs automatically from the date on which tax first becomes due until the date on which it is paid. This can mean that where a Collector allows a taxpayer to spread the payment of his tax liabilities over a period of time, a charge for interest then arises, but this charge should be seen simply as providing a measure of financial recompense to the Exchequer for the time it is out of the money due to it.

/ Although

60

Although interest is bound to run whenever tax is paid late, there is a de minimis limit below which the Inland Revenue do not normally pursue the collection of a charge. For an assessment made on or after 2 August 1980, this limit is £30, but for assessments made prior to that date, the figure is £10. The Inland Revenue have said that your assessment for 1979/80 was made on 18 February 1980, and this means, I am afraid, that the interest of £28.09 which accrued on the tax charged must stand.

I am sorry I cannot send a reply which you would find more welcome, but I hope that what I have said will help you to understand the position.

W. F. S. RICKETT

Mrs Dianne Hall

pwp

20

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CST commented agreeing with H. Evans. JW 5/6

CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

CHANCELLOR

cc Chief Secretary
Minister of State (C)
Minister of State (L)
PCC
MEG
Miss M P Brown
Mr Riley
Mr Sedgewick
Mr Mowl
Mr Ridley
Mr Cardona

Place with papers + summary note

POLICY ASSUMPTIONS FOR THE SUMMER FORECAST

The Financial Secretary has seen Mr Evans' submission to you of 2 June 1981. He thinks it might be helpful, if it does not involve to much extra work, to have the forecast done on two alternative assumptions:-

(a) the income tax increase proposed in paragraph 10; — Not clear either

(b) no real change income tax, the burden borne by increase rates instead.

Not clear: but if he means VAT, then that's better

D.L.W.

D L WILLETTS
4 June 1981

J.W:
OK
As for variants, certainly consider - & give
2 or 3 variants of H. Evans - A. Rise 2(a) + (b), +
whatever can be distilled from FST's mind!
I daresay forecasters will have their own options

21

4/6/81

copy to ~~Mr. Aaronson~~ pwp 8/5/6

62

cc PPS
PS/CST
PS/FST
Mr Kemp
Mrs Gilmore
Miss Peirson
Miss Woods
Mrs Case

Again to note in [illegible] speech

MR SPRINGTHORPE

SHORE PROPOSALS TO BOOST PUBLIC SECTOR INVESTMENT

Mr Shore's speech to the Chartered Institute of Public Finance and Accountancy yesterday is reported in today's FT. He is reported to have set out a list of public sector investment projects and argue that they would be financed with an (unspecified) increase in the PSBR but without any adverse effects on interest rates or inflation. We have only seen press reports of his speech and have not had the time or information to carry out a full appraisal, or costing, of his proposals. A commentary on the specific projects mentioned in the report is attached.

2. Some general points to make are as follows:

- Mr Shore admits his proposals will increase the PSBR but makes no estimate of the adverse consequences for interest rates or private sector investment. He claims that a higher PSBR will not increase inflation.

- Some of his projects (eg expanded road programmes and public sector housing) do not necessarily provide benefits which outweigh their costs

- Government does not reject extra capital expenditure in public sector where this can be justified in terms of a economic return, and when it is consistent with overall macro objectives.

- It is not clear that the case for extra public capital spending has been adequately made out. Priorities must be decided primarily in terms of services, to which current spending may be no less important than capital.

A. Smith

A SMITH
EB
4 June 1981

LISTING OF MR SHORE'S JUNE 3 PUBLIC SECTOR INVESTMENT PROPOSALS

	Proposals	Comments
1.	Electrification of railways	(i) BR's plans would involve some £$\frac{3}{4}$ billion (1980 Survey Prices) over twenty years. (ii) Joint BR/Dept. Transport study currently being considered by Government.
2.	Faster expansion of British Telecom	(i) 1981 PEWP already allows for capital spending of over £1$\frac{1}{2}$ billion (1980 Survey Prices) in 1981-82 and a further £1$\frac{1}{2}$ billion in the next two years. The EFL for 1981-82 has already been increased by £200 million to maintain planned programme.
3.	An advanced housing programme	(i) To restore programme for 1981-82 to Labour's last PEWP plans would require about extra £1 billion (1980 Survey Prices) (ii) More cost effective to make better use of existing stock; local authorities, on own initiative, channelling resources to improvements not new building. (iii) Households and dwellings in best balance since war.
4.	Expanded hospital and prison building	Hospitals (i) Government committed to mantaining expenditure on health services. (ii) Expenditure on health services should be focus of attention; not technical distinction between capital and current spending. Prisons (i) Approval given for 2 new starts a year to 1983-84 (ii) Requirements beyond 1983-84 under review.

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	Proposals	Comments
5.	New investment in water and sewerage systems	(i) In approximate 1980 Survey Prices, Labour's plans would have implied about £170 million extra expenditure for 1981-82
6.	Advancing road programme	(i) Strategic network largely complete; correct to emphasise switch to by-passes
7.	Increase capital spending on inner cities	(i) In approximate 1980 Survey Prices Labour's plans would have involved about £35 million extra expenditure in 1981-82

Mr Gieve for advice please

cc Mr A White (55)

65 22

From Sir John Sainsbury Chairman & Chief Executive

SAINSBURY'S

J Sainsbury Limited
Stamford House
Stamford Street
London SE1 9LL

01-921 6000

Telex 264241

Top copy CH/EX

12/6

For comment & proposed reply

30016

8th June, 1981

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

Dear Geoffrey

Anya and I did so enjoy seeing you and Elspeth over the weekend and showing you round Preston.

I promised to let you have a note on the difficulties of attracting school leavers for part-time work. As you will see from the attached memorandum, all earnings above 75p a day are offset against unemployment benefits. This means that a school leaver aged 16 to 18 would gain very little if any advantage beyond the 75p a day for working up to, say, 15 hours a week.

My colleague and Deputy Chairman Roy Griffiths, who meets with Jim Prior from time to time on industrial relations matters, mentioned this to his Private Office and understands that the point has been raised by Jim with Patrick Jenkins.

I do hope that this information is of help to you.

Yours

John.

P.S. Rumour has it in this building that the 75p dates back to decimalisation and has not been changed since!

66

R.A. Clark　　　　　　The Chairman/Mr. E.R. Griffiths

24th March, 1981　　　　6058

BRANCH PART-TIME SHIFTS

I noticed in the last Directors' Branch Committee Minutes the requirement that I investigate the use of unemployed young people for this work. As you know, part-time shifts vary in length from 2½ - 3½ hours on each of 3 days a week in the case of early morning shifts to 3 hours in the evening for up to 5 days per week. Unemployed people under 18 are entitled to a level of benefit either as Social Security or Unemployment benefit. They can earn up to 75p per day without affecting their level of benefit. Above that, their benefit is reduced pound for pound according to their earnings.

Accordingly, we find that there is little interest in such work at such hours for 75p per day.

pwp 23

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cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Burns
Mr. Byatt
Mr. Middleton
Mr. Brittan
Mr. Bridgeman
Miss Brown
Mr. Cassell
Mr. Dixon
Mr. Kemp
Mr. Monck
Mr. Riley
Mr. Sedgwick
Mr. Mowl
Mr. Ridley

MR. H.P. EVANS

POLICY ASSUMPTIONS FOR THE SUMMER FORECAST

The Chancellor has considered your submission of 2 June, together with the views of the Financial Secretary and Mr. Ridley.

2. He agrees that the forecast should be done on the basis of the assumptions you propose. No doubt the forecasters themselves will have some views on the most useful variants. For his part, he would interested in the falling oil price and "high wages" cases suggested by Mr. Ridley; presumably you will be discussing further with the Financial Secretary's office the interpretation of the alternative assumptions suggested in Mr. Willetts' minute of 4 June.

JW

A.J. WIGGINS
8 June 1981

J11/6 TOP ACK cw44 CH/

CH/EXCHEQUER
REC. 11 JUN1981
ACTION RS/IR.
COPIES TO

68 24

.EPHONE
01-606 1234
TELEX 261461/2

NEW CARMELITE HOUSE,
CARMELITE STREET,
LONDON, EC4Y OJA

10 June 1981

The Rt. Hon. Sir Geoffrey Howe, PC.,MP.,
HM Treasury,
Great George Street,
London SW1.

29026

Dear Geoffrey.

When we had lunch before the interview you were kind enough to do for Money Mail, I said I would let you have readers letters about the small business legislation and what more could be done.

Accordingly, I enclose a batch of letters from readers, all of which I have acknowledged and some of which, I imagine, are out of date because of the changes in the proposed legislation announced while I was on holiday. However, they may be of some help.

I look forward to seeing you again soon.

Yours sincerely,

Patrick

Patrick Sergeant

Chancellor

The batch referred to was at least 3 ins thick! I have asked officials to consider them and to produce a summary of the main & most interesting points.

RIT 11/6.

on which we shd hang a short-ish personal reply to P.S.

25

10, DOWNING STREET,

WHITEHALL S.W.1

69

With the Private Secretary's Compliments

pmp

70

2994?

10 DOWNING STREET

THE PRIME MINISTER

CH/EXCHEQUER

REC.	11 JUN 1981
ACTION	
COPIES TO	

10 June 1981

Thank you for your letter of 14 April with which you enclosed a copy of a letter you had sent to Geoffrey Howe about work incentives. I am sorry that I have not replied before. You will, I think, by now have received a substantive reply from Geoffrey Howe and I do not think there is a great deal that I would want to add to that, except to emphasise the importance that I do attach to solving the incentives problem and to stress that I share Geoffrey Howe's disappointment that tax allowances could not be increased in the last Budget. Equally, I share his belief that in the circumstances it was right not to increase these allowances, and that this Budget will help to restore a sound and vigorous economy which is essential if the incentives problem is to be solved.

(SGD) MARGARET THATCHER

Ralph Howell, Esq., M.P.

26

10, DOWNING STREET,

WHITEHALL S.W.1

72

With the Private Secretary's Compliments

pa

CH/EXCHEQUER
REC. 15 JUN 1981
ACTION
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73

10 DOWNING STREET

From the Private Secretary

12 June, 1981

30037

You wrote to the Prime Minister on 22 May about VAT repayments due to Vural Limited being delayed because of industrial action by computer staff at the Customs and Excise computer centre in Southend.

I regret that Customs and Excise cannot at present make repayments of VAT because all VAT returns from traders are normally processed on the computer at Southend, but this work was halted as from 9 March because of industrial action taken by data processors. Customs and Excise have explored the possibility of making repayments manually, but the size of the operation - about 10,000 repayment claims a day are received in random order - rules out any question of making repayments manually, even on a selective basis. Moreover, information about traders' returns is stored on the computer so that it is not possible to validate specific outstanding claims; nor is there valid means of distinguishing between claims in order, for example, to deal separately with claims from a particular class of trader or those where genuine hardship exists. Once the industrial action is over, Customs and Excise will do all they can to see that repayments are resumed as quickly as possible.

However, although VAT is distinct from income tax and national insurance contributions collected under pay-as-you-earn arrangements Collectors of Taxes will have regard to difficulties facing businesses because repayments of VAT are being delayed. They will not take precipitate action to collect pay-as-you-earn payments falling due where there is a genuine temporary difficulty about paying in cases of this kind.

In her statement in the House of Commons on 5 May the Prime Minister explained that Customs and Excise would, on request, confirm to a trader's bank that the business in question was normally in receipt of regular payments and that as soon as the industrial action was over all valid claims would be met as a matter of urgency. At that time this information was being supplied by the VAT Central Unit in Southend. Subsequently operating staff at Southend took strike action over a quite separate issue, and the work had to be transferred to local VAT offices. Customs and Excise are sorry that when the officer at Holborn received your letter of 11 May he had not been briefed about the changed procedure. However,

/as the

as the officer surmised, the arrangement applies only to businesses which are normally in receipt of regular repayments. The issue of a certificate to the bank was not therefore appropriate in the case of Vural Limited since, I understand, your company normally makes payments of VAT rather than receiving repayments. Nevertheless Customs and Excise regret that the position was not made clearer in the officer's reply to your letter of 22 May to Holborn, and that the reply was unsympathetic.

In your letter of 11 May to the local VAT office you made proposals for the settlement of VAT between your client, Vural Limited, and the company from which he had purchased machinery, Bellows Machine Company Limited. I am afraid that the suggested arrangement is unacceptable - the settlement of VAT on purchases is solely a matter between a purchaser and his suppliers who must, in due course, account to Customs and Excise for the VAT on all the taxable supplies they make.

I know that this reply will be disappointing to you; I am sorry that we cannot do more.

W. F. S. RICKETT

Mr. Mahebub Chatur

27

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CHANCELLOR OF THE EXCHEQUER

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

15 June 1981

Patrick Sergeant Esq
New Carmelite House
Carmelite Street
LONDON   EC4Y OJA

Dear Patrick

Thank you so much for your letter of 10 June and the impressive batch of letters from your readers.

As you say, some of the letters may have been overtaken by the amendments to the start-up scheme which I recently announced in the House. I have, nevertheless, asked my officials to consider the letters carefully to see what common further points are being made.

I hope that with the amendments, the scheme will now command widespread support, as I certainly believe it merits.

GEOFFREY HOWE

76 28

10, DOWNING STREET,

WHI[illegible]HALL S.W.1

C & E letter of
12 June to
R I Tolkien
refers

With the Private Secretary's
Compliments

pa 77

10 DOWNING STREET

From the Private Secretary

16 June 1981

The Prime Minister has asked me to thank you for your telegram of 1 June about the problems caused by delays in VAT repayments.

I regret that Customs and Excise still cannot make repayments of VAT because all VAT returns from traders are normally processed on the computer at Southend, which is now completely shut down because of industrial action. Customs and Excise have explored the possibility of making repayments manually, but the size of the operation - about 450,000 repayment claims which were received in random order are now on hand - rules out any question of making repayments manually, even on a selective basis. Moreover, information about traders' returns is stored on the computer so that it is not possible to validate specific outstanding claims; nor is there any valid means of distinguishing between claims in order, for example, to deal separately with claims from a particular class of trader or those where genuine hardship exists. Once the industrial action is over, Customs and Excise will do all they can to see that repayments are resumed as quickly as possible. In the meantime, however, Customs and Excise will, on request to the local VAT office, confirm to a bank that the business in question is normally in receipt of repayments.

As you are aware, arrangements have been made by DHSS for retail chemists to receive an enhanced payment on account of the amounts due to be paid to them in respect of NHS dispensing. I understand that DHSS are about to issue further advice to family practitioner committees which will

/ allow

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allow an improvement in this enhancement and I hope this will go some way to relieve the immediate problems faced by chemists. DHSS will continue to watch the situation very closely and will consider what further action is necessary should the dispute continue. Currently they have no evidence that any breakdown in the NHS dispensing arrangements is likely.

I hope these arrangements will be of some help.

W. F. S. RICKETT

Lewis Priest, Esq.

CONFIDENTIAL

79 29

~~UNITED KINGDOM TREASURY AND SUPPLY DELEGATION~~

BRITISH EMBASSY

WASHINGTON, D.C. 20008

22 June 1981

A J Wiggins Esq
Principal Private Secretary
to the Chancellor of the Exchequer
HM TREASURY

Dear John,

/ I enclose a personal letter to the Chancellor, to be handled in the usual way.

Yours ever,

John

(J Anson)

CH/EXCHEQUER
REC 24 JUN 1981
~~ACTION~~ SIR D. WASS
COPIES TO SIR K. COUZENS
MR HANCOCK

Enc: 1

24/6

CONFIDENTIAL

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~~UNITED KINGDOM TREASURY AND SUPPLY DELEGATION~~
BRITISH EMBASSY
WASHINGTON, D.C. 20008

22 June 1981

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer

Dear Chancellor,

X1 On 20 April I sent you a copy of the Ambassador's despatch (mainly written by my people here) giving a broad initial assessment of the prospects for President Reagan's economic programme and the US economic outlook. You may wish to have an updated - although still provisional - appraisal.

General

2. The provisional conclusions of the despatch appear to be holding up fairly well. There is still widespread public support for a smaller rôle for government; the proposed expenditure cuts are going well; there has been some deceleration in the rate of inflation; growth prospects in 1981 will be well up to the Administration's expectations and most forecasters expect further growth in 1982. Also, as predicted, the President has now had to moderate his original proposals for personal tax cuts.

3. Reagan has clearly regained the political initiative since his return from hospital, and has shown considerable dexterity in managing the Congressional infighting. He succeeded, for example, in moving to his modified tax proposal without losing credibility for the programme as a whole. The electorate are however beginning to appreciate how the proposed expenditure cuts may affect them. The Administration's proposals for modifying retirement benefits for those retiring in future, in order to keep the social security system solvent, quickly ran into trouble on the Hill. They are cited in the latest Gallup poll as a reason for a quite sharp drop since May in popular approval of his handling of his Presidential duties (see the attached interesting article by Gallup). As time runs on the political lobbyists will also be forming up.

4. Reagan has a strong interest therefore in keeping up the momentum and pursuing his tactic of driving wedges between the Democratic opposition and calling on them to respect the electorate's decision last November and pass his programme into law before the summer holiday. So far the Democrats have not managed to pick themselves up after their electoral defeat and present a coherent front, even in the House where they retain a majority. But actually to get the whole programme through all the Congressional procedures before the summer holidays would be a very difficult task which will further severely test Reagan's acknowledged skills as a communicator.

/Expenditure

81

Expenditure Cuts

5. The Congressional committees responsible for various areas of expenditure have now produced, more or less on time, their proposals to reconcile existing legislation with the lower expenditure levels required under Reagan's programme. In the House some of the committees have included some potentially phoney savings: e.g. imposing artificial expenditure ceilings under existing legislation without changing the permanent legislation (so that supplementary provision would almost certainly be required to fulfil statutory obligations and the way would still be open to increase expenditure in later years). Reagan is making further determined efforts to ensure that the expenditure ceilings are adequately supported by permanent changes in policy. Basically the position remains that for FY82* the bulk of his proposed cut will almost certainly be implemented.

6. As far as the unidentified cuts for FY83 and beyond are concerned, however, the picture at this stage does not appear so bright. A major reform desired by the Administration, the transformation into block grants of many "categorical" programmes (under which residents of cities and states are entitled to benefits involving open-ended federal expenditure) is being opposed in Congress. While this reform has obvious attractions in terms of greater state autonomy, it is feared that some states might let the programmes die. Moreover, when Secretary Schweiker introduced the changes in social security mentioned in paragraph 3 above, which would also have helped towards achieving the fiscal objectives for the years after FY82, he ran into a solid wall of opposition even in the Republican-controlled Senate, and the proposals had to be dropped. There is also growing awareness of the problem that Reagan's defence proposals may pose, especially if defence programmes escalate in cost. But Stockman is working on these problems, and may come up with at least partial solutions by next year when the FY83 budget has finally to be decided.

Taxation

7. On the tax side, Reagan has now amended his proposals on personal tax, so as to provide for a 25% cut in three stages, rather than the original 30%; and he has put off the starting date to 1 October, so that the present fiscal year is not affected. The point made in the despatch that in real terms the proposals imply very little cut in the burden of personal taxation is reinforced now that the nominal cuts proposed amount to only 25%.

/He

*October 1981 - September 1982

82

He has also somewhat diluted the proposal for accelerated depreciation of business investment. The latest version of the cost recovery programme will provide broadly the same relief to industry over a period, but somewhat less in FY82, thus reducing the prospective deficit in that year.

8. The original idea of having a simple tax bill containing these two fundamental proposals, followed by a second one later this year with other more detailed provisions, now looks less likely to happen (although the Administration deny abandoning the second bill). In order to attract support, President Reagan has now had to accept, as candidates for the first bill, some reductions in inheritance and gift taxes, abatement of the "marriage penalty", increases in savings incentives, reductions in oil royalty tax, and reduced taxes for Americans working abroad. If the first bill becomes this kind of a "Christmas tree" (in the jargon used here), early action on a second will become largely unnecessary.

9. Whether all these new elements will be sufficient to attract enough Democrats in the House to ensure the bill's passage has become a major political issue. A key point of dispute remains whether the present bill will include all three instalments of the personal tax cuts and, if so, whether at least the third year will be subject to any degree of conditionality. To some extent this is an unrealistic debate, since 1 July 1983 (the date of the third cut) is a long time from now, and the entire situation may be different by then. If Reagan's original timetable of passing the first tax bill before the summer holiday is to be met, he may have to find a way to force the issue soon, since the House Ways and Means Committee is reviewing the whole bill in slow time, including suggesting changes to the company tax provisions which earlier were thought to be relatively non-controversial.

Monetary Policy

10. On monetary policy, Paul Volcker has continued to pursue the general policy that he announced in October 1979, and growth in the aggregates has for the most part been within the target ranges. High nominal interest rates, going well above 20% on occasions, have been accepted in pursuance of this policy; and they are still well above the current rate of inflation. Interest rates attract attention here not only because of their importance for the domestic economy and the dollar exchange rate, but also as an indicator of market confidence in the Administration's determination to get inflation down. At this moment the prime rate is back at 20%, having been a little lower; but other rates are generally tending to fall.

/11.

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11. Long-term bond rates have quite recently come down, but this may be partly due to technical factors connected with the timing of public borrowing; and the very large overhang of potential corporate borrowers can be expected to dampen any downward movement. Underwriters have been advising those who want to borrow this year to do so now rather than later in the year in case the decline should prove short-lived. On short-term rates, there is some consensus that they may drift downwards for the next month or so, given the increasing indications that the economy levelled off in the second quarter.

12. There is however as yet no firm consensus that by the end of the year either short- or long-term interest rates will be significantly lower, unless the economy remains sluggish. With the present tight monetary policies, it still appears that interest rates will tend to rise on any strong resumption of economic growth. As the despatch pointed out, it remains difficult to see how the Administration could get as much as the 4.2% real growth they are assuming in 1982 while at the same time getting consumer price inflation down to 8.3%.

Deregulation

13. Although deregulation is regarded as an important element in the general programme, it has received very little publicity. For the present, the main effort seems to be devoted to stopping new regulations rather than rolling back old ones. Some major relaxations in prospective safety requirements have however been made for the car industry.

Recent Economic Developments

14. Real GNP increased by what was almost an embarrassing 2% in the first quarter, much faster than had been anticipated. This strengthened the hand of those who wished to delay or reduce the size of the personal tax cuts, and no doubt was a factor in Reagan's decision to delay the introduction of the personal tax cuts until 1 October. There are no final figures for what the economy has done since then; recent developments are more difficult to interpret because there has been no distinct trend.

15. Preliminary indications from the Department of Commerce are that the economy in the second quarter may in fact have been pretty well flat. The inflation picture is however beginning to look considerably better, with the April increase down to 10% on a year earlier. This is down from the peak of over 14% in April 1980. Most of the recent decline in inflation however reflects softer prices of energy and food. There appears to be no break yet in the increase in wage settlements, with earnings rising at an 11.4% annual rate in the first quarter. Unemployment is now 7.6%, which is slightly above the level it was at the time of the despatch, and it would seem doubtful whether Reagan's programme will reduce this much in the short run.

/The New

84

The New Administration

16 There is not a great deal to add to what I said in my letter in February about personalities in the new Administration. The procedures for making the sub-cabinet appointments are still going very slowly and there are still gaps to be filled. I have the impression that, as I foreshadowed in February, Regan is now consolidating his position as economic spokesman for the Administration and getting generally a better press; while Stockman, although much respected for what he has achieved, is getting less media prominence than he did initially. Ironically, this may be partly because the tax proposals - which are the Treasury's business - have encountered more difficulty, while OMB's expenditure cuts have had a relatively clear passage.

Yours sincerely,

John Anson

(J Anson)

Enc: 1

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The Gallup Poll

Reagan's Job Approval Rate Drops Sharply

By George Gallup

PRINCETON, N.J. — President Reagan's job performance rating has dropped sharply, with 59 percent now approving of Reagan's handling of his presidential duties, 28 percent disapproving and 13 percent undecided.

For two months after the March 30 attempt on his life, Reagan enjoyed the confidence of two-thirds of the American people for his handling of his presidential duties. The latest Gallup Poll, however, shows a 9 percentage point decrease from a mid-May survey, when his positive rating stood at 68 percent.

This decline in approval is nearly matched by a seven-point increase in those who disapprove of the president's job performance, from 21 to 28 percent — the highest level of disapproval noted during Reagan's brief tenure and higher than that recorded for any other president at this point in his administration.

By way of contrast, Presidents Carter and Nixon not only had slightly higher approval ratings at similar points in 1977 and 1969, respectively, but significantly fewer people disapproved of their stewardship.

Analysis of the intensity with which the public holds its views of Reagan's job performance shows that about half of those who approve do so "very strongly" and the other half "not so strongly." Conversely, strong disapproval outweighs moderate disapproval by a 3-to-2 ratio. This pattern of disapproval is unlike that usually found in these measurements, in which moderate exceeds strong disapproval.

Recent Gallup surveys showed Reagan to be personally more popular than his handling of specific problems. The current study, however, suggests that concern over the cuts in social programs, dissatisfaction with the proposed reductions in Social Security benefits and criticism of the tax cuts are now being reflected in the president's lower overall performance ratings.

PRESIDENTIAL APPROVAL RATINGS

FOR REAGAN

	APPROVE	DISAPPROVE	NO OPINION
LATEST (JUNE 5-8)	59%	28%	13%
MAY 8-11	68%	21%	11%
APRIL 10-13	67%	19%	14%
APRIL 3-6	67%	18%	15%
MARCH 13-16	60%	24%	16%
FEB. 13-16	55%	18%	27%
JAN. 31-FEB. 2	51%	13%	36%

COMPARISON WITH PREVIOUS PRESIDENTS (AFTER 4 MONTHS IN OFFICE)

	APPROVE	DISAPPROVE	NO OPINION
REAGAN-1981	59%	28%	13%
CARTER-1977	63%	19%	18%
NIXON-1969	63%	16%	21%
KENNEDY-1961	71%	14%	15%
EISENHOWER-1953	74%	10%	16%

SOURCE: GALLUP POLL

Although the Reagan economic and Social Security proposals have been seen by some to have a disproportionate effect on the less-advantaged segments of the population and the elderly, the president's decline in popularity has occurred about equally in all demographic groups.

For example, compared to a nationwide decline of nine percentage points since the previous survey, Reagan lost six points among Americans under 30 years old, 10 points among 30-49-year-olds and nine points among those over 50. Similarly, the president's popularity fell by eight points among individuals whose family income is $15,000 or more and by nine points among those with family incomes of less than $15,000.

Reagan suffered a loss of popularity not only among Democrats (off seven points), but also Republicans (down five) and independents (down 12) as well.

The latest results are based on 1,515 personal interviews with adults, 18 and older, conducted in more than 300 scientifically selected locations across the nation during the period June 5-8.

For results based on a sample of this size, one can say with 95 percent confidence that the error attributable to sampling and other random effects could be three percentage points in either direction.

8630

10 DOWNING STREET

With the compliments of

MICHAEL PATTISON

Your Ref: ES/39/67/07

pa 87

10 DOWNING STREET

THE PRIME MINISTER

23 June 1981

Dear Julian,

Thank you for your letter of 19 May, with which you enclosed one from Mr. P. Walmsley of 10 Broom Acres, Fleet.

Mr. Walmsley expresses concern over public utility price rises. These prices have indeed risen much faster than prices generally, and this is - I agree - a cause of major concern. The fact is that, as monopoly producers, the public utilities are not subject to the same competitive pressures as most firms in the private sector; and all too often, they simply pass on their inefficiency and rising costs into higher prices without regard for the effect this has on jobs and living standards elsewhere in the economy. This has been particularly true of water and electricity.

I can assure Mr. Walmsley that we are fully conscious of the seriousness of this problem; and while there are no easy solutions, we are doing everything we can to improve the situation. For example, we recently sent consultants in to look at the water authorities' accounts; and as a result of their work, the average increases in charges proposed for 1981/82 have been reduced from 19% to 13%. In the case of electricity, we now have a valuable report from the Monopolies Commission which shows the many ways in which the industry ought to be able to reduce its costs. The biggest factor here is the cost of coal. Despite the set-back earlier this year, we are determined to make progress in taking out high cost pits and making the industry more efficient. In the meantime, we are spending several hundred million pounds in grants to the National Coal Board to enable them to keep down their prices. The Chancellor of the Exchequer also announced selective reductions in energy prices at a cost of some £120 million in the

/ last Budget.

last Budget. In telecommunications, we are bringing in competition by opening up part of the business to the private sector.

I fully share Mr. Walmsley's concern over recent increases in local authority rates. However, the blame for high rates should be put squarely at the door of local authorities. If local authority spending had been in line with Government plans there would have been no reason why rate increases should have been any more than moderate. We are nevertheless taking firm action to bring down local authority expenditure; the Secretary of State for the Environment recently announced that he would impose a cut of £450 million in the Rate Support Grant if local authorities collectively fail to reduce their budgets. For the longer term we are considerating the introduction of measures to bring home to local councils and ratepayers the consequences of extravagant spending policies.

On the question of public expenditure on education, I can reassure Mr. Walmsley that we remain committed to the objective of maintaining and improving the quality of education. In our present economic situation it has, however, been necessary to restrict the total level of expenditure on education to what the country can afford at the present time. In addition, it was sensible to carry out some rationalisation of expenditure on primary and secondary schools since pupil numbers are expected to fall substantially in the next few years. Within the resources available, however, our plans allow for the maintenance of the overall pupil:teacher ratio over the next three years. So far as books and equipment are concerned, our plans in fact allow for a 2 per cent increase each year to 1983-84 in provision per pupil.

I am afraid I cannot agree with Mr. Walmsley's view that we are simply "assisting the Common Market" out of some form of misplaced philanthropy. In fact, as a result of our strenuous negotiations last year with fellow members of the Community, we expect to receive net funds of £700 million in respect of 1980, and some £800 million in respect of 1981. The agreement reached last June also provided for a radical review of the

/ Community's

Community's budgetary arrangements and of the pattern of Community spending. If this review has not of itself solved the UK's budget problem by 1982, the Community is committed to extending the arrangements already negotiated.

Mr. Walmsley also raised the issue of the last by-election in Fermanagh and South Tyrone. Events have moved on since Mr. Walmsley wrote, and we have of course now introduced a Representation of the People Bill in Parliament.

Yours ever

Margaret

Julian Critchley, Esq., M.P.

90 31

10, DOWNING STREET,
WHITEHALL S.W.1

With the Private Secretary's Compliments

10 DOWNING STREET

THE PRIME MINISTER

23 June 1981

Dear Mr. Lamond,

You wrote to me on 5 June about representations you have received from Fire Defender Limited regarding VAT repayments delayed because of industrial action by computer staff at the Customs and Excise computer centre in Southend.

I regret that Customs and Excise cannot at present make repayments of VAT because all VAT returns from traders are normally processed on the computer at Southend which is now completely shut down because of industrial action. Customs and Excise have explored the possibility of making repayments manually, but the size of the operation - about 450,000 repayment claims which were received in random order are now on hand - rules out any question of making repayments manually, even on a selective basis. Moreover, information about traders' returns is stored on the computer so that it is not possible to validate specific outstanding claims; nor is there valid means of distinguishing between claims in order, for example, to deal separately with claims from a particular class of trader or those where genuine hardship exists. Once the industrial action is over, Customs and Excise will do all they can to see that repayments are resumed as quickly as possible. In the meantime Customs and Excise will, on request to the local VAT office, confirm to a bank that the business in question is normally in receipt of repayments.

Moreover, although VAT is distinct from income tax and national insurance contributions collected under pay-as-you-earn arrangements, Collectors of Taxes will have regard to difficulties facing businesses because repayments of VAT are being delayed.

/ They will

They will not take precipitate action to collect pay-as-you-earn payments falling due where there is a genuine temporary difficulty about paying in cases of this kind.

I am afraid that there is no provision in law either for the payment of interest by Customs and Excise in respect of delayed repayments of VAT or for the charging of interest by them on overdue amounts of the tax.

Yours sincerely

Margaret Thatcher

James Lamond, Esq., M.P.

332

10, DOWNING STREET,

WHITEHALL S.W.1

With the Private Secretary's Compliments

pay

10 DOWNING STREET

THE PRIME MINISTER

25 June 1981

Thank you for your letter of 5 June, with which you enclosed one from your constituent Mrs. Joan Wynne-Thomas of Fairchild's, Sadgrove, Bucklebury. I can appreciate the feelings of your constituent, but I would suggest she may have under-estimated the size of the tasks confronting us when we came to office - and also what we have already achieved.

The British economy has for years been bedevilled by failure to adjust to new opportunities and challenges, and by pay settlements far in excess of improvements in productivity. Given these entrenched problems, and the background of world recession it would have been unrealistic to expect solutions within two years. Nevertheless we have made a determined and creditable start to laying the foundations for a recovery in the country's economic prosperity. The rate of inflation - which was on a rising trend when we came into office - has been substantially reduced, and further falls in the year ahead are in prospect. We now have interest rates lower than in most industrialised countries. A new mood of realism has been established in pay bargaining, with many settlements in single

/figures.

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figures. We have freed the economy from controls on prices, dividends, wages and currency controls and in successive Budgets have improved the fiscal regime for business and industry. By establishing a stable financial background, with falling inflation and interest rates, our policies represent a clear change in direction. All this contributes to a climate conducive to enterprise and will enable industry and the economy to benefit to the fullest extent from the next upturn in activity.

The Government is certainly not indifferent to the waste and distress involved in unemployment. But the best way for Government to help the economy and job prospects is to continue to pursue the responsible financial policies set out in our medium term strategy. This will curb inflation and bring down interest rates in due course. The Budget was an important further step in this process.

On the particular point your correspondent made about the North Sea oil, you will appreciate that the benefit of Government revenues from the North Sea are currently being applied to the whole economy for the benefit of the nation. Without the North Sea oil revenues, taxation would have to be higher, or public borrowing would rise again, with consequential pressure on interest rates.

(SGD) MARGARET THATCHER

Michael McNair-Wilson, Esq., M.P.

CH/EXCHEQUER 33
REC. 29 JUN 1981
ACTION
COPIES TO

10 DOWNING STREET

THE PRIME MINISTER

26 June, 1981

30899

Dear Mr Tew,

Thank you for your letter of 3 June.

I should like to start by explaining that the married man's allowance has always recognised the special legal and moral obligations on a married man to support his wife. As these obligations can only exist within legal marriage, there can be no justification in principle for extending the allowance to couples living together. Furthermore, treating cohabitation as equivalent to legal marriage for tax purposes would be very difficult - if not impossible as a matter of administration. It would mean the tax authorities conducting detailed enquiries into the living circumstances of taxpayers. This would not only increase the costs of administering the tax system, but would also be seen by many of those concerned as an unwarranted intrusion into their private lives.

The general question of the current relationship between the taxation of people in different circumstances raises very wide issues. Some of these issues are explored in the Green Paper recently published on the Taxation of Husband and Wife, which touches also on the question of the relationship between the taxation of single persons and the taxation of the married couple. It is of course too soon to speculate whether any solution emerging from the discussion of the issues posed by the Green Paper will also have a bearing on the taxation of couples who are living together but are not married. But certainly if any change were to be made in this field it would only be made after the fullest consideration of the very difficult issues involved.

/Supplementary

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Supplementary benefit, however, is means tested and is intended to provide last-resort help in cases where the head of the family is not in full time work for one reason or another. It is always operated, therefore, on the basis of family units as they happen to be whatever the legal relationship between the couple. Thus when a man is unemployed or sick, a supplementary benefit claim covers the needs of his partner and children as well as himself. Thus a couple who are living together are not treated any better or worse than a married couple. The provision for this treatment of couples living together, whether married or unmarried, is laid down in the Supplementary Benefits Act 1976, Schedule 1, paragraph 3(1)(a).

The system is a coherent one as far as the Department of Health and Social Security are concerned and it would be illogical and indeed impracticable to consider paying benefit to the woman solely on the basis that the man is not automatically entitled to a married man's income tax allowance.

Yours sincerely

Margaret Thatcher

James Tinn, Esq., MP.

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10 DOWNING STREET

THE PRIME MINISTER

26 June,1981

Dear Douglas,

You wrote to me on 27 May enclosing a copy of a letter from Mrs L.M. Brooks of Equipwise Limited about VAT repayments delayed because of industrial action by computer staff at the Customs and Excise computer centre in Southend.

As Lord Cockfield has already explained, Customs and Excise cannot at present make repayments of VAT because all VAT returns from traders are normally processed on the computer at Southend which is now completely shut down because of industrial action. Customs and Excise have explored the possibility of making repayments manually, but the size of the operation - about 450,000 repayment claims which were received in random order are now on hand - rules out any question of making repayments manually, even on a selective basis. Moreover, information about traders' returns is stored on the computer so that it is not possible to validate specific outstanding claims; nor is there any valid means of distinguishing between claims in order, for example, to deal separately with claims from a particular class of trader or those where genuine hardship exists. Once the industrial action is over, Customs and Excise will do all they can to see that repayments are resumed as quickly as possible.

There are, however, two ways in which some assistance can be afforded to businesses who are awaiting VAT repayments. First, Customs and Excise will, on request to a trader's local VAT office, confirm to a bank that the business in question is normally in receipt of repayments and that as soon as the industrial action is over all valid repayment claims will be met as a matter of urgency.

/Secondly,

Secondly, although VAT is distinct from income tax and national insurance contributions collected under pay-as-you-earn arrangements, Collectors of Taxes will have regard to difficulties facing businesses because repayments of VAT are being delayed. They will not take precipitate action to collect pay-as-you-earn payments falling due where there is a genuine temporary difficulty about paying in cases of this kind. I am sorry if these arrangements do not meet your constituent's requirements but regret that there are no legal provisions for loans or special payments to traders awaiting repayments.

I am afraid it is fact that there is no provision in law either for the payment of interest by Customs and Excise in respect of delayed repayments of VAT or for the charging of interest by them on overdue amounts of the tax.

Yours sincerely

Margaret Thatcher

The Hon. Douglas Hogg, MP.

35

10 Downing Street,
Whitehall S.W.1

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With the Private Secretary's Compliments

MFJ 26/6
cc HMT 100

10 DOWNING STREET

THE PRIME MINISTER

29 June 1981

You wrote to me on 30 May, on behalf of Mr. Turner of 3 Ashbourne Drive, Silverdale, Staffs, about tax relief to offset the cost of travelling between home and work.

I am, of course, well aware of the steep increases in home to work travel expenses in recent years, especially where people have had to look further afield in order to find employment, and appreciate that such increases are most unwelcome. However, I must explain that the general rule of our income tax law is that an employee can have a deduction for expenses only if they are incurred "wholly, exclusively and necessarily" in the performance of the duties of his or her employment. The cost of travel to work does not qualify for relief under this rule because it is an expense incurred not in performing the work but in putting a person in a position to perform it.

I can well understand your constituent's desire for tax relief on travel expenses but I feel that there are serious objections inasmuch as there is still an element of choice about where an individual lives in relation to his or her work. From an administrative viewpoint I believe that it is in the national interest to reduce the role of Government

/and

and at a time when public expenditure is being restrained, I believe it is right that there should be a contribution from Central Government administration. We have therefore, announced staff reductions in various Government departments. To introduce a scheme of tax relief on commuter fares would be directly contrary to this policy since it would require an increase in the number of officials to administer it. Furthermore, it would add yet another complication to our fiscal system which above all needs to be simplified.

Finally, and perhaps most importantly, if relief were given (as it would have to be) for all travel-to-work expenses, it would cost the Exchequer £1,000 million. In present circumstances, there is no money available for a tax relief of this kind, and if more resources become available in the future, they should, I believe, be used to reduce the weight of direct taxation all round rather than to give specific reliefs which would only increase the pressure for similar concessions elsewhere.

(sgd) M T

John Golding, Esq., M.P.

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