PO CH/GH/0154
PART. B

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PART. B

1981 BUDGET

ENDS - 17-1-83

DD's 28yrs NAgj 7/3/97

CONFIDENTIAL

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MINISTER OF STATE (LORDS)
TREASURY

MR TOLKIEN
(PS/CHANCELLOR OF THE EXCHEQUER)

cc Mr Middleton
Mr Littler
Mr Ridley
Mr Cropper

RESTRICTED
~~REGISTERED~~ INDEXED GILTS

I have discussed your minute of 9 February to Mr Middleton with the Minister of State (Lords).

The Minister, Mr Ridley and Mr Cropper will be seeing Professor Rose at 3.30 pm on Monday 16 February.

The suggestion that the Minister should see the Government Actuary appeared in your minute of 4 February to Mr Littler. That minute, which incidentally was copied to the Government Actuary as was the Minister's minute of 3 February which on reflection was a serious mistake in view of the content, asked for Mr Littler's advice on the proposal. Accordingly the Minister has been awaiting that advice before proceeding.

Tim Milner

J C MILNER
Assistant Private Secretary
12 February 1981

CH/EX REF. NO. B(81)18

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

PRIME MINISTER

THE BUDGET

There have been a number of developments, some of which we have discussed, since my minute to you of 5 February on the likely shape of the Budget. I thought it would be helpful if I now let you have this further account of how the main decisions stand.

2. As I explained to you on 13 February, the PSBR forecast for next year on "present policies" (which assumes full indexation of the personal tax allowances and of the specific duties, and takes account of the new system of stock relief and the revenue raising measures announced last November) has risen to some £13¾ billion. This compares with an expected outturn in the current year of a similar figure, equivalent to some 6% of GDP.

3. My aim is to reduce next year's PSBR to around £11¼ billion. This would be some 4½% of GDP and therefore a substantial reduction on this year's expected outturn. It is somewhat higher than I had originally intended, but to reach this will itself require a tight and restrictive Budget, which will be criticised for going too far when the economy is so depressed. I do not think it would be feasible, politically or in other ways, to go further. A PSBR of £11-11¼ billion is the ~~lowest~~ highest compatible with some modest decline in nominal interest rates in a monetary setting that would be seen as maintaining the thrust of the MTFS. But I do not need to stress the uncertainties round this central factor.

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CHANCELLOR OF THE EXCHEQUER

4. I should still ideally like to make fresh reductions in total public expenditure next year. But I regret that this does not seem possible, particularly given the implications of the NCB decision, so that the main downward adjustments must again fall on tax.

5. The main tax proposals are:-

(i) Increasing the income tax thresholds and allowances by 7½% rather than the 15% required by the statutory indexation formula. This will reduce the PSBR next year by some £0.9 billion compared with the forecast.

(ii) Twice revalorisation of the specific duties overall. This (again compared with the forecast) will reduce the PSBR by about £1 billion and will have an overall RPI impact effect of some 2% (of which 1% is already allowed for in the forecast). We discussed the detailed package last Friday and I attach a summary of it at Annex A.

(iii) A once and for all bank levy of 2½%. This will raise some £420 million next year and reduce the PSBR by only a little less.

6. These are the main measures to reduce the PSBR. I have been guided in considering how best to assist industry by the need to contain the PSBR and thus ease interest rates. The proposals leave little scope for any substantial package of direct measures to help industry and, as you know, I have had to rule out a reduction in the National Insurance Surcharge (NIS). The cost of a modest NIS reduction (say, 1%) from October could conceivably be accommodated this year, but the full year effect is very considerable (some £700 million for each 1% in a full year) and would unacceptably reduce our future room for manoeuvre.

7. However, it is still possible to find room for some useful further measures to encourage enterprise and to give some relief in the construction and disability fields, and I attach at

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annex B a summary of my main proposals in those fields. They will cost less than £100 million next year but will, I believe, be widely welcomed and will help to maintain the momentum of last year's enterprise package. The business start-up and loan guarantee schemes should be particularly well received. I am also, as you know, proposing some modest further improvements in capital gains tax and capital transfer tax, and I have minuted to you on these separately. (Incidentally, I have also now agreed with Patrick Jenkin that we should increase child benefit by 50p next November - in other words, full price protection).

8. I should like also to be able to respond constructively to the forthcoming NEDC report on energy prices, which will point to substantial discrepancies between prices charged to some industrial consumers here and to those on the continent. There seems no way of reducing the heavy fuel oil duty and avoiding costs under the Frigg contract, but I have asked David Howell to seek the Law Officers' advice. As I mentioned to you the other day, I had it in mind instead to provide some relief to bulk users of gas and electricity on the basis of proposals put to me by David Howell. This would cost around £110 million next year and could probably be found from within the contingency reserve. I am, however, taking further stock of this in the light of the implications of the NCB decisions. This may make it difficult to accommodate the relief on prices without adding unacceptably to the PSBR. But I am considering this further and will let you know the outcome separately later.

9. Although the scope for further net relief to industry is so limited - particularly if the assistance on gas and electricity prices has to be restricted - I think the overall picture, in the circumstances, will not be a bad one to

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present. If we can provide the energy price relief, the total full year cost of all the measures to help industry and enterprise (including stock relief and the capital tax changes) would be around £½ billion (although the stock relief measure, worth £200 million in 1981-82, will bring relief of £600 million in 1982-83). Moreover, we shall be able to take positive credit for shielding hard pressed businesses from the requirements for extra revenue by pointing to the way in which the burden here will have been put on the North Sea, the banks and on persons. The impact will, of course, be all the greater if we are at the same time able to announce a further reduction in interest rates.

10. These are the main decisions and I shall confine any further changes at the margin to the minimum. The indirect tax changes are, of course, now past the point of operational no return, and the income tax changes virtually so. My primary concern will now be with presentation. I am working on a draft of the Budget speech and hope to be able to let you see a copy in the course of next week.

R.I. Tolkien

, for ,

(G.H.) (Approved by the Chancellor and signed in his absence)

23 February 1981

ANNEX A

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INDIRECT TAX PACKAGE

The major Excise duties

	Duty change %	Revenue 1981-82 £m	Revenue Full year £m	RPI impact effect %	Approximate price effects (including VAT)
Beer	38	375	390	0.4	4p on typical pint
Spirits	14½	60	60	0.1	60p on bottle of whisky (off-licence)
Table wine	17	25	25	neg	12p on bottle of table wine (off-licence)
Fortified wine	31	45	45	neg	25p on bottle of sherry (off-licence)
Tobacco	30	490	500	0.7	14p on packet of 20 king-size cigarettes
Petrol	38	910	910	0.6	20p on a gallon (of which about 3p VAT reclaimable by most business users)
Derv	38	270	270	nil	20p on a gallon (of which about 3p VAT reclaimable by most business users)
VED	15	225	225	0.1	£10 on car licence
		2400	2425	2.0	

This package assumes no VAT blocking and excludes any change in the rebated oil duty, of which 60% is accounted for by fuel oil.

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ANNEX B

Enterprise

VAT: raising the registration and de-registration limits for small businesses.

Venture capital scheme: extending last year's scheme to give tax relief for losses on unquoted shares to companies as well as individuals.

Loan guarantee scheme: a pilot scheme for 3 years within a limit of £50 m a year.

A business start-up scheme: a brand new scheme of tax relief for equity investment by outsiders (not the proprietors) in new small businesses (an "Aunt Agatha" scheme).

Corporation tax: raising the profit limits for the 40% small companies' rate from £70,000 to £80,000 and considerably easing the transition above that level to the full 52% rate.

Small businesses initiative: I shall also use the Budget Speech to launch the idea of a major initiative to help small businesses, including rationalising existing Government agencies in the field, publicising much more effectively the various tax and other incentives available, and generally encouraging people to think seriously about starting their own businesses.

Construction

Development land tax: I am considering a package of measures to ease the burden of DLT where the shoe pinches most.

Industrial buildings allowance: a (possible) increase from 50% to 75%.

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ANNEX B (CONT)

Disability

Double the income tax allowance for blind persons to £360.

Make a real increase in the mobility allowance to £16.50 a week.

Charities: introduce a number of small reliefs from VAT, including an extension of the zero-rating for items donated to hospitals and zero-rating for car adaptations to suit disabled drivers.

Unemployment benefit: increase income disregard from 75p to £2 per day to encourage part time work in aid of the voluntary sector.

Medical insurance provided by employers: no longer to be taxable in the hands of the lower-paid.

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cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Burns
Sir Anthony Rawlinson
Mr. Ryrie
Mr. Middleton
Mr. Battishill
Mr. Cassell
Mr. Kemp
Mr. Monck
Mrs. Stamler
Mr. Boulton
Mr. Folger
Mr. Wren-Lewis
Mr. Ridley
Mr. Cropper
Sir Douglas Lovelock - C&E
Sir Lawrence Airey - I/R

MR. UNWIN

ILLUSTRATIVE BUDGET PACKAGES

The Chancellor was grateful for your note of 6 February. He has suggested that the presentation could be further simplified by restricting the information to three columns - PSBR (first year), PSBR (full year), effect onnon-oil corporate sector. He would exclude the 2 per cent corporation tax cut, which he regards as not a very serious runner.

2. As to the point that the Government's critics will undoubtedly make what capital they can of what they would describe as the "deflationary" effect of a PSBR-reducing package, the Chancellor regards this as inevitable; he has asked whether the net effect of the whole package on the PSBR would offset the "direct" effect of the reductions in corporate tax payments. I take it that this is a question you will only want to answer in the context of a simulation?

JW

(A.J. WIGGINS)
9 February 1981

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cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Burns
Mr. Ryrie
Mr. Middleton
Mr. Byatt
Mr. Battishill
Mr. Dixon
Mr. Unwin
Mr. Griffiths
Mr. Folger
Mr. Ridley
Mr. Cropper
Mr. Cardona
PS/Sir Lawrence Airey

PS/CUSTOMS AND EXCISE

MULTI-ANNUAL INDEXATION OF SPECIFIC DUTIES

The Chancellor was grateful for Sir Douglas Lovelock's minute of 6 February. He has commented that a mechanism for the more frequent revalorisation of the specific duties clearly cannot be introduced in the forthcoming Budget. Nevertheless he sees some attractions in such a system, although these are limited by the need for three or four overt moves by the Government to increase taxes every year.

2. The Chancellor has asked whether there is no way - notwithstanding the decision on the general issue - of valorising at least petrol on the lines of VAT. Could there be an ad valorem specific duty on petrol?.

JW

(A.J. WIGGINS)
9 February 1981

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cc: PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr. Ryrie
Mr. Burns
Mr. Bailey
Mr. Middleton
Mr. Battishill
Mr. Bridgeman
Mr. Unwin
Mr. C.D. Butler

PS/Inland Revenue

MR. KEMP

CHILD BENEFIT

The Chancellor has seen Mr. Locke's minute of 5 February recording the Financial Secretary's reaction to the tactics on child benefit set out in your note of 3 February.

2. Whilst he accepts that the Financial Secretary might be right in fearing that insisting on reducing the clear water between Supplementary Benefit children's rates and Child Benefit would be more likely to result in a higher rate of child benefit, he is not wholly dissuaded from adopting Mr. your Kemp's approach. He is however conscious that on all the previous occasions on which he has run the argument the DHSS have always seemed to have won, and easily at that! He would therefore be grateful if you would consider further how most effectively he might return to the question of the cash differential between children's rates and child benefit, without adding to the case for a higher rate of child benefit.

R.I.T.

(R.I. TOLKIEN)
9 February 1981

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cc: Chief Secretary
Financial Secretary
Minister of State (L)
Sir D Wass
Sir K Couzens
Mr Ryrie
Mr Burns
Mr Battishill
Mr Dixon
Mr Monck
Mr Unwin
Mr Ridley
Mr Cropper

MR MIDDLETON

RIGs

The Chancellor recalls that at various points during the discussions about RIGs it was proposed that Lord Cockfield might talk to the Government Actuary and Mr Ridley to Professor Rose to find out what their views were. He wonders whether such conversations ever took place and, if so, what was their outcome. In the same vein, he thinks it might be useful if some suitable official were to talk to Dryden Gilling-Smith, the pension pundit, who argued in favour of indexed bonds in Saturday's FT.

2. He is also concerned that commentators might see some inconsistency between, on the one hand, the Government's reaction to Scott that the extension of indexation of pensions was unrealistic in the present economic circumstances, and, on the other, an announcement in the Budget that the Government would be issuing restricted indexed gilts. He also thinks that people might see the issue of RIGs so soon after Scott's recommendation that such instruments be issued as in some way having been prompted by Scott. He would welcome advice on the likelihood of these inferences being drawn and, if so, whether this should cause Ministers to reconsider the decision to proceed with the issue of an RIG.

R.I.T.
R.I. TOLKIEN
9th February 1981

BUDGET CONFIDENTIAL

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cc: Minister of State (C)
Minister of State (L)
Mr. Battishill
Mr. Corlett
Mr. Cropper
Mr. de Waal - Parl. Counsel
Mr. Green - I/R
PS/Inland Revenue

MR. BEIGHTON - INLAND REVENUE

THE GREEK SHIPOWNERS AND CTT

At today's morning meeting Ministers considered, on the basis of the Minister of State (L)'s minute of 4 February and your note of 9 February, the case for exempting Greek shipowners from liability to CTT on their worldwide assets as a result of the deemed domicile provisions.

2. It was agreed that it would be very difficult to include a provision in this year's Finance Bill to exempt Greek shipowners from CTT. They also thought however that consideration should be given after the Budget to seeing whether there was not some solution of more general application to this problem.

R.I.T.

(R.I. TOLKIEN)

10 February 1981

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CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Minister of State (L)
Sir Douglas Wass
Mr. Ryrie
Mr. Middleton
Mr. Battishill
Mr. Corlett
Mr. Cropper

PS/Inland Revenue

MINISTER OF STATE (COMMONS)

STAMP DUTY THRESHOLDS
MORTGAGE INTEREST RELIEF CEILING

The Chancellor has seen your minute of 6 February in which you argue for an increase in the stamp duty threshold to £22,000 and for an increase in the threshold of each band by £2,000. He notes that you agree that there should be no change in the mortgage interest relief ceiling.

2. The Chancellor would be grateful to know first the cost of the further stamp duty reliefs which we are introducing at the behest of the Department of the Environment to assist sales of council houses or interests in council houses, and secondly the cost of your proposals for threshold changes.

PSJ

P.S. JENKINS
10 February 1981

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cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Ryrie
Mr. Middleton
Mr. Battishill
Mr. Bridgeman
Mr. Burgner
Mr. Kitcatt
Mr. Dixon
Mrs. Case

PS/Inland Revenue

MR. C.G. WARE (Inland Revenue)

DEVELOPMENT LAND TAX

The Chancellor has seen Mr. Matthews' minute of 6 February, conveying the Chief Secretary's views, and the minutes of 9th February from the Minister of State (Lords) and Mr. Cropper. The question of suspending DLT is one which is to be considered at the Chancellor's Budget meeting on Friday.

2. He continues to be strongly attracted to the possibility of taking action in this area and is fortified by the support of Mr. Heseltine.

3. He has asked that the evidence, from Whitehall and outside, for relief be marshalled in time for the meeting on Friday. He has also asked how many examples have we had of nationalised industry projects being held up because of DLT and how sure we can be that any such delays would end, if the tax was suspended.

R.I.T.

R.I. TOLKIEN
10 February 1981

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10 DOWNING STREET

CHANCELLOR OF THE EXCHEQUER

During a lunch with Union Discount yesterday, two points arose.

First, Union said that they had already started adapting to the prospective MBC and that they could adjust quickly to the new environment. They are switching rapidly from their traditional deposit business to dealers and agents for commercial and public paper. Union is now much more than a discount house and could readily prosper under MBC.

Secondly, the directors emphasised that the market was looking for a much lower PSBR than appeared to be coming out of 1980/81. A "really satisfactory" figure, consistent with "appropriately" falling interest rates, would be about £7 Bn.

25 February 1981

Pslrek
PCA

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F.9

CHANCELLOR

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir D Wass
Mr Ryrie
Mr Burns
Mr Byatt
Mr Middleton
Mr Unwin
Mr Battishill
Mr Dixon
Mr Griffiths
Mr Cropper

Sir Douglas Lovelock)
Mr Phelps) C&E
Mr Howard)

MAINTAINING THE VALUE OF THE EXCISE DUTIES - MORE FREQUENT UPRATING

May I - as an early supporter of the idea - second the proposal made by the CS/T in his minute to you of 29 January on this subject; and take the opportunity to air the issues once again.

2. The case for, say, quarterly indexing is that

(1) You escape the need for the large annual jumps in nominal duty which torture Treasury Ministers every Budget-time, and which have such an unfortunate impact on the RPI.

(2) You would, on my calculations, gain a significant amount of extra revenue. Last June I calculated crudely that quarterly indexing in this financial year (FY) would have brought in an extra £340m if restricted to drink and tobacco; and £550m if extended to cover oil products. With inflation in the coming FY likely to be no more than two thirds of what it was in 1980/81, the extra revenue in 1981/82 would be less - say a litle over two thirds of the above sums, ie £250m for drink and tobacco alone, and £400m if oil is also included. Less, but certainly non-negligible!

(3) Presentationally you could use such a move as a useful if not compelling concession to the anti-sin lobbies, while stopping short of the massive, discrete duty increases which they tend to ask for.

(4) If the idea attracts in broad terms, the alternative to uprating at regular intervals is after specified increases in the RPI. The trigger could, for example, be a growth of 3%, 4% or whatever after Budget Day or the last uprating.

(5) If you were to do this next year, you would not need new legislation, since the Regulator powers offer you enough headroom. However they are, I suspect, far from ideal, and there would be a case for taking more suitable powers in a future Finance Bill.

(6) The Canadians made such a move last year, and you commented on it when you wrote to their Finance Minister recently.

(7) Mr Unwin's minute to you of 31 July 1980, which dealt largely with broader issues of de-indexation, included a discussion of this idea in paragraph 21 and Annex F, which was written by Customs & Excise. Mr Unwin said that,

"The arguments, though not overwhelming, are against this as a feasible option."

In my view the Customs & Excise Annex (F) to Mr Unwin's report did not really substantiate this allegation of (admittedly) mild infeasibility. The key issues emerged in that Annex as:

(a) <u>Extra work</u> (paragraph 4(ii)) The amount was not, however, quantified. Would it be a serious issue? And would not a marginal return of several hundred £ millions (if that is what it is) justify the work, even if the extra burden was significant - for example extra overtime?

(b) <u>Effect on the trade</u> (para 4(iii)) Resistance and complaints are inevitable. Inevitable, not least since they will doubtless see the inconvenience of annual indexation as a splended way of compelling Ministers to gradually lower the real value of specific duties. But that it surely

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no argument. Your defence could be that the alternative is a much bigger annual up-rating.

(c) Effect on prices (para 5) Customs talk of the risks of "rounding up", eg when drink is sold in small quantities. My own view has always been that, unless competition in the affected business is improbably weak, one would expect rounding-up and rounding-down to cancel one another out over time. I cannot agree that systematic upwards bias is probable, as Customs suggest. Taking one year with another, the RPI effects should be no different from annual upratings of the same size, unless there is an effect on wages. Since each quarterly jump is unlikely to add more than ¼% to the RPI next year, this cannot be a major risk.

(d) Yield Customs spoke (para 2) of "marginally higher yield"; and concluded (para 6), "... there must be some doubt about the need for, and cost-effectiveness of, frequent adjustments of the duties except in periods of extremely high inflation". Unless my calculations are systematically wrong, I would suggest that these conclusions should be re-examined. There is a self-evident need for revenue; no reason to believe that the "costs" would be very great; and inflation will not fall so swiftly, even on a very optimistic view of the world, as to render the gain frivolous.

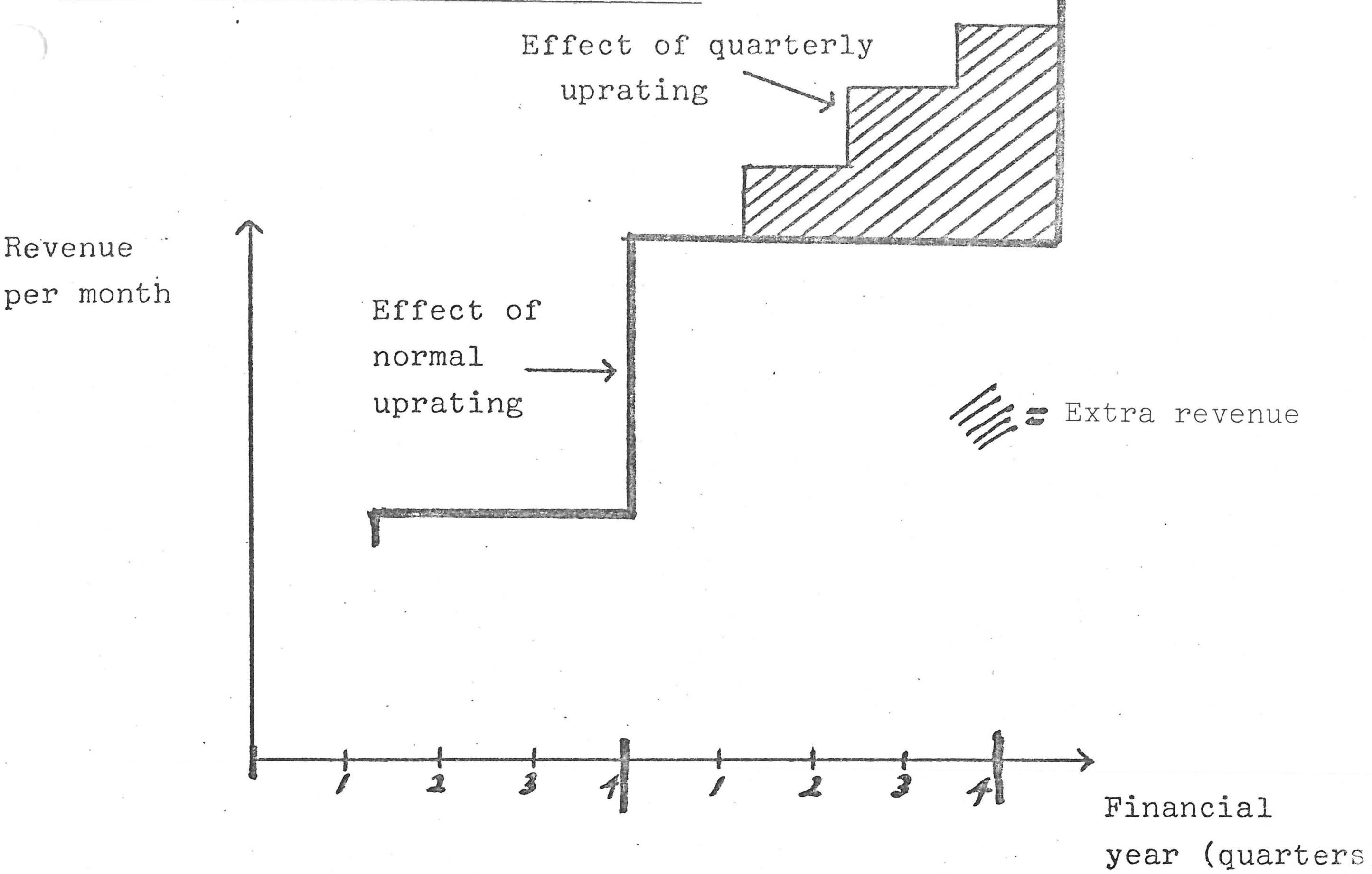
(8) Finally there are the issues of pre-empting, and smoothing the PSBR. With a quarterly system, the scale of any bout of excise duty increases will be much reduced, and the temptation to individuals to pre-empt thus greatly diminished, though not of course completely eliminated. The result should be a marginal but, nonetheless, useful smoothing of the flow of revenue, not least (from "year 2" onwards) a less dramatic fall in revenue from duty immediately after the Budget than has been common recently. One should also note, of course, that quarterly indexing self-evidently makes the path of revenue more buoyant within the quarters of a given financial year.

(9) The attached graph illustrates the proposal in a way which demonstrates the extra revenue it generates.

AR

ADAM RIDLEY
30 January 1981

GRAPH: EFFECT OF QUARTERLY UPRATING



The effect of quarterly uprating on the flow of revenue is given by the hatched area.

Drink and Tobacco alone

Assuming a 16% inflation rate, and an annual flow of revenue from the specifics of [£5,600 million], the quarterly uprating formula would yield 6% more revenue (= £340m) in a year. Its value is obviously greatest at times of high inflation.

Drink, Tobacco and Oil products

In this case the saving would be some £550m.

NB In general, if the Revenue anticipated in the year is £R millions given annual uprating and the RPI increase during the year is p%, then it can be shown that precise quarterly uprating would generate additional revenue of £$\frac{3}{8}$pR millions.

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CH/EX. REF. NO. B(81)5
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NOTE OF A MEETING HELD IN THE CHANCELLOR OF THE EXCHEQUER'S ROOM, H.M. TREASURY ON TUESDAY, 10 FEBRUARY, 1981 AT 10.30 A.M.

Present:

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr. Ryrie
Mr. Burns
Mr. Middleton
Mr. Battishill
Mr. Unwin
Mr. Griffiths
Mr. Gordon
Mr. Cropper
Mr. Ridley
Mr. Wiggins
Mr. Pickering

Sir Douglas Lovelock) Customs
Mr. Phelps) and
Mr. Howard) Excise

The meeting was held to discuss indirect tax options and took as its agenda Mr. Pickering's minute of 9 February.

Smoothing the PSBR: VAT and car tax revenue

2. The Chancellor said that, unless any technical problems arose, the Customs and Excise should plan to implement the scheme for smoothing the flow of VAT and car tax revenue set out in Mrs. Strachan's note of 6 February: the Budget Speech would contain a reference to the scheme.

Multi-annual indexation of specific duties

3. The Chancellor asked for views on the proposal discussed in Sir Douglas Lovelock's submission of 6 February. Mr. Ryrie suggested that more frequent indexation of the specific duties could raise

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additional revenue. Though the Customs had assumed this revenue would be over and above what was obtained from the 1981 indirect tax package, it might be worth framing a proposal that sought no additional revenue in the coming tax year, to achieve a greater revenue in the 1982-83 tax year than might be obtained from the present system of annual changes in specific duties. Mr. Burns said that the political difficulties of changing the duties under the proposed system might be much less than under the present one, though clearly there would be problems when the new system was first introduced. The present system seemed to be a major contributory factor to the failure of specific duties to keep pace with inflation in recent years. Sir Douglas Lovelock thought the political difficulties of the proposed system would be much greater than at present, though this was of course ultimately a matter for Ministerial judgement. Even given automatic multi-annual indexation, Ministers would have to take stock from time to time of whether the duties were set at the right levels. Sir Douglas Wass agreed and added that the major problem raised by the indexation proposal was that it cast doubt on the Government's commitment to reduce inflation. The Financial Secretary said that a proposal to introduce indexation this year seemed wrong in political terms. He favoured as an alternative the introduction of an ad valorem element into the specific duties, analogous to that already in operation for tobacco. The Minister of State (L) suggested that it might be possible to put the excise duties on an ad valorem basis by using posted prices, as in the oil markets, as the basis of valuation. The Chancellor concluded that, multi-annual indexation should not be proposed in the 1981 Budget but Customs and Excise should consider further the Minister of State's suggestion on posted prices.

PACKAGES

4. The Chancellor asked for comments on the C and D packages attached to Sir Douglas Lovelock's minute of 5 February.

5. The Minister of State (L) said that the strongest argument for VAT blocking was the large increase in petrol duty required in

the packages which excluded blocking. It was monstrous that the ordinary motorist should, in effect, finance a business perk, which the Government would never attempt to defend in public. Mr. Battishill said that unfortunately a vicious circle was in operation: if VAT blocking were implemented, this would add to the burden on companies needing to be offset by other measures; but these in turn could only be financed by further increasing the taxes on individuals. The Minister of State (C) said that he continued to favour VAT blocking, among other reasons, as the partial answer to the abuse of free petrol. Many companies could after all avoid the increased VAT burden. The Chief Secretary said he was still opposed to blocking, since many innocent firms and individuals would suffer through the Government's failure to devise another method of controlling the free petrol perk. The Financial Secretary said he was moving away from blocking, because of its effects on business costs. It would have been preferable to end the free petrol perk by changing the car benefits scales: it was unfortunate that that had not proved possible.

6. Mr. Unwin suggested that the attractiveness of VAT blocking depended on what it proved possible to do for business overall. The Chief Secretary agreed: whatever happened, the Budget had to be of benefit, in net terms, to industry. The Minister of State (C) suggested that, when other planned measures to help industry were taken into account, there would be a net benefit. Sir Douglas Wass said that clearly the Budget ought to be of net benefit to industry, preferably a large net benefit, but even if it were, there might still be political criticism because of the effects of VAT blocking on particular sectors of industry.

7. There was a discussion of the relative merits of VAT blocking and the large increases in petrol costs implied by the C and D packages. Sir Douglas Wass said that both raised political problems: in particular, they would hit small businesses hardest, since many larger companies could afford the free petrol perk, even if it were taxed, and they were more likely than small companies to employ vehicles using derv, rather than petrol. The Minister of State (C)

pointed out that the increase in petrol duty had been the most unpopular part of the 1980 Budget. In terms of the number of people affected, increased petrol duty had to be less politically attractive than VAT blocking.

8. There was further discussion of petrol duty. Sir Douglas Lovelock suggested that the increases assumed in the D packages could be held to 12p, if the smaller revenue could be accepted. It was questionable whether a 20p increase would have significantly greater policital costs than a 15p increase; the Government might as well be hung for the sheep. It was noted that a 20p increase would break the £1.50p barrier for a gallon of petrol, though this barrier was bound to be passed sooner or later.

9. The Chancellor asked for views on whether a C or a D package should be chosen. The Financial Secretary said that, given the likely outturn for the PSBR, a D package seemed inevitable. Mr. Burns agreed: the revenue would almost certainly be needed and the additional effect on the RPI was unlikely to be significant: but the recent rapid fall would in any event level out in the spring: thereafter any further decreases in the rate of inflation could only be low. The Chief Secretary did not think that the 0.2 per cent difference in RPI effects was likely to be a deciding factor.

10. The Chancellor asked for views on the relative merits of the three D packages. The Minister of State (L) said that D(ii) seemed more attractive, because of its revenue effects. The Financial Secretary pointed out that the only difference between D(i) and D(iii) was that they had different increases for petrol/derv and VED. The Chief Secretary said that VED increases were likely to incur less political criticism. He favoured D(iii). The Chancellor thought that any of the proposed increases in petrol duties would incur a good deal of political criticism: on balance, D(i) seemed preferable to D(iii).

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11. In further discussion of the packages, the points raised included the following:

(i) The Chancellor asked for comments on the proposal for an across-the-board increase in Vehicle Excise Duty. Mr. Griffiths said that the Secretary of State for Transport would probably be unhappy at a VED increase for a second year running, but, would probably prefer an across-the-board increase to those shown in the 'D' packages.

(ii) Sir Douglas Lovelock confirmed that the Customs were still seeking views from interested Departments at official level on the petrol/derv differential. In later discussion, the Financial Secretary suggested that it would be a mistake to introduce such a differential this year, since the petrol duty increase was already planned to be high, and would have to be even higher to finance a reduced increase in the derv rate, given that no revenue could be spared from elsewhere for this purpose. The Chancellor said that he had just written to colleagues to seek quick comments on this proposals.

(iii) The Chancellor agreed that Customs should submit to the Minister of State (C) on various VAT blocking consequentials for the non-road users of petrol.

(iv) After a brief discussion, the Chancellor concluded that the increase in spirits duty should be no greater than 60p.

12. Concluding the discussion of the packages, the Chancellor said that further discussion of the indirect tax package should be focussed on D(i) and D(ii). The points of detail mentioned in paragraph 11 above should be taken into account in further

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work. The decision on VAT blocking would have to be taken in the context of the overall impact of the Budget on business; it was noted that 13 February was the deadline for VAT structural changes.

(C.R. PICKERING)
11 February 1981

Distribution

Those present
Mr. Byatt
Mr. Folger
Mr. Wren-Lewis
Mr. Cardona
PS/Inland Revenue
Mr. Gracey - I/R

C
You have X, I think.

[illegible] RT

77

CHIEF SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY   cc   see attached note

- Other countries standing [illegible]
- 1 million of [illegible] for public standards

BUDGET SPEECH: DRAFT OF 13 FEBRUARY

The Chief Secretary has seen the draft attached to Mr Unwin's minute of 13 February. He has commented that he thinks it is essential to have a more imaginative section, as he has previously suggested (my minute of 11 February), on the Budget theme. The Chief Secretary still thinks this should be the "launching pad" idea - with a strong section on help to industry. This section should summarise the central objective of the whole Budget - not just leave it to a peroration.

X

2. Relative to this is, of course, the need for a separate "Aid to Industry" section, which would cover this aspect in greater detail.

3. The Chief Secretary has made the following detailed points on the text:-

A2. Examples would help;

A5. Third sentence "monopoly of compassion" - inappropriate here;

A12. Last sentence - too definite;

B2. Second sentence - latest figure?

B10. First sentence - avoid double negative!

B12. Second and third sentences - greater stress on this?

B20. Second sentence in particular - unconvincing I am afraid and better to refer forward to next section;

C15. Fourth sentence - make more of this?

D1. The Chief Secretary would put the last two sentences of explanation first;

D5. Fourth sentence - the Chief Secretary thinks this stark statement is most unwise. Many people will ask: "Why not?".

D6. First sentence - ?

F2. Third sentence to end - the Chief Secretary would replace "to allow for" by "to take account of", but he suggests this should be recast to start off by saying that the aim is to maintain purchasing power: last year too much was given; this year 1% less to make up for it;

F6. Too defensive;

H7. Second sentence - delete "and opportune";

H9. Figures necessary;

H19. The Chief Secretary is not sure that he would seek to make a positive point of this. Why did we get into a mess in the first place?

K1. Last sentence - why put this up front like this?

TM

T F MATHEWS
16 February 1981

29

copy recipients:

Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson
Mr Ryrie
Mr Bailey
Mr Barratt
Mr Byatt
Mr Hancock
Mr Littler
Mr Middleton
Mr Battishill
Mr Bridgeman
Mr Britton
Mr Burgner
Miss Brown
Mr Cassell
Mr Dixon
Mr Evans
Mrs Hedley-Miller
Mr Kemp
Mr Lavelle
Mr Monck
Mr Unwin
Mr Allen
Mr Corlett
Mrs Gilmore
Mr Griffiths
Mr Aaronson
Mr Folger
Mr Kelly
Mr Wren-Lewis
Mr Bush

PS/Customs
Mr Howard - C/E
PS/IR
Mr Gracey - I/R

Mr Ridley
Mr Cropper
Mr Cardona

BUDGET - CONFIDENTIAL

Richard   R/P   7

~~Do you have these pps?~~

~~separate copy Phil~~
~~in my folder~~

FINANCIAL SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Mr Ryrie
Mr Middleton
Mr Battishill
Mr Unwin
Mr P V Dixon
Mr Corlett
Mr Cropper

PS/Inland Revenue
Mr Dalton) Inland Revenue
Mr Isaac)

INCOME TAX RELIEF FOR INVESTMENT IN NEW SMALL COMPANIES

The Financial Secretary has seen Mr Cropper's minute of 17 February, and also Mr Isaac's minutes of 16 and 17 February.

On the main outstanding point, referred to in paragraph 2 of Mr Isaac's minute of 16 February, and paragraph 3 of his minute of 17 February, he considers there to be no case whatever for confining the relief to companies wholly or substantially engaged in manufacturing business.

As to the name of the proposed relief, his preference is "the business start-up scheme".

SAJL

S A J LOCKE
19 February 1981

GF
PCPP

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CHANCELLOR OF THE EXCHEQUER

c c Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Ryrie
Mr Burns

PEX

Mr Evans
Mr Burgner
Mr Unwin
Mr Kemp
Mr Ridley
Mr Cardona

Discussed.

PUBLIC EXPENDITURE AND THE BUDGET

This minute

- responds, negatively I fear, to your request for a fresh search for public expenditure cuts for the Budget;

- reports on the problems created by the NCB affair for the Contingency Reserve and for the public expenditure totals, and the link with the proposals concerning fuel prices.

Mr Ryrie will be minuting separately on this tomorrow.

Scope for fresh cuts

2. I regret to have to say that there is virtually nothing to offer now by way of fresh cuts in 1981-82 which could be announced in the Budget.

3. A small amount could be saved by restricting the indexed increase in public services pensions next November. You are discussing this separately. Apart from that, the technically feasible cut would be the familiar proposal to legislate to cancel the Christmas bonus for pensioners, saving £105m (cash). This has hitherto been excluded on political grounds.

4. For the following year 1982-83 we do envisage cuts. But it is difficult to make much of this in the Budget speech. The

impression is that you have gone as far as you can with colleagues at this stage in getting agreement to the hint in the White Paper, repeated in the present draft for the speech.

5. No more can be done in time for the Budget by the use of consultants as in the water authorities. You have had, and replied to, submissions from Mrs Case about nationalised industries and Mr Bailey about the rest of the field, where the possibility of further follow up is being reappraised, as you have asked. But there will be no savings by this means in time for the Budget.

6. The outstanding decisions for 1981-82 on social security benefits have just been settled with Mr Jenkin. The various employment measures are to be reviewed with Mr Prior in the early summer.

7. We have considered whether in areas subject to cash limits the better outlook for inflation offers scope for volume cuts. Over most of this field the fact that the 11 per cent factor may now be somewhat generous has already been used to persuade your colleagues to stick to the 6 per cent factor for pay. This does not apply to cash limits with little or no pay element, but the main things here are defence procurement, roads and much of PSA.

8. The defence cash limit is to be reviewed with the Secretary of State during the year. The margin in the 11 per cent factor should help to mitigate the extent of upward revision on account of prices, or on account of the practical difficulties in securing the full deduction next year in respect of this year's overspend. A reduction now, even if the Defence Secretary could be persuaded to agree to it, would be reversed in the review and have no effect on the final spend. Both the roads programme and PSA have already been reduced substantially. It would be exceedingly hard to get agreement on a further squeeze. And it would fall on the construction industry.

9. The planning total would be reduced by further special sales of assets. You have pressed the Energy Secretary for a further £100 million at least of receipts in respect of North Sea oil licences. These would reduce both the PSBR and the public expenditure planning total. But the latest letter from Mr Howell said that it would be unwise to count on these licence payments for the Budget PSBR.

Cuts later in the year

10. If not now, could there be crash cuts later in the year, in response to an evident crisis? Does the NCB affair constitute such a crisis?

11. Perhaps. But I do not recommend it. It would be difficult politically. The incidence of such an operation would be erratic and inefficient, and on managerial grounds thoroughly bad. One must question whether the NCB alone would be accepted by colleagues as justifying so extreme a step. It would diminish the chances of making a success of the next survey, working in cash and, we hope, getting some real cuts for the next and later years.

Contingency Reserve

12. Proposals scored against the Reserve do not add to the planning total or to the PSBR. In cash (which I use in this minute instead of the Survey prices of the earlier discussion) we start with a Reserve of £2,300m. Foreseen bids (as mentioned in the minute to the Prime Minister) total £1,650m, within which we had pencilled NCB £130m and industrial support £260m. The remaining £650m has to cover all other charges over the year.

13. I suggested previously that in the Budget you might commit a maximum of half the amount pencilled in for industrial support, i.e. £130m. You decided on help with fuel prices. Mr Howell's original proposals cost £110m. You subsequently asked if he could formulate bigger proposals, going up to £200m. I gather that proposals costing £150m are now emerging.

14. Now we have the NCB problem. The amount is uncertain. Figures are being mentioned of £450m in 1981-82, i.e. some £300m more than we had pencilled in the Reserve. This figure has no status yet, but if what comes out is anything like it, to score it against the Reserve, the normal and natural course, will swamp the Reserve.

15. One might conclude that the proposed package on fuel prices should be entirely cancelled. But that would remove a useful feature of the Budget package, and would not be enough to offset the NCB bid.

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16. A separate submission is being made about the NCB problem. So far as the Reserve is concerned, particularly if the fuel price proposals are to stand, we have to treat the NCB addition as an addition to total public expenditure. Provided it is announced as so treated, it would be defensible, though a bad precedent, not to score it against the Reserve.

17. Alternatively, one could think of scoring the NCB increase against the Reserve and treat the fuel price package as an addition. On balance however I favour so treating the NCB, so as to get the potentially larger amount off the Reserve - an argument which of course cuts both ways.

18. The amount is for consideration. I would go for treating the whole amount in this way, i.e. £450m if the figure mentioned above were correct, partly for ease of exposition, but also so as to free in the Reserve the £130m originally pencilled in for the NCB. That may be useful for other industrial support.

19. This would at least enable us to go into the year with a Reserve which, though tight, is not obviously not viable from the start.

20. But it does add to the total and to the PSBR. And it means that it will not be possible to claim that total public expenditure in 1981-82 will be about the same in volume terms as in 1980-81. It will be higher. That, however, is formally true anyway. The actual totals will also be inflated by the increases in EFLs to take account of the gas levy (British Gas, say £430m) and the oil levy (BNOC, say £100m). These two items (mentioned in Miss Peirson's minute of 14 January on the public expenditure totals) do not add to the PSBR, and their peculiar nature justifies leaving them out of the White Paper and not charging to the Reserve; but they increase the actual expenditure total.

21. My recommendation is that in the circumstances which have now arisen, treating the whole of the present NCB increase as an addition to total expenditure, outside the Reserve, is the least damaging course. Whether and when the amount should be determined, and when and how announced and treated in the Budget arithmetic, is the subject of a separate submission.

AKR

A K RAWLINSON
24 February 1981

BUDGET SECRET

Board Room
H M Customs and Excise
King's Beam House
Mark Lane London EC3R 7HE

24 February 1981

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (Commons)
PS/Minister of State (Lords)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Ryrie
Mr Middleton
Mr Battishill
Mr Kemp
Mr Unwin
Mr Wren-Lewis
Mr Pickering
Mr Ridley
Mr Cropper
Mr Cardona
PS/Sir Lawrence Airey

CARING/CHARITIES PACKAGE

1. I refer to Mr Tolkien's minute of 23 February.

2. To avoid any possible doubt I should record our understanding that the only action to be taken by Customs and Excise in accordance with the decisions at the Chancellor's meeting on 20 February is to implement the package entitled "VAT and Charities" set out in Appendix A to Mr C D Butler's and Mr Corlett's minute of 13 February.

3. These measures can all be implemented by Treasury Order subject to negative resolution, and we are setting this in hand.

A J PHELPS

INTERNAL CIRCULATION:

CPS
Mr Hill
Mr Scholes
Mr Howard
Mr Porter

36

GE
[illegible]

BUDGET CONFIDENTIAL

FINANCIAL SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Sir A Rawlinson
Mr Ryrie
Mr Burns
Mr Bailey
Mr Littler
Mr Bridgeman
Miss Brown
Mr H P Evans
Mr Burgner
Mr Unwin
Mr Kemp
Miss Peirson
Mrs Case
Mr Ridley
Mr Cardona

We [illegible] [illegible] [illegible] - [illegible]. D. En - in the [illegible] [illegible] [illegible]

PUBLIC EXPENDITURE AND THE BUDGET

The Financial Secretary has read Sir Anthony Rawlinson's minute of 24 February, commenting on the scope for fresh cuts in public expenditure for 1981-82, and reporting on the problems created by the NCB affair for the Contingency Reserve and for the public expenditure totals.

For his part, the Financial Secretary has little doubt that we could, if colleagues agree, get more than the £500 million from disposals assumed in the White Paper: an extra £250 million at least looks possible, even without eighth round licences, chiefly from the disposal of gas showrooms and selling a higher stake in Cable and Wireless. But so far such agreement has not been secured.

SAJL

S A J LOCKE
25 February 1981

1759

EF
PCPA

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1. MR LAVELLE
2. FINANCIAL SECRETARY
3. CHANCELLOR OF THE EXCHEQUER

I agree that we should go ahead with the Finance Bill as outlined here and as summarised by Mr Lavelle

cc for: Chief Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Kenneth Couzens
Mr Ryrie
Mr Barratt
Mr Middleton
Mr Battishill
Mr Monck
Mr Unwin
Mr Ridley
Mr Cardona

cc to: Mr Collinson
Mr Corlett
Mr Peretz
Mr Pirie
Mr Perfect
Mr Salveson
Mr C H de Waal (Parly Counsel)
Mr R Armitage (T Sol)
MR D A Dawkins (B/E)

1981 FINANCE BILL: EXCHANGE CONTROL
PROVISIONS TO IMPROVE INFLOW CONTROL POWERS

1. The Financial Secretary agreed before Christmas (Mr Locke's note of 11 December 1980) that new statutory powers should be sought for the purposes described in my submission of 8 December, and that we should get advice from Parliamentary Counsel about including the necessary provisions in the 1981 Finance Bill.

2. We propose repairing the deficiencies for inflow control purposes in our existing powers under the Exchange Control Act 1947 (as amended by the Finance Acts 1968 and 1977) in respect of:

(a) requiring deposits at nil or negative interest to be made with the Bank of England by those taking increased sterling deposits from non-residents;

(b) restricting the acquisition by non-residents of sterling bills of exchange and similar monetary instruments which are not "securities" under the 1947 Act;

(c) controlling the borrowing by UK residents of sterling from non-residents and of foreign currency from any source (including other residents*).

In addition, the Banking and Financial Dealings Act 1971 needs a small amendment to enable dealings in gold and foreign currency to be suspended, if necessary, without having to reappoint authorised dealers under the 1947 Act.

* eg a resident borrowing f.c, for switching into sterling, from a UK bank prevented from switching by our control of its net dealing position.

/3...

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3. Parliamentary Counsel (Mr de Waal) advised that, in view of the 1968 and 1977 precedents, he would not expect the House of Commons officials to raise any objection to including in the Finance Bill a provision about exchange control by means of a procedure resolution (which would fall to be moved on completion of the Budget Statement). He confirmed that including these matters would make it certain that the Bill could not be certified as a money bill under the Parliament Act. He also advised that, while there would be no defence to a charge of "tacking", complaints on that ground would be unlikely if the provisions were found unobjectionable in substance when the Bill gets to the House of Lords.

4. We have accordingly been working out, with the Bank and Treasury Solicitors, the detailed and, in some areas, quite complex requirements so that instructions could be sent to Parliamentary Counsel, as they have been during February. Mr de Waal has drafted the necessary clauses, which he regards as too voluminous to be conveniently inserted in the 1947 Act and so proposes to deal with as a separate Part of the Finance Bill, coming at the end of about 10 other Parts. He has also drafted a procedure resolution as attached. He is including in the money resolution which is needed for the Bill in any case some words to cover the paying into the Consolidated Fund of the Bank's receipts from any negative interest charge (we have satisfied ourselves, in consultation with Inland Revenue, that this would not conflict with the UK's Double Taxation Agreements). Any administrative expense attributable to the new provisions, if they were ever used, would be minimal, so no money resolution is needed for that.

5. It has been recognised (Mr Lavelle's minute of 10 December 1980) that there could be some initial presentational problems in thus seeking these new powers. Some people might think that, until they were on the statute book, the Government would be unable to apply any controls over capital inflows. This would be incorrect: a control package could be introduced at short notice relying on existing powers and on a voluntary arrangement with the banks in respect of interest-free deposits; but it would be less than satisfactory for reasons explained in my submission of 8 December last. Others might suppose that the Finance Bill provisions signalled an intention by the Government to resort to exchange controls over inflows, and this could be a source of some political embarrassment.

6. The Finance Bill provisions could in fact be explained reasonably enough as follows. They represent the first stage in the process described by the Chancellor in his Written Answer of 16 May 1980 of seeking changes in the law to make our

/exchange control...

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exchange control powers more symmetrical as between control of outflows and inflows. Whether or not an occasion at present seems likely when the Government would judge it necessary to apply inflow controls - and sudden severe temporary pressure on the exchange rate due to external causes might be such an occasion - it would be imprudent not to repair as opportunity arose identified deficiencies in the statutory powers, which were originally drafted with an eye to the control of outflows.

7. Another kind of criticism might come from people who believe that no exchange control powers of any sort should be retained. The answer to them remains that, at the least, we need to be in a position, without further enabling measures, to meet the requirements of the EC Council Directive 72/156 on "regulating international capital flows and neutralizing their undesirable effects on domestic liquidity". I should add that, while the new provisions are not essential for meeting those requirements, they would allow us to meet them somewhat more effectively.

8. The House officials have confirmed to Parliamentary Counsel that there is no objection to including the proposed provisions with a procedure resolution. It would be helpful to know as soon as possible whether Treasury Ministers still wish this legislation to proceed as part of the coming Finance Bill. If so, it is suggested that a Treasury Press Notice should be issued, with copies for the Vote Office, when the Procedure Resolution is published on Budget Day. The purpose would be to anticipate enquiries by explaining quite fully what the exchange control provisions are all about and also why they are included in the Bill, on the lines of paragraph 6 above. This would seem appropriate whether or not any brief reference were to be included in the Chancellor's Statement. Depending perhaps on any immediate public or Parliamentary reaction, something might be said to the House of Commons during the course of the Budget Debate.

C H W HODGES

26 February 1981

It would be helpful to know:

(a) that you remain content that we go for these small improvements;

(b) that you are content with the procedural arrangements in paragraph 8.

On (b), I think it would help to underline the technical nature of the change if there were no reference in the Budget Speech itself.

R G LAVELLE

26 February 1981

DRAFT PROCEDURE RESOLUTION

PROCEDURE (EXCHANGE CONTROL): That, nothwithstanding anything to the contrary in the practice of the House relating to matters which may be included in Finance Bills, any Finance Bill of the present Session may -

(a) make provision for the purpose of controlling the acquisition of sterling by persons resident outside the scheduled territories as defined in the Exchange Control Act 1947 and the borrowing of foreign currency by persons resident in the United Kingdom; and

(b) amend the references to authorised dealers in foreign currency or gold in section 2 of the Banking and Financial Dealings Act 1971.

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CHIEF SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY

cc Sir Anthony Rawlinson
Mr Ryrie
Mr Middleton
Mr Littler
Mr Unwin
Mr Bridgeman
Mr Ridley
Mr Cropper
Mr Cardona

BUDGET SPEECH: SECTION J

.... Attached is the Chief Secretary's redraft of the Public Expenditure Section as requested by your minute of 24 February. I let you have it now, to save time, before the Chief Secretary has had a chance to "proof read" the typescript.

TM

T F MATHEWS
26 February 1981

PUBLIC EXPENDITURE SECTION OF THE BUDGET SPEECH

[I understand from Mr Wiggins' memo of 24 February that the 'historical' review is to form part of the opening of the Speech. I have attempted, nonetheless, to rework it, but it is detachable from the rest.]

J1 - as before

J2 - as before

J3 - Public expenditure as a whole has been significantly higher in 1980-81 than expected at the time of the Budget, and slightly higher than I anticipated last November. The cash outturn is now estimated to be about £94,000 million, compared with a Budget forecast of £91,600 million. This amounts to an increase of 22% compared with 1979-80.

J3 There are [three] main reasons for this increase. In the case of some programmes the increased spending has been caused by the form and extent of the current recession. This has obviously led to a substantial increase in spending on unemployment benefit. The increase in social security spending over what had been anticipated is some £700m. In addition, special measures to maintain employment have cost an extra £400 million.

J4 Secondly, there have been specific areas of expenditure where there has been much less underspending in relation to the available cash that can normally be expected and than ~~has been~~ was allowed for. In the case of Defence there has actually been serious overspending. The main reason for this was in a time of recession suppliers have produced and delivered equipment earlier than expected. There has also been overspending by the local authorites and extra borrowing by public corporations. But the £800m increase in the External Financing Limits of the nationalised industries has been taken out of the contingency reserve and has not therefore added to the total of public spending.

J5 The third factor that has resulted in increased public expenditure has been the upward drift of public sector costs, compared with costs in the rest of the economy. Above all, the cost of public service pay has risen faster than that of pay in the private sector. As a result of high pay increases and a slow rundown of employment between 1979-80 and 1980-81 the cost of pay in the public services has risen twice as fast as in the private sector. This figure

Note: This is not an explanation of the excess, valid though the point is in its own right.

reflects not only a comparatively higher increase of earnings in the public sector, but also the fact that the unemployment rate of former public sector employees is 4.2%, compared with 9.4% for the private sector.

J6 Much of the increase in public sector pay was caused by the implementation of the Clegg commitments inherited from the Labour Government, but the trend is a long-standing one. The Department of Employment's New Earnings Survey shows us that comparing 1980 with 1970-72 manual workers had improved their relative position by 8% in the public corporations, by 13% in central government and by 14% in local government.

But the main impact of the Clegg settlements was on the non-manual grades where the relative improvement was only 1%?

J7 The effect of the factors that I have outlined has been that we have not secured the reduction in our predecessors' spending plans that we had hoped to achieve. Nonetheless, the reductions that we have made in those plans have been very substantial, as is clear from the volume of representations made by those who object to their consequences. What has happened is that those reductions, substantial as they are, have been overlaid and exceeded by the other factors, largely associated with the recession, that I have referred to. The next effect of this is that whereas we had intended a 5% reduction in our predecessors' plans this year, we shall secure about two-thirds of that reduction.

J8 In the coming year some of the factors causing higher spending will continue to operate. They were reflected in last November's decisions to spend more on special employment measures and on industrial support and we shall have to pay for the shelving of the accelerated pit closure plans. But I also announced in November further decisions to cut most programmes, reducing planned spending on them in 1981-82 by some [£1400]million cash. Those cuts went some way to effect the increases which would otherwise have occurred.

J9 I should point out that in making cust of this kind I have been following the same policy as that pursued in several other Western countries, where there have been recent announcements of cuts in public spending plans. [Sentences on recent US, Swidish and Dutch cuts, including Swidish posture on breaking automatic indexation link.] It is not, therefore, only we who have to respond in this way, for the economic conditions which have led us to do so are a worldwide phenomenon.

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J10 The effect of our policies next year will be that the volume of our spending will be 5% less than planned by our predecessors, compared with the 8% reduction we envisaged a year ago. [The actual volume will be much the same as this year.] But our decisions should ensure that the volume of spending falls after 1981-82. The Public Expenditure White Paper accordingly shows a fall of 4% up to 1983-84.

J11. But I must stress that the plans for later years - both for totals and individual programmes can be regarded as no more than provisional working targets. Whether we shall be able to spend on that scale depends on whether we can afford to do so. We shall be working very hard at the possibility of further reductions during the annual review of spending plans later this year. If we are able to reduce them, the pressure on the private sector and on interest rates will be correspondingly reduced, to the benefit of the economy as a whole.

J12. The desirability of checking public spending is more dramatically illustrated if one switches from looking at volume to considering cash. This year, as I have said cash spending will be about £94,000 million. In 1979-80 it was . In the coming year it will be £104,000 million. To the extent that this is caused by excessive increases in costs, primarily pay, in the public sector, it can only lead to one of two things: more taxation and borrowing or reduction in the standard of public services. An example will, I hope, bring home that point.

J.13 We are at the moment planning to increase spending on health in real terms. The White Paper plans show it 2½% higher next year than last. But the cost of that in cash terms will involve an increase in actual spending of 40%, because over the two years health service costs are expected to rise by 4% more than costs in the economy generally. The improvement in service involved is dependent on pay settlements being consistent with the cash limits we have set. If they are higher, and are not offset by greater efficiency, we will not be able to finance the improved service we now envisage. Improved services require non medical and supporting staff. The NHS took on 25,000 more between 1979 and 1980. But unless relative costs are kept down this increase simply cannot be sustained. And the consequences of excessive cost increases in other services would be the same: an inevitable lowering in the quality of service. The level at present anticipated would become beyond our means.

J.14 The lesson is a simple one. After the high increases in public service pay in recent years, it is now both fair and essential to look to a low level of public service pay increases this year. In the longer term we must work out a way of setting public sector pay which takes proper account of <u>all</u> the relevant factors: the availability of finance, the balance of supply and demand for particular skills, and not just so-called comparability.

J.15 Restraining public spending requires discipline both within the public services and from the nation as a whole. We must all learn to accept that the public purse is not bottomless. Doing this involves making hard political choices, which as a Government and as a nation we must not and shall not shirk.

J.16 But if we are to be effective in controlling public spending it is essential that the nature and consequences of our decisions should be as clear as they possibly can be. I am not satisfied that this is the case at the moment. This year, as for many years past, the figures in our White Paper are for the most part in terms of volume or constant prices. But there is something inherently unreal in putting everything in terms of what is rightly described as 'funny money'. Goods are not bought and people are not paid in the money of last year or the year before. They are paid in cash, and when the community, acting through the Government decides to buy goods and services, it has to pay the cash of the day, just like any private individual. The justification for volume planning has been the need to plan the number of hospitals or schools or roads or tanks that you are going to build in future years. But its danger is that there is an inevitable tendency to assume that that quantity of goods can be built or bought, however much the cost of buying them or building them may have gone up. What is absolutely essential is that we should control the money that is actually spent, and not just the volume of goods and services that that money was once supposed to be able to buy.

J.17 It is to achieve this end that I am announcing some important changes in the method of controlling and planning public expenditure. These changes cannot be a substitute for the hard political decisions that have to be taken. But they will enable those decisions to be taken with a much clearer appreciation of what is involved, and will help to prevent it being automatically assumed that what was once planned can still be afforded.

J.18 We have accordingly decided to make a major shift in the planning and control of spending from volume to cash. The introduction of cash limits paved the way for this change, but we now need to go a great deal further down that road.

J.19 In the first place we shall, from the coming year onwards, change the way in which we operate the contingency reserve. This will now be treated as a cash control. Previously only decisions which increased the volume of spending during the year were a charge to the Reserve. Next year any decision to increase a cash limit - whether in respect of volume, pay or prices - will be treated as a charge on it. The Reserve will be £2,300 million cash, about 2½% of the total of programmes.

J.20 But the more fundamental change that we shall be making will be in the way we go about the coming annual reviews of public spending. In planning what we shall be spending in 1982-83 we

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shall from the outset be conducting our examination and discussions in terms of the actual cash which will be available for that year. This will change the whole framework and ethos within which decisions are taken. I recognise that in many ways it will make things more difficult for those who have to manage spending programmes, and for the Government as a whole. We will be forced from the outset to form a view as to what our money will buy, rather than decide what to buy, and wait to see how much money we are somehow going to have to provide in order to pay for it. But this sort of difficulty is just the kind of problem that every businessman in the land has to face in planning his own future spending. He may have to make adjustments to his plans as the year developes, according to the way costs move and according to the availability of finance. But he always has to focus on how much he is actually going to be able to pay. It is high time for public spending to be subjected to the same discipline. I believe it will make a major contribution to improving financial management, and will do much to support the other efforts that we are making to increase cost consciousness and accountability throughout the public sector.

J.21 ( )
(As in J.24 and J.25 of the draft)
J.22 ( )

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CHIEF SECRETARY TO THE TREASURY

PRINCIPAL PRIVATE SECRETARY

cc Sir Anthony Rawlinson
Mr Ryrie
Mr Middleton
Mr Littler
Mr Unwin
Mr Bridgeman
Mr Ridley
Mr Cropper
Mr Cardona

BUDGET SPEECH: SECTION J (CORRECTED)

... Further to my earlier minute today, I attach a corrected version of the Chief Secretary's draft.

TM

T F MATHEWS
26 February 1981

PUBLIC EXPENDITURE SECTION OF THE BUDGET SPEECH

[I understand from Mr Wiggins' memo of 24 February that the 'historical' review is to form part of the opening of the Speech. I have attempted, nonetheless, to rework it, but it is detachable from the rest.] The remarks on cash planning start at J16]

J1 - as before

J2 - as before

J3 - Public expenditure as a whole has been significantly higher in 1980-81 than expected at the time of the Budget, and slightly higher than I anticipated last November. The cash outturn is now estimated to be about £94,000 million, compared with a Budget forecast of £91,600 million. This amounts to an increase of 22% compared with 1979-80.

J3 There are three main reasons for this increase. In the case of some programmes the increased spending has been caused by the form and extent of the current recession. This has obviously led to a substantial increase in spending on unemployment benefit. The increase in social security spending over what had been anticipated is some £700m. In addition, special measures to maintain employment have cost an extra £400 million.

J4 Secondly, there have been specific areas of expenditure where there has been much less underspending in relation to the available cash than can normally be expected and than has been allowed for. In the case of Defence there has actually been serious overspending. The main reason for this was that in a time of recession suppliers have produced and delivered equipment earlier than expected. There has also been overspending by the local authorites and extra borrowing by public corporations. But the £800m increase in the External Financing Limits of the nationalised industries has been taken out of the contingency reserve and has not therefore added to the total of public spending.

J5 The third factor that has resulted in increased public expenditure has been the upward drift of public sector costs, compared with costs in the rest of the economy. Above all, the cost of public service pay has risen faster than that of pay in the private sector. As a result of high pay increases and a slow rundown of employment between 1979-80 and 1980-81 the cost of pay in the public services has risen twice as fast as in the private sector. This figure

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reflects not only a comparatively higher increase of earnings in the public sector, but also the fact that the unemployment rate of former public sector employees is 4.2%, compared with 9.4% for the private sector.

J6 Much of the increase in public sector pay was caused by the implementation of the Clegg commitments inherited from the Labour Government, but the trend is a long-standing one. The Department of Employment's New Earnings Survey shows us that comparing 1980 with 1970-72 manual workers had improved their relative position by 8% in the public corporations, by 13% in central government and by 14% in local government.

J7 The effect of the factors that I have outlined has been that we have not secured the reduction in our predecessors' spending plans that we had hoped to achieve. Nonetheless, the reductions that we have made in those plans have been very substantial, as is clear from the volume of representations made by those who object to their consequences. What has happened is that those reductions, substantial as they are, have been overlaid and exceeded by the other factors, largely associated with the recession, that I have referred to. The ~~next~~ net effect of this is that whereas we had intended a 5% reduction in our predecessors' plans this year, we shall actually secure about two-thirds of that reduction.

J8 In the coming year some of the factors causing higher spending will continue to operate. They were reflected in last November's decisions to spend more on special employment measures and on industrial support, and we shall also of course have to pay for the shelving of the accelerated pit closure plans. But I also announced in November further decisions to cut most programmes, reducing planned spending on them in 1981-82 by some £140 million cash. Those cuts went some way to offset the increases which would otherwise have occurred.

J9 I should point out that in making cuts of this kind I have been following the same policy as that pursued in several other Western countries, where there have been recent announcements of cuts in public spending plans. [Sentences on recent US, Swedish and Dutch cuts, including Swedish posture on breaking automatic indexation link.] It is not, therefore, only we who have to respond in this way, for the economic conditions which have led us to do so are a worldwide phenomenon.

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J10 The effect of our policies next year will be that the volume of our spending will be 5% less than planned by our predecessors, compared with the 8% reduction we envisaged a year ago. The actual volume will be much the same as this year. But our decisions should ensure that the volume of spending falls after 1981-82. The Public Expenditure White Paper accordingly shows a fall of 4% up to 1983-84.

J11. But I must stress that the plans for later years - both for totals and individual programmes can be regarded as no more than provisional working targets. Whether we shall be able to spend on that scale depends on whether we can afford to do so. We shall be

× ~~working~~ looking very hard at the possibility of further reductions during the annual review of spending plans later this year. If we are able to reduce them, the pressure on the private sector and on interest rates will be correspondingly reduced, to the benefit of the economy as a whole.

J12. The desirability of checking public spending is more dramatically illustrated if one switches from looking at volume to considering cash. This year, as I have said cash spending will be about £94,000 million. In 1979-80 it was . In the coming year it will be £104,000 million. To the extent that this increase is caused by excessive increases in costs, primarily pay, in the public sector, it can only lead to one of two things: more taxation and borrowing or reduction in the standard of public services. An example will, I hope, bring home that point.

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J.13 We are at the moment planning to increase spending on health in real terms. The White Paper plans show it 2½% higher next year than last. But the cost of that in cash terms will involve an increase in actual spending of 40%, because over the two years health service costs are expected to rise by 4% more than costs in the economy generally. The improvement in service involved is dependent on pay settlements being consistent with the cash limits we have set. If they are higher, and are not offset by greater efficiency, we will not be able to finance the improved service we now envisage. Improved services require ~~non~~ more medical and supporting staff. The NHS took on 25,000 more between 1979 and 1980. But unless relative costs are kept down this increase simply cannot be sustained. And the consequences of excessive cost increases in other services would be the same: an inevitable lowering in the quality of service. The level at present anticipated would become beyond our means.

J.14 The lesson is a simple one. After the high increases in public service pay in recent years, it is now both fair and essential to look to a low level of public service pay increases this year. In the longer term we must work out a way of setting public sector pay which takes proper account of all the relevant factors: the availability of finance, the balance of supply and demand for particular skills, and not just so-called comparability.

J.15 Restraining public spending requires discipline both within the public services and from the nation as a whole. We must all learn to accept that the public purse is not bottomless. Doing this involves making hard political choices, which as a Government and as a nation we must not and shall not shirk.

J.16 But if we are to be effective in controlling public spending it is essential that the nature and consequences of our decisions should be as clear as they possibly can be. I am not satisfied that this is the case at the moment. This year, as for many years past, the figures in our White Paper are for the most part in terms of volume or constant prices. But there is something inherently unreal in putting everything in terms of what is rightly described as 'funny money'. Goods are not bought and people are not paid in

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the money of last year or the year before. They are paid in cash, and when the community, acting through the Government decides to buy goods and services, it has to pay the cash of the day, just like any private individual. The justification for volume planning has been the need to plan the number of hospitals or schools or roads or tanks that you are going to build in future years. But its danger is that there is an inevitable tendency to assume that that quantity of goods can be built or bought, however much the cost of buying them or building them may have gone up. What is absolutely essential is that we should control the money that is actually spent, and not just the volume of goods and services that that money was once supposed to be able to buy.

J.17 It is to achieve this end that I am announcing some important changes in the method of controlling and planning public expenditure. These changes cannot be a substitute for the hard political decisions that have to be taken. But they will enable those decisions to be taken with a much clearer appreciation of what is involved, and will help to prevent it being automatically assumed that what was once planned can still be afforded.

J.18 We have accordingly decided to make a major shift in the planning and control of spending from volume to cash. The introduction of cash limits paved the way for this change, but we now need to go a great deal further down that road.

J.19 In the first place we shall, from the coming year onwards, change the way in which we operate the contingency reserve. This will now be treated as a cash control. Previously only decisions which increased the volume of spending during the year were a charge to the Reserve. Next year any decision to increase a cash limit - whether in respect of volume, pay or prices - will be treated as a charge on it. The Reserve will be £2,300 million cash, about 2½% of the total of programmes.

J.20 But the more fundamental change that we shall be making will be in the way we go about the coming annual reviews of public spending. In planning what we shall be spending in 1982-83 we

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shall from the outset be conducting our examination and discussions in terms of the actual cash which will be available for that year. This will change the whole framework and ethos within which decisions are taken. I recognise that in many ways it will make things more difficult for those who have to manage spending programmes, and for the Government as a whole. We will be forced from the outset to form a view as to what our money will buy, rather than decide what to buy, and wait to see how much money we are somehow going to have to provide in order to pay for it. But this sort of difficulty is just the kind of problem that every businessman in the land has to face in planning his own future spending. He may have to make adjustments to his plans as the year developes, according to the way costs move and according to the availability of finance. But he always has to focus on how much he is actually going to be able to pay. It is high time for public spending to be subjected to the same discipline. I believe it will make a major contribution to improving financial management, and will do much to support the other efforts that we are making to increase cost consciousness and accountability throughout the public sector.

J.21 (As in J.24 and J.25 of the draft)
J.22

55

COPY NO 1 OF 27

MR WIGGINS

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Mr Burns
Sir Kenneth Couzens
Sir Anthony Rawlinson
PCC
Mr Battishill Mr Burgner
Mrs Gilmore
Mr Aaronson
Mr Ridley
Mr Cropper
Mr Cardona

BUDGET SPEECH: 27TH FEBRUARY DRAFT

I have the following major comments. Some minor points are in the note attached to this minute.

2. First, the two imbalances. This is an important theme and I think it should be emphasised more. This might be done partly by a recapitulation at the end of Section E. If people are going to take the point in, the Chancellor should bring the theme of the two imbalances together in one short, emphatic passage. I would suggest replacing the present paragraph E.14 with the following:-

> "We have seen these two major imbalances grow worse over the past year: first, the imblance between persons and companies, with personal incomes rising and companies under great pressure. Second, the imbalance between the public and the private sectors, with the spending and pay of the public sector rising too fast and the private sector generally under great pressure. One of the purposes of this Budget is to do something to correct these imbalances."

3. The first sentence of paragraph D.4 might also be amended to read: "This contrast between individuals and businesses is one of two major imbalances in the economy."

4. In the same connection, I would suggest a much shorter and punchier paragraph E.13, omitting the generalisations about pay and

productivity. The preceding paragraphs lead to a clear conclusion which might be expressed: "That is why the public sector pay bill must be restrained and we intend to make sure that it is."

5. The 1981-82 PSBR. The figures in paragraphs G.3 and G.4 will of course have to be looked at again. But as the draft reads at present, it implies that the pre-Budget PSBR is £14 billion. One question is whether this should be implied or stated directly.

6. Nationalised industries. I would like to suggest some redrafting of paragraphs J.20-22. I think the opportunity should be taken to re-affirm the necessity for firm financial disciplines through EFLs.

7. I suggest the following revision beginning from the last sentence of paragraph J.20 (the rest of J.20 to stand):-

"I know there are many in the nationalised industries who are working hard at this, but in present circumstances a much greater effort is needed.

J21 The Government can help - in two ways. First by maintaining a strong framework of financial control. This does not mean starving the industries of cash needed to sustain vital investment programmes - we intend to ensure that investment which is essential to our future prosperity is financed. And we have taken a realistic view of the financial pressures which recession places on some of the industries. But the discipline of tight control over what the industries borrow is an essential means of improving efficiency and that control must be maintained.

J22 Secondly, market disciplines must be brought to bear more on the industries which have a degree of monopoly. That is why we are legislating to increase competition in transport and telecommunications and taking action to return parts of the state-owned sector to private enterprise. At the same time we are exploring new ways of borrowing which could bring a degree of market pressure to bear on the overall performance of some industries. /I hope that my rt hon friend the Secretary of State for Industry will be able to announce a new initiative of this kind in the case of Telecommunications very shortly./"

I continue to think it w^d be better not to refer explicitly to borrowing

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8. Income tax. I think the opening paragraphs of Section Q need rewriting. The first three paragraphs would be suitable as a lead in for a partial revalorisation, but not for what is actually coming. I suggest that the Chancellor would do best to come to this decision very early and directly in this Section.

9. Finally, paragraph Q.8 suggests that there should be no reference to the NIC increase. Of course, there is no need to dwell on it, but in view of the way the speech (rightly) harks back to the November Statement on both North Sea oil taxation and stock relief, I think it would be odd not to mention it at all. I suggest that the right course is to include a reference to it in the section on social security.

10. Section T: capital taxes. I suggest that this section should be considerably shortened. It is rather out of balance with the rest of the speech, especially since very little is being announced. Some points could be announced later in the Debate.

W.S.R.

W S RYRIE

2nd March 1981

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BUDGET SPEECH: 27TH FEBRUARY DRAFT

Drafting changes

C.3, third sentence. Omit the reference to subsidies. cf BSC, coal etc.

C.4. My impression is that the majority of settlements in manufacturing is well below 10% - we should check this.

C.5, third sentence. This is cumbersome. What about: "managers are learning again that their problems can only be solved by management."

C.7. This kind of presentation of the balance of payments is risky. It invites the retort that depressed imports have done it. At least, I think, some reference to export performance is needed.

J.6B, second sentence. Amend to read: "Any further adjustment will be a charge on the contingency reserve."

K.3, first sentence. This invites ridicule. Amend to read:"I would dearly like to be able to do more on social security."

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CHANCELLOR OF THE EXCHEQUER

Chancellor

Points not in the speech.

1. CE are considering a sentence about public expenditure cash control & the later years.

2. The omission of the beer/wine duty relativity point in the speech was deliberate, on the grounds that we don't want to give the impression that the EC are dictating the duty changes to us. This cd be dealt with if necessary in response to questions.

3. I doubt whether we want to mention industrial consultations in talking about the absence of a differential between petrol & derv — it will just prompt more peripheral questions, & draw attention to UK weakness as a manufacturer of small diesels.

?

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Covering
BUDGET SECRET

COPY NO. 70 OF 70 COPIES

Ch/Ex. Ref. No. B(81)30

cc: Chief Secretary
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Mr Ryrie
Mr Bailey
Mr Barratt
Mr Byatt
Mr Hancock
Mr Littler
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Mr Kemp	K,L,T
Mr Corlett	L,N-V*
Mr Gordon	S,V
Mr Griffiths	L,N-V
Mr Kelly	L,N-V*

MR UNWIN

BUDGET SPEECH: TAX SECTIONS

.... I attach a revised version of Sections K-L and N-V, incorporating comments by the Chancellor and other Treasury Ministers.

2. I should be grateful for comments to me (233-5728) or if I

*with a copy of MST(L)'s annotated text of the last version of Section R, paras 1-12

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am unobtainable Mr Aaronson (233-3241) in the course of tomorrow (3 March).

3. I have indicated in the margin various questions on which I should be grateful for advice: a number of loose ends remain on which we shall be arranging further discussions where possible.

4. I should be grateful if Inland Revenue and the FP Group could prepare new and shorter versions of the Sections on stock relief and CTT reliefs as indicated below, consulting MST(L).

5. Mr Kemp will need to look again at Section K, in the light of the tentative agreement between the Chancellor and Mr Jenkin about who announces what.

R.I.T.
for

A.J. WIGGINS
2 March 1981

BUDGET SECRET

SECTION K : SOCIAL SECURITY

K.1. As I have already explained, social security expenditure represents a sharply rising burden on the productive economy. As is usual, there will be increases in benefit rates next November, which my rt. hon. Friend the Secretary of State for Social Services will announce tomorrow. These will cost in total over £2 billion in a full year. The Social Security programme is far and away the biggest element in public expenditure - more than a quarter of all programmes taken together. It costs over £27 billion a year, or about £20 a week for every worker in the country.

K.2. The rate of inflation between November 1979 and November 1980 was lower than expected. This meant that the increase in pensions and other benefits made in last year's uprating was more than intended. I expect prices to rise by 10 per cent in the year to next November. State retirement pensions, public service pensions and supplementary, unemployment and sickness benefit will be increased in November by 9 per cent. This reflects the expected rise in prices but, as previously announced also puts right the over-provision made last year. Thus the retirement pension for a married couple will go up by £3.90 to £47.35 per week and for a single person by £2.45 to £29.60 per week.

K.3. I realise that there are those who would like us to have done more on Social Security. They must remember that because of the recession and of demographic changes, social security represents a sharply rising real burden on a contracting economy and a diminishing number of people at work. We talk about individual benefits in terms of pence per week. But we forget what a burden this is when looked at as an annual sum multiplied by many millions of beneficiaries. The cash costs of next year's increase alone is equivalent to the whole of the roads programme or about [3p] off the basic rate of income tax.

K.4. The Social Security programme has grown at a dizzy rate in the last decade. In part this is due to the increasing number of beneficiaries and changes such as the switch to Child Benefit. But it mainly comprises the real increase in the rate of benefits. Thus the retirement pension has gone up by about 30 per cent in real terms. This is double the real increase in GDP. The pension has also gone up substantially as a percentage of average earnings.

BUDGET SECRET

SECTION L: THE DISABLED

L.1. But there is one group of disadvantaged people to whom we must pay special attention this year. I refer, of course, to the disabled, for this is the International Year of Disabled People. [First, mobility allowance. This will go up by £2 per week to £16.50 from November. This is the third successive year we have increased the allowance in real terms, and it is now £6.50 per week higher than it was when we came into office.]

[Leave to Mr. Jenkin?]

L.2. The special income tax allowance for the blind has stood at its present level since 1975. It will now be doubled to £360. I hope this will at least give some help to the blind in tackling the very great problems they have to face.

L.3. There has been a strong body of representation to me for VAT relief on purchases made by charities. I have regretfully concluded that such relief would be impossible to administer equitably or economically and would cost too much. I do, however, propose to extend existing VAT reliefs for the disabled and the charities serving them. For example, the present zero-rating for articles given to hospitals will in future cover ambulances and wheelchairs. The benefit of this zero rating will also be extended to institutions providing care for the handicapped. Car adaptations for disabled drivers will also be relieved from VAT. The necessary Treasury Order will be laid very shortly.

[Can we make this intelligible?]

[L.4. Also this year I am very pleased to be able to propose changes which will make more generally available the capital gains tax exempt allowance to trusts for the disabled.]

L.5. To encourage part-time work in support of the voluntary movement, the amount a person can earn without affecting unemployment benefit will be increased from 75p per day to £2 per day.

L.6. The total cost of these measures will be about £[ ] per year. This is a modest sum, but if put alongside the reliefs I announced last year in respect of covenanted gifts to charities, the total amount is a very substantial one. These reliefs gave to charities a great opportunity to tap the well of personal beneficence. They are not as well known and certainly not as widely used as I should like. [I am glad to say that I have agreed with [name] on a campaign to publicise these reliefs and the opportunities they offer] <u>or</u> [I shall be arranging for a campaign to be put in hand to publicise these reliefs and the opportunities they offer].

[Who is going to take this further?]

BUDGET SECRET

L.7. There are two other matters I might briefly mention. First, I announced last year that we planned when we could to bring into tax invalidity and other incapacity benefits. We had hoped that this might be from April 1982. We propose now to postpone this. I can confirm, however, that the 5 per cent deduction made from the November 1980 uprating of Invalidity Benefit will be made good when this benefit comes into tax. Notwithstanding this postponement the 5 per cent deduction from Invalidity Allowance - the special additional allowance which people can get if they become chronically ill before certain ages - will be restored from next November.

[Why the postponement?]

[Why is Allowance treated differently from Benefit?]

SECTION N: RAISING THE REVENUE: BUSINESSES

Oil companies

N1. I come now to the measures necessary to raise extra revenue needed for this year. Continuing increases since 1979 in the real price of oil have brought substantial benefits to the oil companies. They have altered for the better the economics of many North Sea oil fields. At the same time, for various reasons, the Government's share of the revenues has consistently fallen below what we expected. I believe I may properly look to this area for additional revenue. I foreshadowed in my statement last November the measures which I had in mind for increasing the Government's share of the revenue from the North Sea, while maintaining incentives for further exploration and development. Consultations with the oil industry have taken place and I can now announce detailed proposals.

N2. I intend to introduce a new tax - the supplementary petroleum duty - broadly as outlined last November. This will secure an immediate and sustained increase in North Sea revenues. The new tax will be at a rate of 20 per cent on the total value of oil and gas produced after deduction of an allowance of 1 million tonnes a year for each field.

It will be deductible in computing liability to Petroleum Revenue Tax and Corporation Tax. The legislation will exempt gas supplied to the British Gas Corporation from earlier North Sea fields. There will be provision for the new tax to be refunded where fields do not fully recover their initial development expenditures. These two proposals respond to particular representations by the industry.

N3. I have mentioned already the need to secure a smoother public sector cash flow through the year. It is sensible therefore to make arrangements for this new tax that will help in that direction. The new tax will be payable in monthly instalments. This will be an important contribution to achieving a smoother PSBR through the year. I shall also invite the industry to consider with the Inland Revenue how a broadly similar pattern of payments might be introduced for PRT.

N4. As I announced in November last year I think it right that some of the special reliefs devised for PRT should be altered. I propose therefore

[explain?] some restriction to "uplift" and to "safeguard".

I do not however propose any change to oil allowance, in view of its important to small marginal fields. These alterations should not, however, prejudice the recovery by oil companies of their proper costs of exploration and investment in the North Sea.

N5. There are a number of other minor changes to improve the oil taxation regime - partly in response to the industry's own views.

N6. The new tax together with a contribution from changes to the PRT reliefs will raise about an extra [£1,000m] in 1981-82. There will be a substantial continuing yield in later years.

N7. The oil companies have urged that my objectives of more revenue, and a more efficient and economical pattern of tax relief could better be secured by a more thorough-going reform of PRT, which would avoid the introduction of a permanent new tax. Although the industry has not yet tabled proposals which I could regard as satisfactory, I do not want to close my mind to the possibility that such proposals might be forthcoming. I propose therefore that the new tax, SPD, should in the first instance have legislative effect only for the 18 months ended on the 30 June 1982. This should allow ample time for further thought and consultation and if anything constructive emerges I shall be prepared to introduce appropriate provisions in the Finance Bill of next year.

Banks

N8. The other business sector which has largely been protected from the effects of the recession is banking. During the last two years the banks have earned exceptional profits as a direct consequence of high interest rates: these have arisen mainly from the employment by the banks of current accounts on which no interest is paid. This has come about because of economic circumstances rather than because of action initiated by the banks. Yet the amounts of corporation tax actually paid by many banks have been relatively low. [IR to supply figures, drawing if necessary on e.g. published accounts of clearers.]

N9. The present level of bank profits is partly, of course, a cyclical recovery from the low level to which they fell in the mid-1970s. The banks have needed to make provision against the effects of inflation and to rebuild the reserves needed to underpin the valuable support they give - and which I acknowledge - to businesses in difficult times. Nevertheless they have enjoyed an economic rent not available to other businesses: and in present difficult circumstances I cannot escape asking them for a special fiscal contribution.

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N10. This will take the form of a once for all tax on the deposits of banking businesses which are in operation today. The tax will be charged by reference to non-interest bearing sterling deposits in excess of £10m, averaged over the final three months of 1980. The rate of tax will be 2½ per cent, not deductible against corporation tax. The levy will apply in principle to all banks, but I estimate that the clearing banks will be the source of some [90] per cent of the revenue. Altogether an estimated £400m will be raised in three instalments over the second half of 1981-82. This revenue will enable me to give fiscal reliefs to the rest of industry this year which otherwise I could not afford at all.

SECTION P: RAISING THE REVENUE - INDIRECT TAXES

P1. For the reasons I have explained earlier it is necessary to look to the personal sector for additional revenue. On average, people in employment - the vast majority of people - have had more money to spend. Some extra tax must, regrettably, be levied on that expenditure.

P2. I do not propose any increase in the 15 per cent rate of VAT. As last year, most of the extra revenue needed must come from the excise duties. Increases would be necessary again this year simply to keep the rates in line with the movement of prices generally. However, even with such increases many of the duties would be lower in real terms than they were for long periods in the past. For example, since April 1975 the beer duty has risen by only about half as much as prices generally. I propose therefore to increase the excise duties to produce, in total, about twice as much additional revenue as would be required to compensate for one year's inflation.

Alcoholic drinks and tobacco

P3. First, the duties on alcoholic drinks and tobacco. I propose to increase from midnight tonight the duties on drinks by amounts which, including VAT, represent about 4p on the price of a typical pint of beer, 12p on a bottle of table wine, 25p on a bottle of fortified wine, and 60p on a bottle of spirits.

P4. On tobacco, I propose from midnight on Friday to increase the duty by an amount which, including VAT, will represent 14p on a packet of 20 king-sized cigarettes. At the same time I am abolishing the surcharge on higher tar cigarettes.

P5. There will be consequential increases for other alcoholic drinks and tobacco products. But a little less for pipe tobacco which is used particularly by pensioners. We estimate that the increases on alcoholic drinks will yield £500 million in 1981-82 and £515 million in a full year, and those on tobacco £500 million in 1981-82 and £510 million respectively.

Road fuel duties

P6. Road fuel must also make a substantial contribution. The duties on petrol and derv, will be increased from 6pm tonight, by the equivalent, including VAT, of 20p a gallon. These increases will yield an additional £910 million from petrol and £270 million from derv in 1981-82 and the same in a full year.

Vehicle Excise Duty

P7. I propose to increase the Vehicle Excise Duty on most vehicles by about 15 per cent. The annual duty on cars will increase by £10 to £70. As the duty on derv is being increased in line with that on petrol I do not propose any differential increase on heavy lorries. The VED increase will yield £225 million in 1981-82 and the same in a full year.

Car tax

P8. I propose extending the car tax, which is charged at 10 per cent on the wholesale value and is in addition to VAT, to motor cycles, scooters and mopeds. There is no longer any case for the exclusion of these machines: demand is strong, and there is no reason why they should be treated more favourably than motor cars. The change will raise about £10 million in 1981-82 and £15 million in a full year.

Matches and Mechanical Lighters

P9. Finally, the duties on matches and mechanical lighters were last increased in 1949. They are therefore overdue for some change. I propose to increase the duty on mechanical lighters from 20p per lighter to 50p and the duty on matches by an amount which will add about ½p to the price of a typical box of matches. These changes will come into force at midnight tonight. The increases will yield about £15 million a year.

Summary

P10. In all, these changes should raise £2,430 million in 1981-82 and £2,460 million in a full year. The fact that the yield this year is almost equal to the full year's yield reflects the advantages to the Exchequer of an early Budget.

P11. In deciding on these measures I have done what I reasonably can to limit their direct effect on industry. Admittedly, the increase in derv will primarily affect businesses. But most of the increases fall on those products which are bought by private consumers. Had all these excise duties been increased in line with inflation this would have added 1 percentage point to the RPI. The increases I propose will add a further point. This is the immediate effect. But in the longer run by reducing public borrowing, they will help to bring inflation down and ensure that it stays down. /These tax increases are deliberately designed to reduce real spending power; their purpose would be frustrated if they were regarded as justifying higher money incomes to offset the consequential increase in the general price level./

SECTION Q: RAISING THE REVENUE - DIRECT PERSONAL TAXATION

Q1. I come now to income tax.

Q2. It is well known that inflation exerts an insidious influence on the tax yield for Income Tax. By reducing the real value of the tax free personal allowances, inflation brings about an increase in the burden of tax which we on this side of the House have termed taxation by stealth.

Q3. It was in order to counteract taxation by stealth that certain Hon. Members introduced, and carried, a measure during Finance Bill debates in 1978, requiring Governments to raise the tax allowances by each year's inflation - except where economic circumstances made it impossible.

Q4. This, I regret to have to tell the House, is one of those years. We will not, because of the pressing need for revenue this year, be able to increase the personal allowances and the House will be asked to approve a Special Resolution to this effect. As compared will full indexation of the allowances and rate bands, this will "save" £2½ billion. The need for this revenue is illustrated by the fact that, if I had done no more than revalorise both direct and indirect taxation, the PSBR would be likely, on present forecasts, to approach £14 billion.

[Q5. This has been an exceptionally unpleasant decision to have to take, and I share the disappointment everyone will feel. I have been particularly conscious of the possible impact on the families of people in less well-paid work. In order to provide a measure of protection to this hard pressed group, we have decided that child benefit should be increased in line with inflation; it will go up by 50p a week per child from November, to £5.25. The resources are not available this year for the tax reductions which would sharply increase work incentives for people in every possible family circumstance; but this decision on child benefit will ensure, for the most important group, that the poverty trap is not made markedly worse.]

Fringe Benefits

Q6. At a time when the income tax burden cannot be eased, it is all the more important that the burden should be fairly shared. This is more easily achieved if the tax system encourages employers to provide remuneration in cash rather than in kind.

Q7. The benefit of a company car is already subject to tax, but the tax scales fall short of the true value - for example, the amounts assessed to tax are less than half the AA's estimate of the annual costs of running a car. Last year's Finance Act prescribed an increase of 20 per cent in the scales from this April, just about enough to keep them rising in line with the costs of motoring. I now propose they should be increased by a further 20 per cent in April 1982. For company cars which have little or no business use there is a higher schedule of taxation. I propose to raise the upper limit for this charge from 1,000 to 2,500 miles a year with effect from this April. [? provision of free petrol. Reminder of last year's threat of action.]

Q8. Most people have to pay for their own travel to work whether by rail or by road. Most of the remainder whose travel costs are met by employers pay tax on the benefit. A small minority, however, perhaps one in ten of commuters, escape tax through a weakness in the present legislation. A similar devise enables employees to use credit cards to obtain a wide range of goods and services which are charged to the employer without the employee paying tax. It is quite wrong that there should be these distinctions based on the fine point of ingenious arrangements. I shall ensure that these benefits are brought under charge to tax for all employees.

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[The Chancellor doubts whether this will be readily understood. Does it have to be included?]

Q9. Following consultations which took place last year I have decided to leave in place for the time being the earnings threshold for the special rules for taxing most fringe benefits. These will continue to apply only to those earning more than £8,500 a year. Consistently with this approach, I propose to remove the charge to tax on medical insurance premiums paid by employers for the benefit of their employees earning less than this amount. [The other point discussed in that consultative paper was the method of taxing these benefits. I have decided that with effect from April 1982 the benefit from a company car [and the provision of petrol] should be treated as pay for the operation of PAYE, instead of being taken into account separately in the code number. This means that some [200] fewer staff will be needed in tax offices for this purpose.]

Q10. [Vestey to be dealt with by IR in 6 lines]

SECTION R: HELPING BUSINESSES

R1. So far I have been dealing almost entirely with measures that will increase the revenue. From those who have benefitted from high interest rates and from the high exchange rate: banks, oil companies, the 90 per cent still in work who have enjoyed rising living standards. The total raised - including the November measures - is about [£] billion.

R2. An increase in revenue on this scale is essential if we are to offer the prospect of lower interest rates. For that reason most of the revenue must go to reducing the PSBR. But some can go, as it should, to lighten the tax burden on business and enterprise.

R3. However, there is not a great deal available. Not enough for across-the-board measures. It is important to concentrate relief where it will be most effective. A reduction in the NIS cannot be afforded. Nor would a general reduction in corporation tax be appropriate - in any event it would not help those who are so hard-pressed that they are making no profit. Let me explain the ways in which I propose to bring help to business and enterprise.

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R4. The first measure is one I have already announced in principle last November: the reform of the stock relief scheme.

R5. Stock relief paragraphs. [IR to revise, and shorten drastically, taking into account MST(L)'s comments, and minimising references to the consultative Docuemnt.]

SECTION S: CONSTRUCTION

Development Land Tax

S1. Because the construction industry is also very hard pressed, it is sensible to remove obstacles to development wherever we can. The Government are committed to retaining the Development Land Tax, but while maintaining the basic features of the tax, we have identified three changes to the tax as which could help to give a stimulus to development, particularly this year and next.

S2. First under the present law if industrial development is undertaken by the owner for his own use, tax is deferred until the property is sold or put to other use. I propose that for two years this relief should be extended. If a development is begun by 1 April 1983 there will be no DLT for an owner to pay on any part intended for his own use until the property is sold or otherwise disposed of. This will be an encouragement to bring forward commercial development including hotels.

S3. Secondly, where property is extended there will in future be no charge if the extension does not increase the size of the building by more than one-third. The current limit is one-tenth.

S4. My third proposal is to help the housebuilding industry and will be of benefit where land is accquired from local authorities for residential development. Builders will not have to pay DLT if the market value of land held by them as part of their stock in trade does not exceed the cost by more than 50 per cent at the time development begins. The present limit is 15 per cent. The cost of these measures is put at up to £m5 in a full year but the benefit to the economy could be much greater.

Industrial Buildings Allowance

S5. As I have said, I am concerned that businesses should continue to invest for the future. Our tax system already provides generous incentives for investment in new machinery. But new modern machines will seldom yield their full potential if they are housed in obsolete and inefficient factories. I therefore propose to increase from 50 per cent to 75 per cent the initial allowance for expenditure on the construction of new industrial buildings incurred from today. The cost will be negligible for 1981-82 and [£215m] in a full year. It will of course benefit not only manufacturing but also the construction industry.

SECTION T: CAPITAL TAXES

T1. The measures I have just announced, which will help very wide sections of industry, will be worth £[ ]billion in a full year.

T2. But it is not enough only to help those already established. If we are to build a strong and vigorous economy we must also encourage and reward the creation of new enterprises and new wealth. I shall say more on this theme later. But I want first to turn to the subject of capital taxation, which is particularly important for small firms.

Capital Transfer Tax

T3. In a year in which we can give no income tax relief, I fear that I cannot make major changes in capital taxation. I realise how onerous the present taxes are.

[Can T4-T11 be reduced by one half?]

T4. I do however propose to continue the gradual process of knocking the capital taxes into shape. One of the major changes made when the capital transfer tax was introduced in 1975 was the idea of lifetime cumulation. A lower scale was introduced for lifetime gifts but this extends in full only up to £110,000 and the relief disappears altogether about £310,000. This attempt to tax all transfers throughout life with only very limited reliefs has proved ineffective. Last year only £15m or 5 per cent of the total yield came from lifetime transfers. Most of that came from trusts which were trapped by the new regime, the yield from gifts being only £2 or £3m. Because the tax on lifetime gifts has to be paid often ten or twenty years earlier than it would have been paid had the property passed on death, people have for all practical purposes stopped transferring property during lifetime.

5. This is in itself a bad thing. Property should pass freely from one generation to another. People should not be compelled to wait for dead men's shoes.

T6. I propose therefore refurbishing the provisions in a way which will be fairer to the taxpayer and at least offer the Exchequer the hope of collection some revenue. At present the lifetime scale at the bottom end is one half of the death scale. I cannot extend the half rate all the way up, although the factor of early payment might well justify this. I propose instead a new scale which will retain the half rate at the bottom and move to a top rate two thirds of that chargeable on death. At the same time I propose limiting cumulation to 10 years. Even that is longer than in many other countries.

T8. These measures have a nominal cost if measured against the situation which at present exists. But in the longer term by easing the way for lifetime transfers, I would hope that the Exchequer as well as the taxpayer would show a net benefit.

T9. As a minor but further measure of simplification I propose increasing the annual exemption to £3000.

[Present as "bringing help to the country side."]

T10. I propose also to deal with the unequal treatment of farmland which is let. If the owner farms himself he qualifies for 50 per cent agricultural relief. If he lets the farm he loses the relief. I propose that in future let land should qualify for relief at 20 per cent, the present 50 per cent relief continuing where the land is not subject to a lease. This should remove one of the factors restricting the supply of farms for letting and provide better opportunities for the new generation of young farmers coming into the industry. [The tax is not of course the only problem. Discussions have been proceeding in both Scotland and in England and Wales on ways to improve the situation. Agreement has been reached in Scotland. I hope it will soon be reached in England and Wales as well. Meantime the changes I propose should help matters forward.] I propose at the same time extending to let agricultural land the facility to pay by interest free instalments and the limit of £¼m will be removed.

[This has nothing to do with the Chancellor?]

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T11. Finally trusts where we have recently circulated a Green Paper for consultation. I am grateful to all those who responded. It is more important in this area to get the legislation right rather than legislate in a hurry. I propose therefore that draft clauses dealing with discretionary trusts should be drawn up after discussion with the professional bodies: they will then be published for wider comment and discussion and we will legislate next year. To facilitate this there will be a further and final extension of the transitional period until 31 March 1983, or 31 March 1984 where an application has to be made to the Court.

[No need for separate suggestion?]

[T13. In the aggregate the capital transfer tax reliefs will cost £[ ]m this year and £[ ]m in a full year.]

Capital Gains Tax

T14. I cannot this year give further general relief from capital gains tax. There are, however, two specialised but important matters I do propose dealing with.

T15. First, I propose taking one of last year's reforms a stage further. Then, I had to exclude from the capital gains tax rollover relief for gifts property going into and coming out of settlement. We have since given very careful study to this specialised area and to the necessary safeguards. I am now able to make the rollover available in those cases, too, and so remove the double charge to capital transfer tax and capital gains tax.

T16. Second, I propose taking action against certain devices for artificially reducing capital gains. These devices centre on the market value rule. The measure I propose will ensure that the rule meets its original intention. The tax saved should largely offset the cost of extending the rollover relief - some £60m in a full year. I also propose aligning the capital gains tax rules with new income rules that are being developed following the Vestey case.

/Subsumes Q15 in draft of 28 Feb?/

Stamp Duties

/17. I cannot make any general change this year in the thresholds for stamp duty on house purchases. However, I intend to include one provision in the Finance Bill which will help those buying Council houses. This will ensure that stamp duty will be payable only the discounted price that the buyer actually pays /and not on some higher figure/./

SECTION V : ENTERPRISE

V.1. Last year, I introduced a number of measures to help small firms. In addition to the major new initiative to establish Enterprise Zones, these included a venture capital scheme, improved tax relief for small workshops, and a reduction in the rate of corporation tax for small companies.

V.2. All these measures to encourage enterprise have been widely welcomed. The eleven proposed enterprise zones have stimulated intense interest among investors and the private sector has begun to respond even before the zones are formally established. There are many heartening examples. For example, in Greater Manchester [ ]acres at Salford Docks which have been lying idle for years are now to be released for redevelopment, creating one of the largest single investment opportunities on the area. On Tyneside, Vickers have already begun preparations for redevelopment of a disused site. In the Midlands, the owners of surplus land in Dudley have come together to market it and promote its rapid development. At Clydeside, the local authority has received [over 1,000] enquiries from prospective businesses.

V.3. Meanwhile provision for small factory units financed wholly by the private sector has grown rapidly. The English Industrial Estates Corporation has already raised £25 million from the private sector which, together with the £5 million from the Department of Industry, will bring forward more than 1,500 workshops. To give one specific example, three-quarters of the units in pilot schemes at Jarrow, Sunderland and Wallsey have already been let or reserved for tenants. The continuing demand for small workshops shows the strength of the small business sector.

V.4. But we can and must do more through the tax system to help existing small businesses to grow, and to encourage new businesses to start-up. This remains an essential key to new jobs.

<u>VAT</u>

V.5. First VAT. I propose that, as in past years, the registration threshold should be increased in line with prices - on this occasion from £13,500 to £15,000. The de-registration limit will also be increased from 1 June.

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Small companies corporation tax

V.6. Second, I propose to increase from £70,000 to £80,000 the limit up to which the lower 40 per cent rate of corporation tax is payable by small companies. But, I also intend to respond to one of the longstanding complaints from small companies, which is the relatively high marginal rate of tax which they have to pay if their profits lie just above this limit. The limit at which the full corporation tax rate of 52 per cent becomes payable will be raised from £130,000 to £200,000. This will make for a gentler progression from the small companies rate to the full corporation tax rate. The cost of these changes will be £[12] million in 1981-82 and £[21] in a full year.

Industrial co-operatives and partnerships

V.7. Third, new businesses depend on ready access to fresh capital. Last year I relaxed the conditions governing tax relief for money borrowed to invest in close companies. That was good for small companies. This year I am making a similar relaxation for industrial co-operatives and partnerships.

Purchase of own shares

V.8. Fourth, as the House knows, the Government will shortly introduce new clauses at Committee stage of the Companies Bill, to enable companies to purchase their own shares. This will meet a number of problems arising in small and family businesses in connection with minority shareholders and the reluctance of proprietors to part permanently with an equity share in their businesses. [These provisions will be of limited utility unless corresponding changes are made in the present tax structure.] I am, therefore, asking the Inland Revenue to issue a Consultative Document on this subject this summer, with a view to legislation in next year's Finance Bill.

Venture capital scheme

V.9. Fifth, I intend to extend the venture capital scheme introduced last year. This scheme encourages investment in small businesses by allowing capital losses on shares in unquoted trading companies to be set off against income. At present, it is confined to investment by individuals. I propose to extend it to investment by companies, who may be in a good position to attract funds to assist expanding small companies. [I also propose to bring in investment by trustees.]

V.10. All these measures will be of significant help to small businesses. But I intend to go even further. I have three entirely new measures to announce.

[Loan guarantee scheme

V.11. First, I have been very strongly pressed to introduce what is known as a loan guarantee scheme. There are some people who, for one reason or another, have difficulty borrowing the money to start a business. They may, for example, not have the necessary collateral. I am pleased to be able to announce that agreement has been reached with the major clearing banks and the ICFC on the introduction of a pilot loan guarantee scheme.

V.12. The scheme will run for three years initially, subject to an overall maximum limit of £50 million for each year. Individual term loans of up to [ ] will be available for periods of between 2 and 7 years. Government guarantees will be available for up to 80 per cent of each loan. The scheme will be administered by the Department of Industry. Further details will be given by my rt. hon. Friend the Secretary of State.

V.13. The scheme is intended to be self-financing. Lenders will make a full commercial charge for their loans, part of which will be passed on to the Department of Industry in the form of a guarantee premium payment. These premiums will be available to meet calls on guarantees if borrowers default on their loans. They have been set at levels which should meet in full any claims under the guarantee provisions.]

[New enterprise allowance

V.14. My second group of new proposals is directed at encouraging people who are unemployed, particularly those who have just become redundant, to help themselves, and the economy, by setting up in business for themselves. It is sometimes said that the existing Social Security rules, which mean that benefits in general cease when a man does this, can make people hesitate to take the plunge. Accordingly, we are considering a scheme whereby anyone who has recently become redundant and invests and works in a new small business of their own can receive what I propose to call an "Enterprise Allowance" of £35 per week for a limited period while the business finds its feet. This is something which has not been done in this country before, but we think it is worth a try.]

[This proposal is still under discussion in Mr. Kemp's group, and is strongly opposed by IA and IP]

V.15. A similar point arises in the area of income tax. Redundancy payments and other payments made on termination of employment are presently taxable if they exceed £10,000. I am raising this threshold to £25,000 with effect from 6 April. Again, the primary objective is to make it easier for people declared redundant to move to another job or to start a business of their own.

Business start-up scheme

V.16. My third new proposal breaks entirely fresh ground.

V.17. One of the biggest problems faced by people thinking of starting their own business is the difficulty of attracting sufficient risk capital to finance it during its critical early years. The amounts of additional money needed can be modest - at least as compared with the sums in which the big financial institutions commonly deal. But they can be crucial in individual cases.

V.18. The individual private investor has for many years had little encouragement to help fill this gap. I propose to change this. The private investor can often contribute not only risk capital, but also direct personal business experience.

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The opportunities are certainly there. What is needed is to make it more attractive and more rewarding for private investors to seize them.

V.19. I am, therefore, introducing an entirely new tax incentive to attract investors to back new enterprise. It is designed for the outside or minority investor in a new small trading company, as distinct from the owner of the business, or his close family or associates. I am calling it the Business Start-up Scheme.

V.20. The scheme will need to include strict rules to ensure that it goes only to support genuine new business enterprises of the kind I have in mind, and is not used for investment in merely financial or passive operations, or for tax avoidance. This is a bold new incentive.

V.21. I am introducing the new scheme in the first instance for a three year period, beginning with the coming financial year 1981-82.

V.22. This Business Start-up Scheme will be [depending on FP view of similar US schemes: "unique, not only in this country, but among our trading competitors. It will be"] a striking new incentive to channel investment into small businesses.

[Operation Enterprise]

V.23. Despite the tight circumstances of this coming year, these measures to encourage enterprise and risk-taking are essential. The future health and resilience of our economy, and the provision of well founded new jobs depend crucially on a healthy flow of new enterprises. We must be ready to set aside resources now to encourage them. They are the real future hope for absorbing and re-directing the people and other resources presently squeezed out of employment by the forces of economic adjustment.

V.24. As I have said, this is the second Budget in which I have included measures to help and encourage small businesses. The measures I have just announced, together with those last year, constitute a formidable battery of incentives. The tax system is now geared significantly in favour of enterprise.

V.25. Much has also been done by this Government to ease the problems of small businesses in other ways - for example by relaxing employment and planning rules. All this represents a complete change in the climate within which the small business operates. It is vital that these enterprise measures be widely known and understood, and that people are encouraged to take advantage of them.

V.26. The Government needs to take the initiative here. We are, therefore, launching a campaign - to be known as [Operation Enterprise] - to publicise the help, advice and incentives which are available to small businesses. At the same time, we shall be setting up a Small Enterprise Council, which will draw together the activities of the various Government agencies involved in helping small businesses. More details of this important campaign will be given by my rt. hon. Friend the Secretary of State for Industry on [ ].

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MR UNWIN

BUDGET SPEECH: TAX SECTIONS

I attach a revised version of Sections K-L and N-V, incorporating comments by the Chancellor and other Treasury Ministers.

2. I should be grateful for comments to me (233-5728) or if I

*with a copy of MST(L)'s annotated text of the last version of Section R, paras 1-12

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am unobtainable Mr Aaronson (233-3241) in the course of tomorrow (3 March).

3. I have indicated in the margin various questions on which I should be grateful for advice: a number of loose ends remain on which we shall be arranging further discussions where possible.

4. I should be grateful if Inland Revenue and the FP Group could prepare new and shorter versions of the Sections on stock relief and CTT reliefs as indicated below, consulting MST(L).

5. Mr Kemp will need to look again at Section K, in the light of the tentative agreement between the Chancellor and Mr Jenkin about who announces what.

R.I.T.
for

A.J. WIGGINS
2 March 1981

BUDGET SECRET

SECTION K : SOCIAL SECURITY

K.1. As I have already explained, social security expenditure represents a sharply rising burden on the productive economy. As is usual, there will be increases in benefit rates next November, which my rt. hon. Friend the Secretary of State for Social Services will announce tomorrow. These will cost in total over £2 billion in a full year. The Social Security programme is far and away the biggest element in public expenditure - more than a quarter of all programmes taken together. It costs over £27 billion a year, or about £20 a week for every worker in the country.

K.2. The rate of inflation between November 1979 and November 1980 was lower than expected. This meant that the increase in pensions and other benefits made in last year's uprating was more than intended. I expect prices to rise by 10 per cent in the year to next November. State retirement pensions, public service pensions and supplementary, unemployment and sickness benefit will be increased in November by 9 per cent. This reflects the expected rise in prices but, as previously announced also puts right the over-provision made last year. Thus the retirement pension for a married couple will go up by £3.90 to £47.35 per week and for a single person by £2.45 to £29.60 per week.

K.3. I realise that there are those who would like us to have done more on Social Security. They must remember that because of the recession and of demographic changes, social security represents a sharply rising real burden on a contracting economy and a diminishing number of people at work. We talk about individual benefits in terms of pence per week. But we forget what a burden this is when looked at as an annual sum multiplied by many millions of beneficiaries. The cash costs of next year's increase alone is equivalent to the whole of the roads programme or about [3p] off the basic rate of income tax.

K.4. The Social Security programme has grown at a dizzy rate in the last decade. In part this is due to the increasing number of beneficiaries and changes such as the switch to Child Benefit. But it mainly comprises the real increase in the rate of benefits. Thus the retirement pension has gone up by about 30 per cent in real terms. This is double the real increase in GDP. The pension has also gone up substantially as a percentage of average earnings.

SECTION L: THE DISABLED

L.1. But there is one group of disadvantaged people to whom we must pay special attention this year. I refer, of course, to the disabled, for this is the International Year of Disabled People. [First, mobility allowance. This will go up by £2 per week to £16.50 from November. This is the third successive year we have increased the allowance in real terms, and it is now £6.50 per week higher than it was when we came into office.]

[Leave to Mr. Jenkin?]

L.2. The special income tax allowance for the blind has stood at its present level since 1975. It will now be doubled to £360. I hope this will at least give some help to the blind in tackling the very great problems they have to face.

L.3. There has been a strong body of representation to me for VAT relief on purchases made by charities. I have regretfully concluded that such relief would be impossible to administer equitably or economically and would cost too much. I do, however, propose to extend existing VAT reliefs for the disabled and the charities serving them. For example, the present zero-rating for articles given to hospitals will in future cover ambulances and wheelchairs. The benefit of this zero rating will also be extended to institutions providing care for the handicapped. Car adaptations for disabled drivers will also be relieved from VAT. The necessary Treasury Order will be laid very shortly.

[Can we make this intelligible?]

[L.4. Also this year I am very pleased to be able to propose changes which will make more generally available the capital gains tax exempt allowance to trusts for the disabled.]

L.5. To encourage part-time work in support of the voluntary movement, the amount a person can earn without affecting unemployment benefit will be increased from 75p per day to £2 per day.

L.6. The total cost of these measures will be about £[ ] per year. This is a modest sum, but if put alongside the reliefs I announced last year in respect of covenanted gifts to charities, the total amount is a very substantial one. These reliefs gave to charities a great opportunity to tap the well of personal beneficence. They are not as well known and certainly not as widely used as I should like. [I am glad to say that I have agreed with [name] on a campaign to publicise these reliefs and the opportunities they offer] or [I shall be arranging for a campaign to be put in hand to publicise these reliefs and the opportunities they offer].

[Who is going to take this further?]

L.7. There are two other matters I might briefly mention. First, I announced last year that we planned when we could to bring into tax invalidity and other incapacity benefits. We had hoped that this might be from April 1982. We propose now to postpone this. I can confirm, however, that the 5 per cent deduction made from the November 1980 uprating of Invalidity Benefit will be made good when this benefit comes into tax. Notwithstanding this postponement the 5 per cent deduction from Invalidity Allowance - the special additional allowance which people can get if they become chronically ill before certain ages - will be restored from next November.

[Why the postponement?]

[Why is Allowance treated differently from Benefit?]

SECTION N: RAISING THE REVENUE: BUSINESSES

Oil companies

N1. I come now to the measures necessary to raise extra revenue needed for this year. Continuing increases since 1979 in the real price of oil have brought substantial benefits to the oil companies. They have altered for the better the economics of many North Sea oil fields. At the same time, for various reasons, the Government's share of the revenues has consistently fallen below what we expected. I believe I may properly look to this area for additional revenue. I foreshadowed in my statement last November the measures which I had in mind for increasing the Government's share of the revenue from the North Sea, while maintaining incentives for further exploration and development. Consultations with the oil industry have taken place and I can now announce detailed proposals.

N2. I intend to introduce a new tax - the supplementary petroleum duty - broadly as outlined last November. This will secure an immediate and sustained increase in North Sea revenues. The new tax will be at a rate of 20 per cent on the total value of oil and gas produced after deduction of an allowance of 1 million tonnes a year for each field.

It will be deductible in computing liability to Petroleum Revenue Tax and Corporation Tax. The legislation will exempt gas supplied to the British Gas Corporation from earlier North Sea fields. There will be provision for the new tax to be refunded where fields do not fully recover their initial development expenditures. These two proposals respond to particular representations by the industry.

N3. I have mentioned already the need to secure a smoother public sector cash flow through the year. It is sensible therefore to make arrangements for this new tax that will help in that direction. The new tax will be payable in monthly instalments. This will be an important contribution to achieving a smoother PSBR through the year. I shall also invite the industry to consider with the Inland Revenue how a broadly similar pattern of payments might be introduced for PRT.

N4. As I announced in November last year I think it right that some of the special reliefs devised for PRT should be altered. I propose therefore some restriction to "uplift" and to "safeguard". [explain?] I do not however propose any change to oil allowance, in view of its important to small marginal fields. These alterations should not, however, prejudice the recovery by oil companies of their proper costs of exploration and investment in the North Sea.

N5. There are a number of other minor changes to improve the oil taxation regime - partly in response to the industry's own views.

N6. The new tax together with a contribution from changes to the PRT reliefs will raise about an extra [£1,000m] in 1981-82. There will be a substantial continuing yield in later years.

N7. The oil companies have urged that my objectives of more revenue, and a more efficient and economical pattern of tax relief could better be secured by a more thorough-going reform of PRT, which would avoid the introduction of a permanent new tax. Although the industry has not yet tabled proposals which I could regard as satisfactory, I do not want to close my mind to the possibility that such proposals might be forthcoming. I propose therefore that the new tax, SPD, should in the first instance have legislative effect only for the 18 months ended on the 30 June 1982. This should allow ample time for further thought and consultation and if anything constructive emerges I shall be prepared to introduce appropriate provisions in the Finance Bill of next year.

Banks

N8. The other business sector which has largely been protected from the effects of the recession is banking. During the last two years the banks have earned exceptional profits as a direct consequence of high interest rates: these have arisen mainly from the employment by the banks of current accounts on which no interest is paid. This has come about because of economic circumstances rather than because of action initiated by the banks. Yet the amounts of corporation tax actually paid by many banks have been relatively low. [IR to supply figures, drawing if necessary on e.g. published accounts of clearers.]

N9. The present level of bank profits is partly, of course, a cyclical recovery from the low level to which they fell in the mid-1970s. The banks have needed to make provision against the effects of inflation and to rebuild the reserves needed to underpin the valuable support they give - and which I acknowledge - to businesses in difficult times. Nevertheless they have enjoyed an economic rent not available to other businesses: and in present difficult circumstances I cannot escape asking them for a special fiscal contribution.

N10. This will take the form of a once for all tax on the deposits of banking businesses which are in operation today. The tax will be charged by reference to non-interest bearing sterling deposits in excess of £10m, averaged over the final three months of 1980. The rate of tax will be 2½ per cent, not deductible against corporation tax. The levy will apply in principle to all banks, but I estimate that the clearing banks will be the source of some [90] per cent of the revenue. Altogether an estimated £400m will be raised in three instalments over the second half of 1981-82. This revenue will enable me to give fiscal reliefs to the rest of industry this year which otherwise I could not afford at all.

SECTION P: RAISING THE REVENUE - INDIRECT TAXES

P1. For the reasons I have explained earlier it is necessary to look to the personal sector for additional revenue. On average, people in employment - the vast majority of people - have had more money to spend. Some extra tax must, regrettably, be levied on that expenditure.

P2. I do not propose any increase in the 15 per cent rate of VAT. As last year, most of the extra revenue needed must come from the excise duties. Increases would be necessary again this year simply to keep the rates in line with the movement of prices generally. However, even with such increases many of the duties would be lower in real terms than they were for long periods in the past. For example, since April 1975 the beer duty has risen by only about half as much as prices generally. I propose therefore to increase the excise duties to produce, in total, about twice as much additional revenue as would be required to compensate for one year's inflation.

Alcoholic drinks and tobacco

P3. First, the duties on alcoholic drinks and tobacco. I propose to increase from midnight tonight the duties on drinks by amounts which, including VAT, represent about 4p on the price of a typical pint of beer, 12p on a bottle of table wine, 25p on a bottle of fortified wine, and 60p on a bottle of spirits.

P4. On tobacco, I propose from midnight on Friday to increase the duty by an amount which, including VAT, will represent 14p on a packet of 20 king-sized cigarettes. At the same time I am abolishing the surcharge on higher tar cigarettes.

P5. There will be consequential increases for other alcoholic drinks and tobacco products. But a little less for pipe tobacco which is used particularly by pensioners. We estimate that the increases on alcoholic drinks will yield £500 million in 1981-82 and £515 million in a full year, and those on tobacco £500 million in 1981-82 and £510 million respectively.

Road fuel duties

P6. Road fuel must also make a substantial contribution. The duties on petrol and derv, will be increased from 6pm tonight, by the equivalent, including VAT, of 20p a gallon. These increases will yield an additional £910 million from petrol and £270 million from derv in 1981-82 and the same in a full year.

Vehicle Excise Duty

P7. I propose to increase the Vehicle Excise Duty on most vehicles by about 15 per cent. The annual duty on cars will increase by £10 to £70. As the duty on derv is being increased in line with that on petrol I do not propose any differential increase on heavy lorries. The VED increase will yield £225 million in 1981-82 and the same in a full year.

Car tax

P8. I propose extending the car tax, which is charged at 10 per cent on the wholesale value and is in addition to VAT, to motor cycles, scooters and mopeds. There is no longer any case for the exclusion of these machines: demand is strong, and there is no reason why they should be treated more favourably than motor cars. The change will raise about £10 million in 1981-82 and £15 million in a full year.

Matches and Mechanical Lighters

P9. Finally, the duties on matches and mechanical lighters were last increased in 1949. They are therefore overdue for some change. I propose to increase the duty on mechanical lighters from 20p per lighter to 50p and the duty on matches by an amount which will add about ½p to the price of a typical box of matches. These changes will come into force at midnight tonight. The increases will yield about £15 million a year.

Summary

P10. In all, these changes should raise £2,430 million in 1981-82 and £2,460 million in a full year. The fact that the yield this year is almost equal to the full year's yield reflects the advantages to the Exchequer of an early Budget.

P11. In deciding on these measures I have done what I reasonably can to limit their direct effect on industry. Admittedly, the increase in derv will primarily affect businesses. But most of the increases fall on those products which are bought by private consumers. Had all these excise duties been increased in line with inflation this would have added 1 percentage point to the RPI. The increases I propose will add a further point. This is the immediate effect. But in the longer run by reducing public borrowing, they will help to bring inflation down and ensure that it stays down. /These tax increases are deliberately designed to reduce real spending power; their purpose would be frustrated if they were regarded as justifying higher money incomes to offset the consequential increase in the general price level./

SECTION Q: RAISING THE REVENUE - DIRECT PERSONAL TAXATION

Q1. I come now to income tax.

Q2. It is well known that inflation exerts an insidious influence on the tax yield for Income Tax. By reducing the real value of the tax free personal allowances, inflation brings about an increase in the burden of tax which we on this side of the House have termed taxation by stealth.

Q3. It was in order to counteract taxation by stealth that certain Hon. Members introduced, and carried, a measure during Finance Bill debates in 1978, requiring Governments to raise the tax allowances by each year's inflation - except where economic circumstances made it impossible.

Q4. This, I regret to have to tell the House, is one of those years. We will not, because of the pressing need for revenue this year, be able to increase the personal allowances and the House will be asked to approve a Special Resolution to this effect. As compared will full indexation of the allowances and rate bands, this will "save" £2½ billion. The need for this revenue is illustrated by the fact that, if I had done no more than revalorise both direct and indirect taxation, the PSBR would be likely, on present forecasts, to approach £14 billion.

[Q5. This has been an exceptionally unpleasant decision to have to take, and I share the disappointment everyone will feel. I have been particularly conscious of the possible impact on the families of people in less well-paid work. In order to provide a measure of protection to this hard pressed group, we have decided that child benefit should be increased in line with inflation; it will go up by 50p a week per child from November, to £5.25. The resources are not available this year for the tax reductions which would sharply increase work incentives for people in every possible family circumstance; but this decision on child benefit will ensure, for the most important group, that the poverty trap is not made markedly worse.]

Fringe Benefits

Q6. At a time when the income tax burden cannot be eased, it is all the more important that the burden should be fairly shared. This is more easily achieved if the tax system encourages employers to provide remuneration in cash rather than in kind.

Q7. The benefit of a company car is already subject to tax, but the tax scales fall short of the true value - for example, the amounts assessed to tax are less than half the AA's estimate of the annual costs of running a car. Last year's Finance Act prescribed an increase of 20 per cent in the scales from this April, just about enough to keep them rising in line with the costs of motoring. I now propose they should be increased by a further 20 per cent in April 1982. For company cars which have little or no business use there is a higher schedule of taxation. I propose to raise the upper limit for this charge from 1,000 to 2,500 miles a year with effect from this April. [? provision of free petrol. Reminder of last year's threat of action.]

Q8. Most people have to pay for their own travel to work whether by rail or by road. Most of the remainder whose travel costs are met by employers pay tax on the benefit. A small minority, however, perhaps one in ten of commuters, escape tax through a weakness in the present legislation. A similar devise enables employees to use credit cards to obtain a wide range of goods and services which are charged to the employer without the employee paying tax. It is quite wrong that there should be these distinctions based on the fine point of ingenious arrangements. I shall ensure that these benefits are brought under charge to tax for all employees.

Q9. Following consultations which took place last year I have decided to leave in place for the time being the earnings threshold for the special rules for taxing most fringe benefits. These will continue to apply only to those earning more than £8,500 a year. Consistently with this approach, I propose to remove the charge to tax on medical insurance premiums paid by employers for the benefit of their employees earning less than this amount. [The other point discussed in that consultative paper was the method of taxing these benefits. I have decided that with effect from April 1982 the benefit from a company car [and the provision of petrol] should be treated as pay for the operation of PAYE, instead of being taken into account separately in the code number. This means that some [200] fewer staff will be needed in tax offices for this purpose.]

[The Chancellor doubts whether this will be readily understood. Does it have to be included?]

Q10. [Vestey to be dealt with by IR in 6 lines]

SECTION R: HELPING BUSINESSES

R1. So far I have been dealing almost entirely with measures that will increase the revenue. From those who have benefitted from high interest rates and from the high exchange rate: banks, oil companies, the 90 per cent still in work who have enjoyed rising living standards. The total raised - including the November measures - is about [£] billion.

R2. An increase in revenue on this scale is essential if we are to offer the prospect of lower interest rates. For that reason most of the revenue must go to reducing the PSBR. But some can go, as it should, to lighten the tax burden on business and enterprise.

R3. However, there is not a great deal available. Not enough for across-the-board measures. It is important to concentrate relief where it will be most effective. A reduction in the NIS cannot be afforded. Nor would a general reduction in corporation tax be appropriate - in any event it would not help those who are so hard-pressed that they are making no profit. Let me explain the ways in which I propose to bring help to business and enterprise.

R4. The first measure is one I have already announced in principle last November: the reform of the stock relief scheme.

R5. Stock relief paragraphs. [IR to revise, and shorten drastically, taking into account MST(L)'s comments, and minimising references to the consultative Docuemnt.]

SECTION S: CONSTRUCTION

Development Land Tax

S1. Because the construction industry is also very hard pressed, it is sensible to remove obstacles to development wherever we can. The Government are committed to retaining the Development Land Tax, but while maintaining the basic features of the tax, we have identified three changes to the tax as which could help to give a stimulus to development, particularly this year and next.

S2. First under the present law if industrial development is undertaken by the owner for his own use, tax is deferred until the property is sold or put to other use. I propose that for two years this relief should be extended. If a development is begun by 1 April 1983 there will be no DLT for an owner to pay on any part intended for his own use until the property is sold or otherwise disposed of. This will be an encouragement to bring forward commercial development including hotels.

S3. Secondly, where property is extended there will in future be no charge if the extension does not increase the size of the building by more than one-third. The current limit is one-tenth.

S4. My third proposal is to help the housebuilding industry and will be of benefit where land is acquired from local authorities for residential development. Builders will not have to pay DLT if the market value of land held by them as part of their stock in trade does not exceed the cost by more than 50 per cent at the time development begins. The present limit is 15 per cent. The cost of these measures is put at up to £m5 in a full year but the benefit to the economy could be much greater.

Industrial Buildings Allowance

S5. As I have said, I am concerned that businesses should continue to invest for the future. Our tax system already provides generous incentives for investment in new machinery. But new modern machines will seldom yield their full potential if they are housed in obsolete and inefficient factories. I therefore propose to increase from 50 per cent to 75 per cent the initial allowance for expenditure on the construction of new industrial buildings incurred from today. The cost will be negligible for 1981-82 and [£215m] in a full year. It will of course benefit not only manufacturing but also the construction industry.

SECTION T: CAPITAL TAXES

T1. The measures I have just announced, which will help very wide sections of industry, will be worth £[ ]billion in a full year.

T2. But it is not enough only to help those already established. If we are to build a strong and vigorous economy we must also encourage and reward the creation of new enterprises and new wealth. I shall say more on this theme later. But I want first to turn to the subject of capital taxation, which is particularly important for small firms.

Capital Transfer Tax

T3. In a year in which we can give no income tax relief, I fear that I cannot make major changes in capital taxation. I realise how onerous the present taxes are.

[Can T4-T11 be reduced by one half?]

T4. I do however propose to continue the gradual process of knocking the capital taxes into shape. One of the major changes made when the capital transfer tax was introduced in 1975 was the idea of lifetime cumulation. A lower scale was introduced for lifetime gifts but this extends in full only up to £110,000 and the relief disappears altogether about £310,000. This attempt to tax all transfers throughout life with only very limited reliefs has proved ineffective. Last year only £15m or 5 per cent of the total yield came from lifetime transfers. Most of that came from trusts which were trapped by the new regime, the yield from gifts being only £2 or £3m. Because the tax on lifetime gifts has to be paid often ten or twenty years earlier than it would have been paid had the property passed on death, people have for all practical purposes stopped transferring property during lifetime.

5. This is in itself a bad thing. Property should pass freely from one generation to another. People should not be compelled to wait for dead men's shoes.

T6. I propose therefore refurbishing the provisions in a way which will be fairer to the taxpayer and at least offer the Exchequer the hope of collection some revenue. At present the lifetime scale at the bottom end is one half of the death scale. I cannot extend the half rate all the way up, although the factor of early payment might well justify this. I propose instead a new scale which will retain the half rate at the bottom and move to a top rate two thirds of that chargeable on death. At the same time I propose limiting cumulation to 10 years. Even that is longer than in many other countries.

T8. These measures have a nominal cost if measured against the situation which at present exists. But in the longer term by easing the way for lifetime transfers, I would hope that the Exchequer as well as the taxpayer would show a net benefit.

T9. As a minor but further measure of simplification I propose increasing the annual exemption to £3000.

[Present as "bringing help to the country side."]

T10. I propose also to deal with the unequal treatment of farmland which is let. If the owner farms himself he qualifies for 50 per cent agricultural relief. If he lets the farm he loses the relief. I propose that in future let land should qualify for relief at 20 per cent, the present 50 per cent relief continuing where the land is not subject to a lease. This should remove one of the factors restricting the supply of farms for letting and provide better opportunities for the new generation of young farmers coming into the industry. [The tax is not of course the only problem. Discussions have been proceeding in both Scotland and in England and Wales on ways to improve the situation. Agreement has been reached in Scotland. I hope it will soon be reached in England and Wales as well. Meantime the changes I propose should help matters forward.] I propose at the same time extending to let agricultural land the facility to pay by interest free instalments and the limit of £¼m will be removed.

[This has nothing to do with the Chancellor?]

T11. Finally trusts where we have recently circulated a Green Paper for consultation. I am grateful to all those who responded. It is more important in this area to get the legislation right rather than legislate in a hurry. I propose therefore that draft clauses dealing with discretionary trusts should be drawn up after discussion with the professional bodies: they will then be published for wider comment and discussion and we will legislate next year. To facilitate this there will be a further and final extension of the transitional period until 31 March 1983, or 31 March 1984 where an application has to be made to the Court.

[No need for separate suggestion?]

[T13. In the aggregate the capital transfer tax reliefs will cost £[ ]m this year and £[ ]m in a full year.]

Capital Gains Tax

T14. I cannot this year give further general relief from capital gains tax. There are, however, two specialised but important matters I do propose dealing with.

T15. First, I propose taking one of last year's reforms a stage further. Then, I had to exclude from the capital gains tax rollover relief for gifts property going into and coming out of settlement. We have since given very careful study to this specialised area and to the necessary safeguards. I am now able to make the rollover available in those cases, too, and so remove the double charge to capital transfer tax and capital gains tax.

T16. Second, I propose taking action against certain devices for artificially reducing capital gains. These devices centre on the market value rule. The measure I propose will ensure that the rule meets its original intention. The tax saved should largely offset the cost of extending the rollover relief - some £60m in a full year. I also propose aligning the capital gains tax rules with new income rules that are being developed following the Vestey case.

/Subsumes Q15 in draft of 28 Feb?/

Stamp Duties

/17. I cannot make any general change this year in the thresholds for stamp duty on house purchases. However, I intend to include one provision in the Finance Bill which will help those buying Council houses. This will ensure that stamp duty will be payable only the discounted price that the buyer actually pays /and not on some higher figure/./

SECTION V : ENTERPRISE

V.1. Last year, I introduced a number of measures to help small firms. In addition to the major new initiative to establish Enterprise Zones, these included a venture capital scheme, improved tax relief for small workshops, and a reduction in the rate of corporation tax for small companies.

V.2. All these measures to encourage enterprise have been widely welcomed. The eleven proposed enterprise zones have stimulated intense interest among investors and the private sector has begun to respond even before the zones are formally established. There are many heartening examples. For example, in Greater Manchester [ ]acres at Salford Docks which have been lying idle for years are now to be released for redevelopment, creating one of the largest single investment opportunities on the area. On Tyneside, Vickers have already begun preparations for redevelopment of a disused site. In the Midlands, the owners of surplus land in Dudley have come together to market it and promote its rapid development. At Clydeside, the local authority has received [over 1,000] enquiries from prospective businesses.

V.3. Meanwhile provision for small factory units financed wholly by the private sector has grown rapidly. The English Industrial Estates Corporation has already raised £25 million from the private sector which, together with the £5 million from the Department of Industry, will bring forward more than 1,500 workshops. To give one specific example, three-quarters of the units in pilot schemes at Jarrow, Sunderland and Wallsey have already been let or reserved for tenants. The continuing demand for small workshops shows the strength of the small business sector.

V.4. But we can and must do more through the tax system to help existing small businesses to grow, and to encourage new businesses to start-up. This remains an essential key to new jobs.

VAT

V.5. First VAT. I propose that, as in past years, the registration threshold should be increased in line with prices - on this occasion from £13,500 to £15,000. The de-registration limit will also be increased from 1 June.

Small companies corporation tax

V.6. Second, I propose to increase from £70,000 to £80,000 the limit up to which the lower 40 per cent rate of corporation tax is payable by small companies. But, I also intend to respond to one of the longstanding complaints from small companies, which is the relatively high marginal rate of tax which they have to pay if their profits lie just above this limit. The limit at which the full corporation tax rate of 52 per cent becomes payable will be raised from £130,000 to £200,000. This will make for a gentler progression from the small companies rate to the full corporation tax rate. The cost of these changes will be £[12] million in 1981-82 and £[21] in a full year.

Industrial co-operatives and partnerships

V.7. Third, new businesses depend on ready access to fresh capital. Last year I relaxed the conditions governing tax relief for money borrowed to invest in close companies. That was good for small companies. This year I am making a similar relaxation for industrial co-operatives and partnerships.

Purchase of own shares

V.8. Fourth, as the House knows, the Government will shortly introduce new clauses at Committee stage of the Companies Bill, to enable companies to purchase their own shares. This will meet a number of problems arising in small and family businesses in connection with minority shareholders and the reluctance of proprietors to part permanently with an equity share in their businesses. [These provisions will be of limited utility unless corresponding changes are made in the present tax structure.] I am, therefore, asking the Inland Revenue to issue a Consultative Document on this subject this summer, with a view to legislation in next year's Finance Bill.

Venture capital scheme

V.9. Fifth, I intend to extend the venture capital scheme introduced last year. This scheme encourages investment in small businesses by allowing capital losses on shares in unquoted trading companies to be set off against income. At present, it is confined to investment by individuals. I propose to extend it to investment by companies, who may be in a good position to attract funds to assist expanding small companies. [I also propose to bring in investment by trustees.]

V.10. All these measures will be of significant help to small businesses. But I intend to go even further. I have three entirely new measures to announce.

[Loan guarantee scheme

V.11. First, I have been very strongly pressed to introduce what is known as a loan guarantee scheme. There are some people who, for one reason or another, have difficulty borrowing the money to start a business. They may, for example, not have the necessary collateral. I am pleased to be able to announce that agreement has been reached with the major clearing banks and the ICFC on the introduction of a pilot loan guarantee scheme.

V.12. The scheme will run for three years initially, subject to an overall maximum limit of £50 million for each year. Individual term loans of up to [ ] will be available for periods of between 2 and 7 years. Government guarantees will be available for up to 80 per cent of each loan. The scheme will be administered by the Department of Industry. Further details will be given by my rt. hon. Friend the Secretary of State.

V.13. The scheme is intended to be self-financing. Lenders will make a full commercial charge for their loans, part of which will be passed on to the Department of Industry in the form of a guarantee premium payment. These premiums will be available to meet calls on guarantees if borrowers default on their loans. They have been set at levels which should meet in full any claims under the guarantee provisions.]

[New enterprise allowance

V.14. My second group of new proposals is directed at encouraging people who are unemployed, particularly those who have just become redundant, to help themselves, and the economy, by setting up in business for themselves. It is sometimes said that the existing Social Security rules, which mean that benefits in general cease when a man does this, can make people hesitate to take the plunge. Accordingly, we are considering a scheme whereby anyone who has recently become redundant and invests and works in a new small business of their own can receive what I propose to call an "Enterprise Allowance" of £35 per week for a limited period while the business finds its feet. This is something which has not been done in this country before, but we think it is worth a try.]

[This proposal is still under discussion in Mr. Kemp's group, and is strongly opposed by IA and IP]

V.15. A similar point arises in the area of income tax. Redundancy payments and other payments made on termination of employment are presently taxable if they exceed £10,000. I am raising this threshold to £25,000 with effect from 6 April. Again, the primary objective is to make it easier for people declared redundant to move to another job or to start a business of their own.

Business start-up scheme

V.16. My third new proposal breaks entirely fresh ground.

V.17. One of the biggest problems faced by people thinking of starting their own business is the difficulty of attracting sufficient risk capital to finance it during its critical early years. The amounts of additional money needed can be modest - at least as compared with the sums in which the big financial institutions commonly deal. But they can be crucial in individual cases.

V.18. The individual private investor has for many years had little encouragement to help fill this gap. I propose to change this. The private investor can often contribute not only risk capital, but also direct personal business experience.

The opportunities are certainly there. What is needed is to make it more attractive and more rewarding for private investors to seize them.

V.19. I am, therefore, introducing an entirely new tax incentive to attract investors to back new enterprise. It is designed for the outside or minority investor in a new small trading company, as distinct from the owner of the business, or his close family or associates. I am calling it the Business Start-up Scheme.

V.20. The scheme will need to include strict rules to ensure that it goes only to support genuine new business enterprises of the kind I have in mind, and is not used for investment in merely financial or passive operations, or for tax avoidance. This is a bold new incentive.

V.21. I am introducing the new scheme in the first instance for a three year period, beginning with the coming financial year 1981-82.

V.22. This Business Start-up Scheme will be [depending on FP view of similar US schemes: "unique, not only in this country, but among our trading competitors. It will be"] a striking new incentive to channel investment into small businesses.

[Operation Enterprise]

V.23. Despite the tight circumstances of this coming year, these measures to encourage enterprise and risk-taking are essential. The future health and resilience of our economy, and the provision of well founded new jobs depend crucially on a healthy flow of new enterprises. We must be ready to set aside resources now to encourage them. They are the real future hope for absorbing and re-directing the people and other resources presently squeezed out of employment by the forces of economic adjustment.

V.24. As I have said, this is the second Budget in which I have included measures to help and encourage small businesses. The measures I have just announced, together with those last year, constitute a formidable battery of incentives. The tax system is now geared significantly in favour of enterprise.

V.25. Much has also been done by this Government to ease the problems of small businesses in other ways - for example by relaxing employment and planning rules. All this represents a complete change in the climate within which the small business operates. It is vital that these enterprise measures be widely known and understood, and that people are encouraged to take advantage of them.

V.26. The Government needs to take the initiative here. We are, therefore, launching a campaign - to be known as [Operation Enterprise] - to publicise the help, advice and incentives which are available to small businesses. At the same time, we shall be setting up a Small Enterprise Council, which will draw together the activities of the various Government agencies involved in helping small businesses. More details of this important campaign will be given by my rt. hon. Friend the Secretary of State for Industry on [ ].

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CHANCELLOR OF THE EXCHEQUER

1 Sections K1 to K4 are rather repetitious: can R.A. have a shot at bringing bits (or all) of K.3/K.4 forward into K.1 – or vice versa?

Give to RA

✓ 2 EEC effect of wine duty?

3 What is PSBR effect of lower costs of stock relief, IBA? The changes make the package hardly missable. Anything else to be done?

RT asking IR

4 Refers to TCSC

5 D.W or F-H?

6 M has – more or less

consciously – distilleard.

Shd. any part of it

be recaptured?

(7) Can you (+ RA)

now consider how far

we need some linking

§§ + sentences to carry

the general argument through?

(8) Peroration? Any

thoughts?

BUDGET SECRET

1(39)

MR WIGGINS

cc PS/Chief Secretary
PS/Minister of State (C)
PS/Minister of State (L)
Sir D Wass
Mr Ryrie
Mr Burns
Mr Middleton
Mr Unwin
Mr Monck
Mr Battishill
Mr Pirie
Mr Cropper

Mr Isaac - Inland Revenue

BUDGET SPEECH: TAX SECTIONS

The Financial Secretary has seen minutes from Mr Unwin and Mr Monck, both of today's date, commenting on sections N, P and Q.

He agrees with all the suggestions made by Mr Unwin, in particular those relating to P1 and Q4. (Noted on the text)

So far as the passage dealing with the tax on banking deposits is concerned, he would prefer Mr Monck's latest version. I've only seen one: this one?

Finally, the Financial Secretary has commented that he is not particularly happy with Q2 and Q3 of the draft circulated on 2 March: he doubts the political advisability of the formulation proposed, and is not in any event convinced of its accuracy. The best course would be, he thinks, to delete Q2, 3, 4 and 5 of this draft, and replace them with Q2, 3, 4 and 6 of the draft circulated on 27 February.

See my amended versions [illegible]

SAJL

S A J LOCKE
3 March 1981

SEE MY OWN AMDTS

SECTION Q: RAISING THE REVENUE - INDIVIDUALS : PERSONAL TAXATION

Main Income Tax Proposals

I come now to income tax.

Q1. /Once again I must have my main priority in mind - the need to contain public borrowing so as to make it possible to reduce interest rates and ease the conditions in which the trading sector of the economy has to operate.

Q2. As is well know, inflation raises the real burden of income tax. This is because allowances and rate bands are fixed in money terms and as the value of money falls so too does the value of these allowances and bands. The question now is how far I can go in lightening the automatic increase in that burden. The position is that, unless Parliament decides otherwise, the various income tax thresholds and allowances are increased in step with the changes in the Retail Price Index during the preceding calendar year.

Q3. To implement this formula now would mean increasing allowances next year by 15 per cent. This would cost about £2½ billion in a full year. This simply is not possible in the circumstances of this year. The incomes of most people have been rising in both money and real terms: but many companies have seen their profits virtually disappear with serious implications for jobs and investment. In these circumstances tax relief on this scale for the personal sector simply could not be justified.

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Q4. This year, therefore, if overall we are to go as far as we should in redressing the balance between personal and business incomes, we cannot afford any increases at all in the personal allowances or the rate bands for income tax. The proposal is thus that the single and married allowances, the corresponding age allowance and related income limits, and the starting points for the higher rates and the investment income surcharge will remain at their present levels.

Q5. I should like to have been able to make some increases in the personal allowances, even in a year in which industry must have first priority. But, despite this, it remains true that for the coming year a man on average earnings will not pay any higher proportion of his income in tax than he did when we took office. And widows and others whose only source of income is a basic pension will not pay tax. [Presumably no reference in speech to implications of non-revalorisation for numbers of tax payers/Inland Revenue staff.]

Q6. I propose no change in the rates of income tax - neither the basic rate nor the higher rates. It would be all too easy to propose such an increase. And it would produce a great deal of revenue. But it would mean going precisely in the wrong direction. Our objective must be to improve incentives to provide motivation, to lay the foundation for enterprise and expansion. This requires lower, not higher rates of tax. My regret is that circumstances mean we cannot reduce the rates of tax this year. But our objective for the longer term remains unaltered.

Q7. [Anything to be said about "holding the position" on the direct/indirect tax balance - to be supplied by FP in the light of calculations on the post-Budget forecast.]

Q8. [NIC increase? - presumably better to omit any reference and cover in briefing.]

Fringe Benefits

Q9. At a time when the income tax burden cannot be eased, it is all the more important that the burden should be shared fairly. Income tax should therefore be levied on income received in kind as well as in cash. There is almost universal agreement, at least in theory, that it is impossible to justify "perks" going tax free. The tax system should therefore encourage employers to provide remuneration in cash rather than in kind. But there is a limit to what can be done in increasing the tax liability on fringe benefits in one year. And a limit to how widely the net can be spread.

Q10. Less than one employee in ten enjoys the benefit of a free company car and roughly half the two million employees involved are subject to tax on the benefit. The tax scales fall short of the true value - as those who have to pay for their own motoring well know. The scale charges are already due to be increased by 20 per cent this April and I propose they should be increased by a

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ISSUES ON WHICH PAPERS ARE REQUESTED

1. Briefing papers provided on arrival in HM Treasury in 1979.

2. Papers connected with preparation of first (1979) Budget, including records of first meetings. Cond.

3. Papers concerned with relaxation and abolition of Exchange Control. ??? ? ~~153~~ 84/01 Exc

4. Preparations for 1981 Budget:

   - HM Treasury to/from Number 10, Bank
   - Chancellor to/from Prime Minister, Governor
   - ? Papers for Parliament and Budget speech

5. Preparation for and of Chancellor's paper to Cabinet in [?] September, 1982 on long-term public spending.

   - Including with and by CPRS
   - Including with and by Number 10/Prime Minister

6. Papers (Cabinet and Cabinet Committees) on Civil Service pay claims, strike and settlement. Some

7. Papers in and from HM Treasury/Chancellor to/from Foreign and Commonwealth Office, Ministry of Defence regarding withdrawal of HM "Endurance" from South Atlantic. Some more to find

8. Selection and appointment of Terence Burns as Chief Economic Adviser. (!) 79/80

9. Selection and appointment of Robin Leigh-Pemberton as Bank Governor.

10. EC Budget - 1980 "Settlement" (papers preceding and surrounding).

Keep in Budget File
MTFS

CHEVENING DISCUSSIONS 15/16 JANUARY 1983

This note seeks to set down the principal points emerging from the Chevening discussions of 15-16 January 1983. It is not a full record of everything that was said.

Towards the Budget - DAY ONE

2. Policy should generally speaking remain as before. As between any alleged trade-off between output and inflation, it was noted that it would be wrong to give any impression that this existed; policies to beat inflation were policies to promote output. Moreover, markets would take it amiss if any such trade-off were admitted; and even more so if there were any overt acknowledgement that pursuit of output were taking precedence over beating inflation.

3. Even the apparent distinction (as set out in the Burns paper) between policies needed to achieve a further significant reduction in inflation in the medium-term, and policies required to stabilize the inflation rate and permit some recovery in output, was not clear cut. It was not the objective to single out a further significant reduction in inflation as a policy aim, regardless of the cost this might bring. On the other hand nor was it the policy simply to stabilize the inflation rate. The aim was somewhere inbetween.

4. It was noted that on the inescapable arithmetic inflation was likely to rise during 1983. This would have to be accepted publicly. The question was whether this should be presented as merely a blip upwards in the course of an onward downward path, or whether it should be seen as the manifestation of a plateauing out around the present (RPI) level. We should lean towards the first interpretation.

5. There was a disturbing inconsistency between the Treasury forecast of year end inflation of 5½/6½ per cent, and that presented by the Bank which appeared to be more of the order of 8½ per cent. There were various possible reasons for this, which should be pursued.

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6. Generally speaking it was felt that especially given the recent fall in the exchange rate, the relatively tight monetary and fiscal policies should continue to be followed. There appeared to be no reason to shift from the general approach set out in the last MTFS.

7. Specifically on monetary targets, the range of 7-11 per cent for 1983-84 was endorsed. It was noted that the fact that inflation was now lower than had been expected at the time of the Budget was in no way a reason for revising this figure downwards. It was left open, however, whether all the aggregates should, as last year, continue to comprise within this 7-11 per cent; or whether different treatment might be appropriate for different aggregates. The exchange rate should continue to be given its current weight in assessing the tightness or otherwise of monetary policy.

8. Specifically on fiscal policy, it was noted that the size of the PSBR for 1983-84 depended on a number of factors including the reaction of the markets, the forthcoming election, and the size of the fiscal adjustment which would accompany it. In summary, it was thought that a PSBR of £8 billion coupled with a fiscal adjustment of up to £2 billion might - assuming the arithmetic of the forecast so permitted - be about right from the differing points of view of the market and home presentation. There was a case for a lower PSBR, and if the fiscal adjustment showed signs of coming out at more than say £2 billion then that case could become very strong.

9. So far as where any fiscal relief might go, the view taken was that, having regard to the recent fall in the exchange rate, and noting what had been done for industry in the Autumn Statement, it was probably not necessary to do as much now for industry as might otherwise be the case. There was a feeling that this year, in contrast to what was done last year, the desired increase in personal thresholds should be built into the arithmetic as a requirement, with any possible reduction in NIS (or other company help) taken as the residual.

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10. Looking specifically at elements in possible Budgets, it was noted that it would be unwise to think too far ahead until it was clearer what fiscal adjustment could be available. Illustrative Budgets of £1.5 billion had been circulated, and the possibility of a £2 billion Budget was mentioned at the meeting. On specific elements in possible Budgets the following points were noted :-

a. On the indirect taxes there was no case, generally speaking, for other than straight revalorisation. However it was noted that some Ministerial colleagues might suggest doing less than this, both for presentational reasons and to help with the RPI (though from this point of view non-revalorisation was a very bad buy). However individual indirect taxes might have to be looked at separately.

b. There was a case for seeking to go for 8 percentage points over Rooker/Wise on thresholds, which would take the tax and NIC burden back to the 1978-79 level as a percentage of average earnings. It would also, of course, help with poverty and unemployment traps, and with Inland Revenue staff numbers.

c. The question of child benefit, in this context, was discussed. Further submissions would be necessary, but if a number of percentage points over Rooker/Wise were given on the thresholds then certainly something over the 3 per cent already built into public expenditure plans would have to be given on child benefit. The view was expressed that within reason such an increase (which would affect 1984-85 more than 1983-84) might be capable of being accommodated within the public expenditure contingency reserve.

d. There was considerable argument over NIS and the three options; do nothing more; reduce by ½ percentage point (leaving it at 1 percentage point); and abolition. Cases were made out for each of these three

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options.

e. The idea that Corporation Tax might be reduced by 2 percentage points to 50 per cent found a good deal of favour, if this could be accommodated within the arithmetic.

f. It was noted that an amount of £300 million, unspecified, had been provisionally allocated for "packages", including the possible cost of any increase in the Mortgage Interest Relief ceiling. These packages would have to be pursued in more detail.

g. A number of fiscal risks not otherwise identified were noted. These included (i) North Sea oil on which work was in hand (and where the interaction of any possible reduction in Corporation Tax would have to be borne in mind) (ii) the petrochemical industry, where submissions should be made urgently (iii) coal prices, where submissions should be made but where it was thought both unlikely and undesirable for any cost to arise (iv) unemployment measures, where it was noted that any costs for 1983-84 might be small though there could be future developments worthy of mention in the Budget Speech (v) industrial rates, which although much pressed was not thought to be any kind of starter for the 1983 Budget and (vi) the motoring taxes, on which a separate submission is being prepared.

11. It was noted that in considering possible fiscal action for the 1983 Budget two particular points should be borne closely in mind :-

a. The impact on 1984-85, both in reality as constraining the 1984 Budget and presentationally as affecting how the 1984-85 fiscal adjustment would appear in the 1983 FSBR, and

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b. The public expenditure element (see for instance child benefit above and also reflected in some of the packages), having regard to the separate constraints that exist here.

The International scene - DAY TWO

12. A number of points were made in discussion.

13. It was noted that concern this year on the international scene might continue to be expressed by the question "Where is the growth going to come from", to which the answer had to be "Keep calm; it will come". But it was suggested that 1983 could be the year of the turning point, when growth would indeed begin and the question would then arise as to how fast this growth was coming, and whether it might not in fact be too fast having regard to the need always to continue to keep control of inflation. On the other hand it was pointed out that there was still considerable downside risks, not perhaps so much in the United States but in Europe.

14. There was debate as to whether variants in the exchange rates as between given currencies were self-cancelling. On the whole it was felt that this should be so, but that it need not always be so especially if individual countries took individual steps to frustrate or otherwise alter the "natural" effect of the effect on them of changes in exchange rates. The Dollar still dominated. A lot depended, as ever, on the stance of US domestic monetary and fiscal policy, and on the world's expectations resulting from it. It was important to try to avoid the 1977 (and previously) experience where the behaviour of the Dollar, coupled with higher national deficits world-wide, reinforced each other in slowing up world growth.

15. It was necessary to continue to keep pressure on the United States so as to support the elements there which looked for restraining the budget deficit. The general benefit to world trade of the lower interest rates this would bring about would surely be more beneficial than the effect of trade of the additional deficit spending in the United States. Such an approach was not, of course, inconsistent with the stance of British domestic fiscal and monetary policy.

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16. It was difficult to see what, in terms of "agenda items" could be discerned to help the general process along. It was suggested that there were signs in the Jurgensen Group that the United States might be starting to see the need to take more account of international factors, rather than just their "benign neglect" attitude. But it did not appear that any new institution or machinery was necessary, what was really required was a fresh attitude and intention.

17. The notion of "convergence" was one which had to be carefully watched. "Convergence" towards a given aim might well be acceptable, provided that aim were the right one. But what was dangerous was the notion of "convergence" towards some kind of average, implying that some countries should go in the opposite direction to what was surely desirable. There were signs in both OECD and the EC that this latter notion was very much alive. In this context it was noted that the United Kingdom's domestic "fiscal adjustment" was not to be seen as "room for manoeuvre" within fiscal policy; it ought to be seen as something which necessarily had to be dealt with if a pre-stated downward path for fiscal deficit were to be achieved. The 1981 Budget showed that this could work both ways.

18. It should be noted, realistically, that two of the important countries on the world's financial scene - the United States and the United Kingdom - both had important elections in the near future. It was thus unreasonable not to expect domestic considerations to be of great importance to them.

19. Turning to the European Monetary System (EMS) a number of points were made. It was thought it would not be at all desirable to join before the election, even if joining were justified on merits. On those merits there was room for disagreement. On the one hand if the United Kingdom is a continuing member of the European Community then it would make sense in a number of ways to join. On the other there was the possibility of the EMS itself not surviving, and in any case the pattern of our trade, and in particular our possession of oil, put us in rather a different category to the other member countries.

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In any case following the election there would no doubt be a period of possibly difficult adjustment in the exchange markets, when again joining EMS would probably not be appropriate.

20. In terms of the EC Budget problems it was not thought that joining EMS would "buy" anything. There was no reason why the other member countries should pay anything to get Britain to join. On the other hand in the context of any general settlement for future financial arrangements, such as surely have to come, joining EMS could be a useful "flavour"element. Much depended on whether one saw the European Community as an important ongoing social, political and economic supa-national entity, on the one hand, or merely a brutal forum of individual national interests, on the other.

21. There was some discussion as to whether in the context of the EC Budget negotiation we were approaching it the right way; would it not be more appropriate to tackle yet again the reform of the Common Agricultural Policy? It was noted that this had been discussed a number of times recently, and in any case could hardly be mounted in time to deal with some of the immediately Budget problems - which included the need to obtain full and proper title to the £500 million due to us for 1982, the need for a proper settlement for 1983, and then onwards the need for a proper long-term settlement.

22. Turning to the question of sovereign debt and the problem of default, it was suggested that the risk might be bigger than hitherto appreciated - particularly on the question of the real oil price, where a reduction might help some non-oil countries such as Brazil but could severely imperil oil producers such as Nigeria. A worsening of the position on international debt could greatly hinder the whole question of world-wide recovery.

23. In a question of dealing with potential default situations the importance of speedy rescheduling arrangements was stressed. Otherwise there could be a tendency for individual banks to take the opportunity of the situation to get out. This might be

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particularly so where geographical interest appear to emerge - for instance the United States appeared more interested in coming to the aid of Latin American countries than to the aid, of say, Yugoslavia.

24. Arrangements for dealing with potential defaulting countries were not good, either domestically within Whitehall and internationally. There ought to be better sorts of machinery. The different loyalties which could emerge - for instance Foreign Offices' wish to stay friends with people and Central Banks' wish to protect the debt owed to them and to those for whom they were responsible, had to be very much borne in mind.

25. The meeting did not have time to consider the questions of trade policy and protectionism, and a further discussion within the Treasury would be set up on this in due course.

The participants were :-

Chancellor of the Exchequer
Chief Secretary
Financial Secretary
Economic Secretary
Minister of State (C)
Minister of State (R)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Littler
Mr Middleton
Mr Kemp
Mr Kerr
Mr Ridley
Mr Harris
Mr French
Sir Lawrence Airey (Day One)
Sir Kenneth Couzens (Day Two)

E P KEMP

17 January 1983

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