PREM 19/176

PART 3

SECRET 189

Confidential Filing

The 1980 Budget. Review of Corporation Tax and Stock Relief. Review of Capital Taxation: ~~The 1980 Budget~~.

ECONOMIC POLICY

PART 1: MAY 1979

PART 3: FEB 1980

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
~~3-3-80~~							
~~5.3.80~~							
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~~27.3.80~~							
~~24.4.80~~							
12.5.80							
Ends							

PREM 19/176

PART 3 ends:-

PM to Bennett 12.5.80

PART 4 begins:-

Ch Ex to PM 31.10.80

TO BE RETAINED AS TOP ENCLOSURE

Cabinet / Cabinet Committee Documents

Reference	Date
CC(80) 12th Conclusions, Item 1 (Extract)	20/03/80
CC(80) 13th Conclusions	26/03/80
CC(80) 14th Conclusions, Item 1	27/03/80

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

Signed OWayland Date 9 March 2010

PREM Records Team

Published Papers

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

House of Commons Hansard 26 March 1980	Columns 1439-1518 Budget Statement

Signed CMWayland Date 9 March 2010

PREM Records Team

Papers removed from file

Date

Financial ~~Statement~~

& Budget Report 1980-1.

ECON POL - Budget Pt3

10 DOWNING STREET

THE PRIME MINISTER

12 May 1980

Dear Mr. Bennett

You wrote to me on 8 April asking for a meeting to discuss the problems you believe development land tax causes London Transport and other statutory undertakers.

I am glad to learn that you regard the proposed advance notification procedures which the Chancellor announced in his Budget Statement as a useful step forward. This and the other detailed changes we are proposing follow from our consideration of the many representations we have received, and, as you may know, Lord Cockfield had a useful discussion with Mr. Bagnall towards the end of last year in which many aspects of development land tax were covered.

I feel bound to say, however, that in reviewing development land tax we have felt it important to be guided by the principle that the public and private sectors should be treated equally. It would in our view be quite wrong to treat one more favourably than the other. If nevertheless there are still matters of general application which you think could still be helpfully discussed, Lord Cockfield would be happy to meet you.

May I suggest, however, that you first re-assess your position in the light of the information in the Inland Revenue

/ Press

Press Statement of 26 March and the recently published Finance Bill. I understand that Lord Cockfield made this point recently when he replied to a request by the Director of the Nationalised Industries' Chairman's Group to send a representative group of chairmen to see him.

Yours sincerely

MT

Ralph Bennett, Esq.

CONFIDENTIAL PFC (80) 2

PRIME MINISTER

MJS

FINANCE (NO. 2) BILL

It is hoped that Members may find the following notes summarising the provisions of the Bill helpful for the Second Reading debate on Thursday, 8th May 1980.

Copies of clause-by-clause background notes issued by H.M. Treasury Press Office are also available in the Whips' Office.

Contents

Excise Duties

Value Added Tax

Income Tax

Encouraging Personal Investment

Fringe Benefits

Heritage

Charities

Small Businesses

CTT

CGT

Development Land Tax

Enterprise Zones

Housing

Oil Taxation

Stock Relief

Other Business Taxes

Trustee Savings Banks

Interest on Unpaid Tax

Conservative Research Department,
32 Smith Square, London SW1

AB/JV
6.5.80

FINANCE (NO. 2) BILL

Summary of the proposals in the Chancellor's Budget statement implemented in the Bill.

1. EXCISE DUTIES

a. Alcohol and Tobacco - Clauses 1 & 2

These are being raised in line with last year's inflation, to keep the real yield roughly constant. Since some - including alcohol and tobacco - have not been raised since 1977, the increase will still fall far short of the rise in prices over recent years. The effects, including the consequential increase in VAT is to raise prices by about:

2p a pint on beer
8p on a bottle of table wine
50p on a bottle of whisky
5p on 20 king size cigarettes, less on pipe tobacco

Yield: alcoholic drinks £273m. 1980-81; £288min full year
tobacco £180m. 1980-81; £195m. in full year

b. Hydrocarbon oil - Clause 3

Duty increased by 10p a gallon on petrol, including VAT. Duty on derv. increased by only 4p a gallon, to bring it back into line with petrol.

Yield: £450m. from petrol; £55m. from derv. in 1980-81 and in a full year.

Heavy oil duty raised by ½p a gallon - yield £50m.
No increase in burning oil or domestic parafin.

c. Vehicle Excise Duty - Clause 4 & 5 & Schedules 3 & 4

Duty increased by about 20 per cent on cars - from £10 to £60, and by about 30 per cent on the heaviest lorries. Duties still lower in real terms than after the last increase in 1977 - Yield £240m. a year.

Duty on electric vehicles abolished; 4 monthly vehicle licences to be replaced by six monthly.

d. Betting and Gaming - Clauses 6,7 & 8 and Schedule 5

Gaming duty restructured, from October 1981, to be payable in 2 parts - fixed sum in advance and variable amount related to gross gaming yield in arrears. Transitional provisions for October 1980 - October 1981. Yield up 2½ times. Brings duty to be increased to 7½ per cent from 5 per cent on 29th September. Gaming machine duty restructured - penny machines exempt. Yield £5m. in 1980-81; £20m. full year.

e. Scotch and Irish Whisky/ey - redefined. (Clause 9)

f. Regulator powers - Clause 10

The power to raise or lower excise duties by 10 per cent is made permanent, and restrictions on the purposes for which such changes can be made are removed.

2. VALUE ADDED TAX

a. The registration threshold is raised from £10,000 to £13,500; the registration provisions are simplified, and relief from payment of

..../

tax on stocks on deregistration raised to £250 from £50 - Clauses 11,12 and 13.

b. Penalties for late payment raised, from £100 + £10 per day to £100 + £10 per day or ½ per cent of the tax due, whichever is the greater - Clause 14.

Lubricating oils are being charged at the full rate from 1st May - change made by Order. Yield: £12m. in 1980-81; £17m. in a full year.

c. Clubs and associations to be registrable in the name of the club rather than of members - Clause 15.

d. Mutual recovery arrangements among EEC member states to be extended to VAT - Clause 16.

3. INCOME TAX

a. Clause 17 - lower rate - 25 per cent on first £750 of taxable income abolished - saving £750m. Higher rate thresholds increased to:

Bands of taxable income	
£	%
0 - 11,250	30
11,251 - 13,250	40
13,251 - 16,750	45
16,751 - 22,250	50
22,251 - 27,750	55
Over 27,750	60

and investment income surcharge threshold increased to £5,500, e,g.: band thresholds are raised by 11 per cent; surcharge by 10 per cent. Cost £100m. 198[illegible]-81; £223m. full year.

b. Clause 21 increases personal allowances:

	from	to
Married allowance	1,815	2,145
Single and wife's earned income relief	1,165	1,375
Additional personal allowance	650	770
Age allowance - married	2,455	2,895
Age allowance - single	1,540	1,820

Cost £1,800m. 1980-81; £2,217m. in full year.

The increase in allowances, 18 per cent, conforms to the indexation requirement of the 1977 Finance Act (Rooker Wise). The net effect, after deduction of the 25 per cent lower rate band, is to raise allowances by 11 per cent for a married couple, and rather less for a single person. Higher rate thresholds are also raised by 11 per cent (as is child benefit, compared to its April 1979 level).

c. Income tax thresholds and allowances and the investment income surcharge level, are to be indexed from 1981-82 Clause 23 .

d. Child tax allowances for children living abroad are to be phased out over 2 years, from 1981-82 - Clause 24.

e. Widows' bereavement allowance is provided under Clause 22.
Gallantry awards are extended to awards other than VC and GC - Clause 25.

There is to be a Green Paper on taxation of husband and wife later in the year.

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4. ENCOURAGING PERSONAL INVESTMENT

a. Profit sharing; 1978 scheme modified by raising the limit on value of shares allocated to employees from £500 to £1,000 per annum and reducing minimum retention period from 5 to 2 years. Minimum tax free period reduced from 10 to 7 years - Clause 45.

b. Share options: 1973 scheme re-introduced: employees to be able to receive options to buy shares in their companies free of income tax liability, linked to contractual savings - Clause 46 and Schedule 10.

c. Life assurance relief anomaly - relief reduced to 15 per cent from April 1981; certain policies disqualified from relief - Clauses 28 & 29.

d. Traded options to be treated as share warrants instead of as wasting assets for CGT purposes - Clause 77.

5. FRINGE BENEFITS

a. From April 1981 scale figures used for measuring the benefit of a company car for tax purposes to be raised by 20 per cent; annual mileage qualifying for reduced rate of tax to be reduced from 25,000 to 18,000 - Clause 47. (Charge of tax on value of petrol provided by employers to be considered for next year if such provision continues to increase).

b. Proportion of value of other benefits (suits, TV sets) to be taken as basis for tax assessment raised to 20 per cent, and charge imposed for acquisition at a discount - Clause 48.

c. Rate of interest taken as basis for tax assessment of value of cheap loans raised to 15 per cent, and exemption limit to £200 - Clause 49.

6. HERITAGE

a. National Heritage Fund to be treated as a charity for tax purposes - income tax, CGT, DLT, stamp duty and NI surcharge; gifts to it to be exempt from CGT and CTT - Clause 103.

b. New extended scheme of tax relief for maintenance funds for historic buildings - Clause 51, 81 and 82 - CTT to be charged on property taken out of fund for non-heritage purpose.

7. CHARITIES

a. CTT exemption for bequests up to £200,000 (gifts made more than a year before death are exempt) - Clause 79.

b. Disposals of land by charities to be exempt from DLT from 25th March 1980 - Clause 98.

c. Income tax relief for covenanted payments to charity extended to higher rates of tax and investment income surcharge, up to £3,000 a year - Clause 54.

d. Minimum period of covenants to qualify for tax relief reduced from 'over 6 years'to'over 3 years'- Clause 53.

e. Gifts to charity by a business which would otherwise qualify for relief not to be debarred by legislation on businesses entertaining and gifts - Clause 52 (replaces extra-statutory concession).

f. Stamp duty/ or deeds of covenant in favour of charities freed from 50 p fixed duty - Clause 87.

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8. SMALL BUSINESSES

a. 100 per cent capital allowances on construction (not on first letting) for small industrial buildings up to 2,500 sq. ft. from 26th March 1980 to 27th March 1983 - Clause 69 & Schedule 13.

b. Venture capital - losses on investment in unquoted companies to be set off against income tax - Clause 36.

c. Small companies' rate of Corporation Tax reduced from 42 to 40 per cent; raises profit limits from £60,000 to £70,000 and marginal relief limits from £100,000 to £130,000 - Clause 20.

d. 'Material interest' conditions relaxed for tax relief for interest on loans for investment in close companies, to encourage outside investment in small firms - Clause 27.

e. Apportionment of income of close companies abolished; maximum investment income disregard increased from £1,000 to £3,000 - Clause 43 and Schedule 9.

f. Restriction on amount deductible for interest paid to directors and associates in close companies abolished - Clause 44.

g. Limits on percentage of earnings qualifying for retirement annuity relief raised from 15 to 17½ per cent; ceiling on qualifying premium abolished; new provision for carrying forward of relief - Clauses 30, 31 and 32.

h. Improvements in tax treatment of partnership retirement annuities - Clause 33.

9. CTT

a. Threshold raised to £50,000 - exempting from tax at least ⅔ of estates which would otherwise have been liable (with 50 per cent existing relief for business transfers; transfer of a business worth £100,000 will incur no CTT if there are no other assets) - Clause 78 and Schedule 14.

b. Small gifts exemption raised from £100 to £250.

c. Exemption for transfers to non-domiciled spouses raised to £50,000 - Clause 79.

Cost of CTT changes £60m. this year; £120m. full year.

10. CGT

a. Exemption limit raised from £1,000 to £3,000, and to £1,500 for trusts - Clauses 71 and 72.

Investment and unit trusts to be exempt (though investors remain liable above the exemption limit) - Clause 75.

Changes will remove from tax half the cases at present liable.

Cost - nil 1980-81; £25m. in 1981-82.

Roll over relief for CGT to avoid overlap of CTT and CGT on gifts - cost £10m. full year - Clause 73.

Extensive consultations on capital taxation to be continued, in particular certain specialised areas such as settled property require very detailed consideration (Budget statement).

Total relief on capital taxes as a result of these measures £210m. in a full year. This compares with an overall net increase in taxation in all forms of £235m. this year.

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11. DEVELOPMENT LAND TAX

a. First instalment of tax on material developments to be payable after 2 years, instead of 1 year, after commencement of the project - Clause 100.

Other changes - Clauses 99 - 102

(Enterprise zones and charities exempt - see above and below.

12. ENTERPRISE ZONES

The Chancellor announced proposals for setting up, on an experimental basis, about six enterprise zones. Sites short-listed at the time of the Budget, and to be discussed with the local authorities concerned, were:-

Attercliffe, Sheffield; a site in Tyne and Wear; a site in Liverpool; Manchester and Salford Docks/Trafford Park; Bilston, Wolverhampton; a London site - possibly Tower Hamlets/Newham, parts of the UDC area/Shoreditch, North Wandsworth; Lower Swansea Valley; a Clydesdale site; Belfast inner city.

The tax proposals relating to the zones are:-

a. 100 per cent capital allowances (for income & Corporation Tax purposes) for industrial buildings, hotels and commercial buildings for 10 years after designation (may be taken at 25 per cent on the straight line basis if preferred) - Clause 68 and Schedule 13.

b. Exemption from Development Land Tax for disposals of land within ten years of designation - Clause 97.

13. HOUSING

a. Thresholds and reduced rate bands for stamp duty on property transfers are raised by £5,000 - exemption limit to £20,000, full 2 per cent rate to be reached at £35,000. Cost £75m. 1980-81, £85m. full year - Clause 86.

b. CGT relief on part of residence that is sub-let as residential accommodation, not exceeding £10,000 or the amount of relief on part occupied by the owner - Clause 74.

Mortgage interest relief ceiling remains at £25,000 - Clause 26.

14. OIL TAXATION

a. Rate of PRT increased from 60 to 70 per cent - Clause 91.

b. Advance payments of 15 per cent 2 months into the chargeable period - Clause 92.

c. Anomalies in rules over transfers of North Sea assets - Clause 93 and Schedule 16.

d. Special provision for fields straddling UK and Norwegian sectors - Clause 94.

Total net yield of changes £535 1980-81; £163m full year.

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15. STOCK RELIEF

Part of stock relief recovery charge consequent on reduction of stocks to be deferable for 1 year for accounts ending in 1979-80. Cost £210m 1980-81 - Clause 39 and Schedule 7.

Flats in tenement blocks no longer to qualify for relief.

16. OTHER BUSINESS TAXES

a. Costs for raising business loan finance to be allowable for tax purposes - Clause 37.

b. Relief for pre-trading costs of business where they would have been allowable during trading - Clause 38.

c. 714 certificates' provisions modified - easier qualification after sickness or absence abroad; public liability insurance no longer required; jurisdiction of Appeal Commissioners extended - Clause 42 and Schedule 8.

d. Redundancy payments: amounts up to 3 times in excess of statutory requirement to be allowable as deduction in computing profits - Clause 40.

e. Capital allowances: leasing and business cars changes - Clauses 60 - 67.

f. Income of authorised unit trusts specialising in gilts and debenture interest to be subject to income instead of Corporation Tax - Clause 56.

17. TRUSTEE SAVINGS BANKS

Tax exemption for first £70 of ordinary deposit interest to be withdrawn; status of TSB s to be that of trading companies - Clause 55 and Schedule 11.

18. INTEREST ON UNPAID TAX

Amount of disregard to be raised from £10 to £30 - Clause 54.

It is intended that provisions to deal with de-mergers should be brought forward during the passage of the Bill.

There is to be a Green Paper on Corporation Tax later in the year.

Conservative Research Department,
32 Smith Square, London SW1

AB/JV
6.5.80

Econ Pol 2

Prime Minister

To glance: a good reaction overseas to the Budget.

TL 24/4

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

24th April 1980

G G H Walden Esq.
Private Secretary to the
Foreign and Commonwealth Secretary

Dear George,

THE BUDGET: OVERSEAS REACTIONS

On the day of his Budget Statement, the Chancellor of the Exchequer sent a message, outlining the Budget measures, to his Finance Minister colleagues in the Economic Summit group of countries, in EC countries not in the Summit group, to the German Economics Minister, Count Lambsdorff, to the EC Commissioner for Economic and Monetary Affairs, M. Ortoli, and to the Managing Director of the IMF.

Such messages have been sent in the past, without causing much of a ripple. This time however there has been positive response, conveying much sympathy with and support for the Chancellor's approach and methods. The Chancellor finds this most encouraging, and thinks the Foreign Secretary and the other Cabinet colleagues may be interested in the (unusual) degree of overseas support the Budget strategy has received. The following paragraphs summerize the various reactions.

Secretary Miller expresses his strong support for "our resolve to control inflation", and his "great interest" in our "elaboration of" a medium-term financial strategy.

When he was in London with the Federal German Chancellor recently, Herr Lahnstein, State Secretary in the German Finance Ministry, said that the Germans had found the message "extremely useful": they had however been concerned

/about the

about the apparent prospect that the output of the non-oil sector of UK industry would be declining over the period to 1983-84. The Chancellor explained the significance of the 1 per cent growth assumption: and the manifest danger of planning public expenditure on the assumption of fast growth. On behalf of Count Lambsdorff, Herr Schlecht wrote at some length to "welcome your Government's financial strategy warmly", adding that, in particular, "an economic policy geared more explicitly to the broad improvement of the supply side of the economy holds out the best prospect of strengthening Great Britain's economic base again in due course". He also said that "especially admirable is the ..... courage in setting annual targets ..... for the growth of the money supply up to the financial year 1983-84": that "socio-economic conditions for growth in the private enterprise sector ..... have to improve continuously over a couple of years. This is likely to bring the British economy back onto a path of sustained non-inflationary growth", and ended by saying that "The German Government supports the priority of principles on which the British Government's medium-term strategy is presently based. Internationally this approach to our common economic ills deserves our continuous and steady support".

The Japanese Finance Minister wrote more briefly, but says that the "explanation ..... is full of useful suggestions to us".

The French Finance Minister also wrote briefly but with an approving reference to our medium-term strategy.

The Managing Director of the International Monetary Fund referred to the "enormity" of the task we have undertaken. He is "impressed by the determination with which you have pursued the aims of reducing public sector spending and controlling the growth in the money supply". He fully supports the medium-term strategy which we have chosen.

I am sending copies of this letter to Tim Lankester, to the Private Secretaries to the other members of the Cabinet, and the Minister of Transport, and to David Wright.

Yours ever,

MH

M.A. HALL
Private Secretary

NOTE: THIS TRANSCRIPT WAS TYPED FROM A TELEDIPHONE RECORDING AND NOT COPIED FROM AN ORIGINAL SCRIPT. BECAUSE OF THE RISK OF MISHEARING, THE BBC CANNOT VOUCH FOR ITS ACCURACY

.. THE BUDGET

recorded from transmission 2125 (BBC-1) 26th March, 1980

RT.HON.SIR GEOFFREY HOWE MP,
CHANCELLOR OF THE EXCHEQUER: As you've heard, it hasn't been an easy Budget, but then we are not going through an easy time. Prices are going up too fast. Too many people are out of a job. Interest rates are much too high. In other words, the economy is still in pretty poor shape and it's going to take a long time to get things right.

It's less than a year since we won the election and it takes much longer than that. Much, much longer to change the whole course of a modern industrial economy. But there's quite a lot of evidence that when we've done it things could look a whole lot better than they've been for many, many years.

The real trouble with Britain is that things have been going the wrong way for a long time. It's true that for most of the last thirty years our standard of living has been going up but more and more slowly. In other countries it's forging ahead. Look from it as to how our standard of living compares with our neighbours. We've been falling steadily behind for a generation. Unless we really do get a hold of things, and soon, we shall go on falling further and further behind.

There are other ways of reminding ourselves of what is going wrong. Look for instance at mortgage rates over the last 20 years. A steady rise through the Sixties and worse still in the Seventies. Or unemployment. Again, you see, the same pattern but even more pronounced. And that's not just a line on a chart. It's people without jobs.

When things have been going wrong for as long as that you can't expect to put them right with a few quick financial conjuring tricks. It will take more than one Budget, more even than two or three because it is bound to take time. Time and patience and the right strategy. So, what is the plan? Enemy No.1 is inflation. Inflation wrecks everything. It pushes interests rates sky-high. Everyone with a mortgage knows what that means. It destroys the value of savings and it often destroys the chances of a job as well. How can an employer be sure of a future if he has to pay 20% interest on every penny that he invests?
BBH

And inflation plays havoc with pay as well as prices. It's no wonder the number of strikes has gone up. But in the end strikes benefit nobody except our competitors. We can't strike ourselves out of trouble.

So inflation is the first big problem. It's taken years to get as bad as it is so it needs a long-term solution and a determined one. We have to set a course and stick to it. So that's why in my Budget to-day I've set out a clear strategy for beating inflation over a period of years. Let me tell you what that strategy involves. First, the Government must stop printing too much money -- the money that fuels the inflation. Or, as the economists put it — all of them incidentally, even Karl Marx — we've got to reduce the growth of the money supply and that means Government must cut its own spending, and cut borrowing too.

Over too many years, Governments have been borrowing too much money. So what's the result? This year we are paying nearly as much in interest on what Governments have borrowed as we spend on the whole of the Health Service. So we must borrow less, much less. And that means spending less.

I know people don't want me to try to balance the books by putting up taxes. Last year I made big cuts in income tax and just as soon as I can I mean to do more because lower income tax means more incentive and more incentive means a better chance of prosperity. But we have got to tackle spending first. So to-day we've published our plans for public spending over the next four years and for the first time since anyone can remember Government spending will actually come down throughout the next four years and come down quite a lot. You can see here the public spending plans we took over from the Labour Government last May. Up and up. And you can see from this lower line just how well we have done incutting back those plans for higher spending. What they would have meant in terms of inflation and taxes and debts just doesn't bear thinking about.

So we are going to save a lot of money and that means we've had to take some very hard decisions. But the easy thing for politicians is to go on spending other peoples' money. These savings will of course take time to take effect. Again, you see, it's a matter of time. I don't pretend it's going to be anything but tough in the short-run. It'll probably be at least a couple of years before things start coming right but after that we really could be on the way up. And not just on another bubble of inflation but well set for steady improvement.

If you have to cut spending then you have to have the right priorities. So we've started by trying to save as much as we can by cutting the cost of administration rather than by cutting services. And we have made a start on that. We have not yet done as well as we should like so we'll keep at it. We are doing our best to look after the services that only Government can provide. We are spending more, for instance, on the war against crime and on defence because economies there are false economies.

BBH

And where we have had to make cuts, we've tried to make the ones that will hurt least. Take education as an example. The number of children in school is falling quite sharply so we are able to make some sensible savings there. We are fully protecting pensioners against rising prices. They pay tax of course on their pensions. Unemployment and sickness benefits are untaxed. So we are not putting up those benefits by quite as much as pensions.

But we are sticking exactly to Labour's plans for overall spending on the Health Service. And the rise in child benefits that will cost over four-hundred-million pounds a year. That will be a real help.

Some of the measures I have announced will be unpopular in certain quarters. Cutting down on benefits to strikers, for example. Most unions give strike pay already but not all. Their members expect to be able to count on the rest of us for support when they are on strike. And most people don't think that's fair.

Of course I'd like to have been able to make bigger cuts in income tax. That's still too much of a drag on enterprise, on hard work and skill. But I do mean to do more on that front just as soon as I can. But this year most taxes are more or less marking time. Some extra taxes on all the usuals I'm afraid. As long as inflation goes on I'll have to do that otherwise they'd go on melting away in value. And some relief from income tax to protect people on lower incomes from the effect of inflation on pay increases they get.

But I have been able to announce a whole raft of positive measures which will help get business moving, particularly small businesses by giving new incentives to people who can enrich the community in other ways. And all these changes should help to check the rise in unemployment. I've cut the tax on small businesses, given them special tax relief for the construction of new factory units, for setting up new enterprise zones, to bring life back to some of the rundown parts of our towns and cities. And we are making other changes. Changes to help people own shares in the company they work for. Changes to help charities and the voluntary organisations. And a reduction in stamp duty to make things a bit easier for home buyers.

As I said, of course this isn't a particularly easy Budget but then we don't live in easy times. Inflation is a world-wide problem. Even in America interest rates are just as high as they are here. The history of Britain in the last twenty years or so, as you saw it on those charts, is the history of short-term solutions that ended up by making things worse. And that's why we've got to have a long-term strategy, even if it does mean difficult decisions in the shorter term and that's what this Budget is all about. It's a long-run Budget to beat inflation, to encourage enterprise and to get us back where we belong.
Goodnight.
BBH

BUDGET SECRET UNTIL END OF BUDGET SPEECH

MAP.

BUDGET SNAPSHOT, 26 MARCH 1980

This condensed summary gives some main points of the Chancellor's Budget proposals. Figures are rounded. Full-year figures are in brackets, those for 1980-81 are not. "COST" is shorthand for extra money taxpayers keep. "YIELD" for extra revenue expected. Not all tax costs and yields are given, so figures do not necessarily add to totals. Tax changes are proposals only, subject to Parliamentary approval. This year, some key points from today's public expenditure White Paper and Medium-Term Financial Strategy are included. This is a working document, designed to help journalists and others to get the main points quickly. It makes no claim to be comprehensive or definitive. For fuller details, see Red Book (FSBR), Public Expenditure White Paper and press notices.

BROAD STRATEGIC AIMS

Budget is further step in new direction signposted by June 1979 Budget. Main purposes: secure eventual slowing of inflation by steady reduction of money growth; reduce public spending and borrowing; offer prospect of lower interest rates in future; continue restoring incentives, encourage enterprise and private effort; retrench now to bring forward day when sustainable economic growth is possible.

MEDIUM-TERM FINANCIAL STRATEGY (MTFS) (RED BOOK P17)

First Budget to set policy for short run in context of published financial strategy over four years (to 1983-84). Set in terms of things Government has power to control. Allows others - decision-makers etc - to work with grain of strategy, understand limits imposed, opportunities offered.

Key points: Growth of money stock slowed on broad lines: 7-11% in 1981-82 down to 4-8% in 1983-84. NOT by excessive use of high interest rates. Therefore progressive reduction of PSBR as % of GDP. Plans for cuts in spending announced today. Revenue depends on growth of output. Cautious 1% annual growth of GDP assumed after 1980. Projections of future growth subject to wide margin of error - dependent on world trade, oil prices, productivity growth, inflation etc. No prediction now what detailed policies needed to keep money growth on beam. But projections show that, on cautious assumptions made, possible to achieve monetary objectives and

- reduce PSBR to 1-2% of GDP by 1983-84
- at same time, leave some scope for tax cuts in later years of period (over and above indexation of direct and indirect taxes).

PUBLIC EXPENDITURE TO 1983-84 (see White Paper, Cmnd 7841, and Treasury Press Notices)

(See also "SOCIAL SECURITY" on page 4.)

Substantial change of direction. Central to curtailing growth of money supply and controlling Government borrowing, and so bringing down inflation and interest rates.

Previous Government's plans for 1982-83 cut by 11½% - nearly £9 billion (1979 survey prices), over £11 billion at today's prices. By 1983-84 planned spending lower by 4% than in 1979-80 (real terms).

UK's net contribution to European Community projected in these plans on basis of existing arrangements: the change under negotiation will increase savings shown.

Increases in services Government best fitted to provide. Cuts where state role not so essential.

Planned increases: defence, 3% annual real increase between 1979-80 and 1983-84; law and order, 2½% annual increase. Planned growth in spending on national health service maintained. Net spending is reduced by increases in charges, including an increase in the prescription charge to £1 from 1 December 1980. For social security see section on page 4.

Planned cuts. Assistance to industry, employment and training, housing (reflecting reduction in local authorities' building programmes and Government's commitment to reduce housing subsidies), education (reflecting fall in pupil numbers), and nationalised industries' borrowing.

Bureaucracy. Previous Government planned for civil service of 748,000 at 1 April 1980. By 1 April 1981 civil service will be smaller than that by at least 50,000.

Local authority manpower: expected to decline overall during next four years: this is consistent with projected decline in gross local authority current expenditure, 70% of which represents manpower costs.

MONETARY TARGET 1980-81

Target range for growth of £M3 (mid-February 1980 to mid-April 1981): 7-11% at annual rate. Objective: to bring £M3 down to centre of range. Monetary growth already slowing down. New target means further slowdown in underlying rate of growth.

Corset scrapped after mid-June. Has affected statistics more than underlying monetary conditions. Firm monetary policy. Essential response to inflation rate. In line with other countries.

PSBR 1980-81 (BUDGET JUDGMENT)

Treasury forecast shows 2½% fall in output, 1980. Should be easier - consistently with given monetary target and maintenance of reasonable interest rates - to finance PSBR in recession. BUT continuing high inflation makes PSBR cut (both in money and as % of national income) imperative. Holding level as % of national income NOT compatible with money targets or MTFS.

Therefore BUDGET AIM: PSBR less than 4% of national income - about £8½ billion (about 4¾% or £9 billion in 1979-80). Necessary in order to achieve target slowdown in monetary growth without putting too much burden on interest rates.

Tax measures (net) make further £235m contribution to PSBR cut next year (direct effect). Full indexation of taxes/benefits not compatible with Budget aim. Right to maintain price protection where most needed. But not possible maintain real value all incomes when national income falling. "Cost plus" mentality in price/pay fixing harmful to conquest of inflation.

Three influences on tax mix judgment:

- Pay settlements (all together) higher than justified by output.
- Large oil price increase (both have boosted inflation and interest rates).
- High £ exchange rate. (Partly due to NS oil.)

Balance has swung in favour of consumers, against companies (except oil companies and banks). Tax measures in accordance with above.

MAIN TAX TOTALS	£m forecast change in yield 1980-81	Full year
INLAND REVENUE TAXES (net)	- 1,020	(- 1,680)
CUSTOMS AND EXCISE TAXES (net)	+ 1,020	(+ 1,065)
VEHICLE EXCISE DUTY (net)	+ 238	(+ 238)
BUS FUEL GRANTS	- 3	(- 3)
TOTAL CHANGE	+ 235	(- 380)
TOTAL IMPACT EFFECT ON RPI OF TAX CHANGES	+ 1.1%	

INCOME TAX (changes from 6 April) (see also SOCIAL SECURITY)

PERSONAL ALLOWANCES All raised by about 18% - equivalent to RPI increase in 1979

People under 65

Married (and single-handed parent): UP £330 from £1,815 to £2,145
Single (and wife's earned income) : UP £210 from £1,165 to £1,375

People over 65 (age allowance)

Married: UP £440 from £2,455 to £2,895. Single: UP £280 from £1,540 to £1,820.

Income ceiling (to qualify for age allowance) UP £900 from £5,000 to £5,900 (full benefit). Some benefit on incomes up to £7,025 (married man) and £6,567 (single).

New tax thresholds (for under-65s without other allowances): UP from £34.90 to £41.25 per week (married man). UP from £22.40 to £26.44 (single).

COST: £1,809m (£2,217m)

BASIC RATE (30%): NO CHANGE

LOWER RATE (25% on first £750): ABOLISHED. Staff saving: 1,300 YIELD: £748m (£901m)

Combined effect for basic rate taxpayers

Take-home pay per week UP £1.18 (married man) - 49p (single). Increase in take-home pay at £80 a week: 1.9% - £120 a week: 1.4% - £180 a week: 0.9%.

AIM: give as much price protection as country can afford. Safeguard position of very poorest taxpayers. Give rather more benefit to married and elderly (married or single) than younger single people.

HIGHER RATES

No change in rates, but all thresholds UP by about 11% on average - similar to net change in tax relief for married man on basic rate after allowing for loss of lower rate band.

% tax	Taxable Income 1980-81	Taxable Income 1979-80	Threshold increase
40	11,251-13,250	10,001-12,000	1,250
45	13,251-16,750	12,001-15,000	1,250
50	16,751-22,250	15,001-20,000	1,750
55	22,251-27,750	20,001-25,000	2,250
60	Over 27,750	Over 25,000	2,750

COST: £98m (£192m)

AIM: give better-off same proportionate relief as married couple paying basic rate tax.

INVESTMENT INCOME SURCHARGE (IIS) (On top of other rates) No change in rate (15%). But threshold UP £500 from £5,000 to £5,500 (10%). Similar modified indexation.

COST: £40m (£86m)

Higher rate and IIS thresholds to be indexed in same way as personal allowances from 1981/82 onwards.

Effects of above changes

1.3m people kept out of all tax. 0.4m people out of higher rate tax. 60,000 out of IIS. Personal allowances kept well above pension levels (otherwise widows and single retired women under 65 liable to tax on pensions). Tax changes reach pay packets: first pay day after 1 June (backdated to 6 April).

OTHER INCOME TAX CHANGES

WIDOWS to receive extra tax allowance (equal to difference between married and single allowance) for rest of tax year after husband's death. AIM: help tide widows over worst period of bereavement. COST: £2m (£2m)

GALLANTRY AWARDS - Pension addition paid to holders of GC, MC, DFC, DCM, CGM, DSM, MM and DFM and annuity and pension addition to holders of MSM to be EXEMPT from tax (as with VC). GC annuitis already exempt. COST: Negligible

LIFE ASSURANCE RELIEF - Tax relief DOWN from 17½% to 15% from 6 April 1981 (Back to half basic rate) YIELD: (£77m in 1981-82)
Relief on certain short-term bond insurances withdrawn from today. AIM: Get rid of anomaly created when basic rate reduced and relief not altered. Prevent abuse of premium relief.

YIELD: £7m (£15m)

FRINGE BENEFITS
COMPANY CARS - From 1981-82. Scale for taxing benefits UP 20% (eg 1301-1800 cc car to count as £300 instead of £250 extra taxable income). ½ scale level (high business mileage) DOWN from 25,000 to 18,000 miles. Cars used less than 1,000 miles for business to pay 1½ times scale.
CHEAP LOANS - Tax to be payable on difference between rate of loan and 15% (instead of 9%) from 6 May 1980. But benefit ignored for tax RAISED to £200 from £50.

Other perks (provision of suits, TV sets, etc). Annual value for tax purposes raised from 10% to 20% or original market value. More effective charge if bought later for less than full value. Consultations on change in earnings threshold for perks tax (£8,500)

YIELD: NIL (£15m)

AIM: In light of last year's cuts in income tax rates, prevent further increase in tax advantage of having company car, cheap loan, instead of cash. Discourage other perks.

CHILD TAX ALLOWANCES (CTAs) - OVERSEAS CHILDREN

Reduced by £200 in 1981-82. Abolished in 1982-83. YIELD:(£4m in 1981-82 £7m in 1982-83)

TAXATION OF MARRIED COUPLES

Green Paper later this year.

TOTAL NET COST OF ABOVE: £1,156m (£1,427m)

SOCIAL SECURITY

Next uprating of benefits: 24 November. Full details from P Jenkin tomorrow.
PENSIONS Married couple: UP £6.15 from £37.50 to £43.45 a week
Single person : UP £3.85 from £23.30 to £27.15
Full estimated price protection since last uprating
Christmas bonus: £10 in early December

CHILD BENEFIT UP from £4 to £4.75 per child. Single parent premium UP from £2.50 to £3.00.

MOBILITY ALLOWANCE (for disabled) UP from £12 to £14.50 a week.

FAMILY INCOME SUPPLEMENT to be extended. SUPPLEMENTARY BENEFIT value maintained.

FUEL COSTS Extra help for poorer people. P Jenkin to give details.

OTHER (UNTAXED) BENEFITS

SICKNESS BENEFIT Employers expected to pay minimum level of taxable sick pay during first eight weeks from April 1982. Discussion paper soon. Brings bulk of sickness benefit into PAYE.

UNEMPLOYMENT BENEFIT To be taxed from 1 April 1982, when payments computerised. No deductions while on benefit. Tax refunds and deductions both, in general, payable after return to work. Tax also on supplementary benefit paid to unemployed, but not on additions for children, rent and rates.
Meanwhile: next uprating of (untaxed) unemployment, sickness, injury and invalidity benefit and maternity allowance to be 5 percentage points lower than estimated rise in prices.

EARNINGS RELATED SUPPLEMENT: REDUCED from January 1981. ABOLISHED from January 1982.

Social Security measures - overall AIM: Concentrate scarce resources where most needed: elderly, families, single parents, disabled, those on FIS and supplementary benefit. Bring short-term benefits into tax, as planned by Beveridge. Widen gap between in-work and out-of-work net income. (Those in work cannot necessarily expect pay to keep up with RPI). Planned spending in 1980-81 already nearly £20bn - ¼ of all public spending.

STRIKERS Assessments of families' needs are to assume striker has £12 a week. First £4 of tax refund no longer to be disregarded. From 1982, benefits and refunds to be taxed/ treated in the same way as unemployment benefit.

AIM: encourage responsibility. Adjust balance now unfairly tilted against employers and responsible union leaders.

SOCIAL SECURITY SAVING IN 1981-82: About £300m

INDEX-LINKED PENSIONS (public sector). Independent inquiry to be set up.

CHARITIES

7-point charities package includes reduction of covenant period from 7 years to 4. Higher rate tax relief on covenants. Exemption limit from CTT for bequests UP from £100,000 to £200,000.

COST £2m (£25m)

HERITAGE

National Heritage Memorial Fund to have tax status of charity. New help for maintenance funds for heritage property.

HOUSING

MORTGAGE INTEREST RELIEF CEILING £25,000): NO CHANGE (rise would not help most home buyers).

STAMP DUTY (on property other than stocks and shares).

All thresholds raised by £5,000. Houses under £20,000 exempted. ½% up to £25,000, 1% up to £30,000, 1½% up to £35,000, 2% above £35,000.

Duty on new leases also eased.

AIM: Help first-time buyers, labour mobility. COST £75m (£85m)

RESIDENT LANDLORDS

Relief doubled on Capital Gains Tax (CGT) payable on part of house let to tenants. (Up to £10,000 extra relief). (eg ¾ of house let. Gain on sale £10,000. Present relief £2,500. New relief £5,000. £5,000 gain taxable not £7,500).

AIM: reduce deterrent to provision of rented accommodation. (For other CGT changes, see "ENTERPRISE PACKAGE".)

INDIRECT TAXES

OIL - CHANGES FROM 6.00pm TODAY

PETROL - UP about 10p a gallon (8½p duty, 1½p VAT). YIELD £450m (£450m)

RPI IMPACT: 0.3%

DERV - UP about 4p a gallon (inc VAT). Duty back to same level as petrol.

DIRECT RPI IMPACT: NIL
INDIRECT: Negligible after one year YIELD £55m (£55m)

100% grant to stage bus operators - no effect on bus fares.

INDUSTRIAL OIL - (for furnaces, aviation fuel etc) - UP ½p a gallon to 3½p.

RPI IMPACT: Negligible YIELD £50m (£50m)

KEROSENE (paraffin and most central heating oil) NO CHANGE (1p a gallon)

TOTAL OIL YIELD: £555m (£555m)

VEHICLE EXCISE DUTY - CHANGES FROM MIDNIGHT TONIGHT

CARS - Licence UP £10 from £50 to £60. Six-monthly licences to replace four-monthlies from 1 October. Stamp payment scheme to come in in August. YIELD £240m (£240m)

Duty on electric vehicles ABOLISHED. (present duty: £40-£70). COST: £2m (£2m)

LORRIES - Licences up about 20%. 30% on heaviest lorries.

RPI IMPACT: About 0.1% NET YIELD £238m (£238m)

DRINK - CHANGES FROM MIDNIGHT TONIGHT

BEER - UP about 2p a pint of average strength. YIELD: £190m (£205m)

SPIRITS - UP 50p a bottle of whisky. YIELD: £40m (£40m)

WINE - UP 8p a bottle (table wine). 9p (Sherry). 11p (Port) 5½p to 8½p (made-wine) ½p a pint (cider). YIELD: £43m (£43m)
All increases include VAT

RPI IMPACT: 0.4% TOTAL YIELD: £273m (£288m).

TOBACCO - CHANGES FROM MIDNIGHT, 28 MARCH

CIGARETTES - UP 5p on packet of 20 king size.

CIGARS - UP 5p on 5 whiffs.

ROLL-YOUR-OWN - UP 7p on 25 gram tobacco pack.

PIPE TOBACCO - UP under 4p on 25 gram pack.

RPI IMPACT: 0.3% YIELD: £180m (£195m)

VAT

NO CHANGE IN RATE (15%)

VAT registration threshold UP from £10,000 to £13,500. COST: £5m (£10m)

No withdrawal of monthly repayments

LATE PAYMENT. Maximum penalty raised to £100 plus £10 or ½% of tax due per day. (New percentage element will affect large companies only).

Lubricating oils. To pay 15% from 1 May. Previously zero rated. Anomaly.

YIELD: £12m (£17m)

BETTING AND GAMING

Racing etc and football pools: NO CHANGE

CASINOS: New tax system related to profits (% of stakes less winnings). Designed to bring in about 2½ times present yield. YIELD: £5m in 1981-82 (£9m)

BINGO: Duty UP from 5% to 7½% from 29 September. YIELD: £5m (£10m)

ONE-ARM BANDITS ETC: Duty changed to exempt penny machines (seaside arcades etc) and increase duty from jackpot machines. YIELD: £1m)

AIMS: (indirect taxes): Help achieve PSBR figure. Prevent inflation eroding real yield of specific duties. Health (tobacco). Energy conservation (road fuel). Fairer share of burden (Casinos).

TOTAL NET INDIRECT TAX YIELD £1,255m (£1,300m)
TOTAL RPI IMPACT: 1.1%

ENTERPRISE ZONES AND ENTERPRISE PACKAGE

ENTERPRISE ZONES

About six Enterprise Zones to be set up in areas of economic decay. Sites up to about 500 acres. New and existing firms in Zones will benefit from:
Exemption from DLT; 100% capital allowances on commercial and industrial buildings; abolition of general rates; simpler planning procedures; exemption from training levies by ITBs; no IDCs needed; minimal Government requests for statistics. Consultative paper today.
AIM: experiment in getting Government off backs of entrepreneurs. Revive industrial wastelands.

COST: (£30-£35m?)

ENTERPRISE PACKAGE

CAPITAL TAXES

CAPITAL GAINS TAX (CGT)

Individuals and Trusts

First £3,000 of individual's gains per year to be EXEMPT. Rest taxed at 30%. (Instead of first £1,000 exempt, next £4,000: 15%, next £4,500: 50%, then 30% on whole gain, if over £9,500.)

First £1,500 of trust's gains to be EXEMPT (instead of £500)

Staff saving: 300 (out of 1,050) COST: 1981-82 £25m (£65m)

Will cut out half of all assessments on individuals and trusts.

Unit and Investment Trusts

Authorised unit trusts and approved investment trusts to be EXEMPT from corporation tax on chargeable gains (present charge 10%). COST: £2.3m (£10m)

Relief for Gifts (between indivuals. Already applies to business assets)

Roll-over relief for donor's gain on gifts between individuals. Relieves double charge to CGT and CTT on gifts. (eg £500 gift including £100 gain to count as £400 acquisition. CGT liability transferred to recipient of gift. Donor's CTT payment to be set against any subsequent capital gain for recipient. COST: (£5m)

Traded Options

Change to CGT, not counting options as "wasting assets".

CAPITAL TRANSFER TAX (CTT)

Threshold for both lifetime and death transfer UP from £25,000 to £50,000. Rates of tax above that UNCHANGED (starting at 30% on death and 15% on lifetime transfers). Exemption for handing on small businesses, farms, UP from £50,000 to £100,000, if no other assets.

Small gifts exemption (Christmas presents etc) UP from £100 to £250.

40,000 estates removed from tax. Staff saving: 400. COST: £60m (£125m)

AIMS: (CGT and CTT): changes of particular help to small business, aid investment, cut discouragement to building up and passing on business. Damage done by capital taxes out of proportion to yield. Big staff savings.

DEVELOPMENT LAND TAX

NO CHANGE in rate (60%) or exempt slice (£50,000).

But developer may apply for earlier tax assessment.

AIM: remove uncertainty about tax liability.

Also DLT loophole closed. And local authorities not to acquire land net of DLT after 5 August.

SMALL BUSINESS PACKAGE

VENTURE CAPITAL. Losses of capital invested in enterprising ventures to be offset against taxed income. (Encourages risk-taking.) Easier tax conditions for CLOSE COMPANIES. (More freedom to get on with business.) And greater ability for them to attract INVESTMENT FROM OUTSIDE.

"Small company" rate of CORPORATION TAX DOWN from 42% to 40%.

Profits limit for "small company" rate UP from £60,000 to £70,000. Higher limit (above which full 52% applies) UP from £100,000 to £130,000. STAMP DUTY on dealings in unlisted securities modified. (Helps financing). Limits on RETIREMENT ANNUITY RELIEF (for self-employed) raised and premium ceiling abolished. New SMALL WORKSHOPS SCHEME with earlier buildings allowances. Easier tax regime when large company splits into smaller units (DEMERGERS).

Also radical changes to remove harsher features of sub-contractors' tax deduction scheme.

TOTAL COST ENTERPRISE PACKAGE (INC. VAT REGISTRATION CHANGE): £124m (£363m)

OTHER BUSINESS TAXES

PETROLEUM REVENUE TAX

Rate UP from 60% to 70% from six months ending 30 June 1980. 15% advance payment in March and September each year from March 1981 for each 6-month period starting with period ending 30 June 1981.

YIELD (Rate): £350m
(Advance payments): £200m

AIM: to secure nation's fair share of profits due to much higher profits

(Less certain concessions relating to NS oil and gas - £15m)

BUDGET SECRET UNTIL END OF BUDGET SPEECH

BANK PROFITS

No hasty action to tax "windfall" profits caused by high interest rates.

CORPORATION TAX

Main rate (52%) UNCHANGED. ACT UNCHANGED. (Not right to reduce tax at expense of higher personal tax. Strategy for lower interest rates best way to help companies.)

Green Paper later in year on taxation of business profits, stock relief and inflation accounting.

Defermentfor year of large part of recovery charge for temporary falls in stocks (eg due to steel strike). AIM: ease temporary pressure on company liquidity.

COST £210m (£125m 1981-82)

LEASING

From 1 June, 100% first-year capital allowance stays only for leased equipment where hirers would qualify had they bought. 25% annual allowance elsewhere (eg public bodies, overseas companies). Transitional provision for TV sets. (No rise for existing TV hire contracts. Small eventual rise for new set rentals.) Cars for disabled (Motability) not affected.

YIELD £90m in 1981-82 (£225m)

REDUNDANCY PAYMENTS

Tax relief for voluntary payments on top of statutory payments, when firms go out of business.

NATIONAL INSURANCE SURCHARGE: NO CHANGE

PROFIT SHARING

Present scheme improved. Annual share limit on allocation to employees raised from £500 to £1,000. Compulsorily held in trust for 2 years (now 5). Income tax charged: 75% (of full charge) in Year 5, 50% Year 6; 25% Year 7; NIL after 7 years (now 10).
AIM: wider share ownership. Aid industrial relations.

COST: (possibly £100-£200)

Share option scheme through SAYE saving to be reintroduced.

PREMIUM SAVINGS BONDS (ERNIE)

ERNIE'S PRIZE FUND to be increased by over 20% from 1 July. (Interest rate up to 7% from 5¾%).

NEW TOP PRIZE OF £250,000 EVERY MONTH

CEILING on holdings UP from £3,000 to £10,000 from 21 April.

NB. Bonds purchased in March 1980 or earlier eligible for 1 July draw for new top prize.

AIM: Add to ERNIE'S attractions. Help finance PSBR.

END

CBI BUDGET REACTION

This is a tough but fair Budget for tough times. The monetary and fiscal policies which the Government are steadily pursuing are the only way left for the UK finally to kill inflation. We have tried everything else. However unpalatable some of the measures may seem, the whole package is the right way to get the economy back on course and we look forward to the lower interest rates so badly needed by businesses to which the Chancellor referred. The Budget would not have needed to have been so tough if we in trade and industry, in particular, managers and unions, had managed our pay bargaining better during this last year. Britain depends on people making and selling things efficiently, so the measures to help small businesses and to encourage wider share ownership and profit-sharing by employees are greatly welcomed by the CBI. What's needed now is realistic pay bargaining and improved efficiency so that we really can begin to march forward to the prosperous future we all want.

Source: CBI Press Office (E. Rayner)
AW. 1800.
26.3.80.

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BUDGET SECRET

COPY NO 40 OF 45

MR HALL

(copy list attached)

BUDGET SPEECH (24 MARCH VERSION)

Your minute of 24 March.

2. The following are my comments (partly for the record) on the parts of the Budget Speech that concern me, namely:-

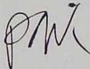
- the two sentences about housing in E.8,
- the local government manpower figures in E.11
- paragraph E.15, about local authority manpower.

3. The two sentences about housing in para E.8 follow very closely wording which Mr Heseltine approved last Friday. Unless there is any significant last-minute change in these two sentences, there is no need for further clearance with DOE.

4. The sentence about local government manpower in para E.11 has been cleared with Mr Dormer (DOE). These are GB figures for the increase in total local government manpower - i.e, both full-time and part-time staff, between June 1974 and June 1979. (If figures are retained in para E.15 - see para 5 below - we need to bear in mind that the totals will not be strictly comparable, since in para E.15 we would be giving full-time equivalents). Miss Peirson is checking that the following sentence in this paragraph about total public service manpower increasing by nearly half a million is still correct in relation to the period 1974 to 1979.

5. As for para E.15, the main point at issue is whether numbers should be quoted or not. The Chancellor wants to give them, to add point and force to the paragraph. Mr Heseltine does not, mainly, we understand, because he considers that the setting of something that looks like a target will lay the Government open to constant enquiries about progress towards it, and criticism if it is apparently not being met. It was left that this point would

be resolved between the Chancellor and Mr Heseltine, in Canterbury today. But I am not clear whether Mr Heseltine knows that there may be a reference in this paragraph to him personally, and perhaps it would be advisable if you were to mention this to his Private Office, if you have not already done so.



P J KITCATT
25 March 1980

CHIEF SECRETARY
FINANCIAL SECRETARY
MINISTER OF STATE (C)
MINISTER OF STATE (L)
SIR DOUGLAS WASS
MR BURNS
MR RYRIE
SIR ANTHONY RAWLINSON
SIR KENNETH COUZENS
SIR DOUGLAS LOVELOCK
SIR LAWRENCE AIREY
MR TOLKIEN
MR BRIDGEMAN
MR LITTLER
MR BARRATT
MR BYATT
MR BAILEY
MR F JONES
MR HANCOCK
MR MIDDLETON
MR UNWIN

MR DAVIES
MR BATTISHILL

MR DIXON
MR KEMP
MRS HEDLEY-MILLER
MISS BROWN
MISS PEIRSON
MR CASSELL
MR BRITTON
MR SHEPHERD
MR FOLGER
MR COLLINSON
MR BOTTRILL
MR CORLETT
MR GRIFFITHS
MR RIDLEY
MR LANKESTER (No 10)
MR BEVERLY (B/E)
MR CROPPER
MR CARDONA
MR WIGGINS

15B

PAYMASTER GENERAL

cc. Mr. Lankester

I am grateful to you for a sight of the CRD report on the ORC survey of reactions to the June 1979 Budget (which I return).

Much of it is, of course, predictable. Indeed, I find most research very useful in supporting one's own judgments. However, research also tends to sharpen perceptions of what needs to be done next time round.

In this connection, the survey has led me to the following conclusions on the action needed this week:

(i) let us decide what is the main message and hammer it home on Budget Day and BD plus 1 in all broadcasts; is there one sentence encapsulating the overall purpose?

(ii) given the ability of people to swallow basic points put simply, we ought to prepare a list of positive bull points for one sheet of paper, perhaps with an intro which says that, whatever else Ministers do, they should get over the main one sentence message (point (i) above) and, where possible, hammer home the following subsidiary points;

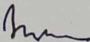
(iii) we need to put over a few bull points which illustrate the essential fairness of the exercise; "fairness" comes through in the survey as one of the main plus/liability points;

(iv) Ministers should pay special attention to getting the message over in Scotland

/(presumably

presumably Wales) and the industrial North where class is more polarised. If millions of trade unionists voted for the Government in 1979, you cannot afford to ignore this constituency. It is also in this context that the main message; the positive bull points; and the fairness angle are particularly important and useful. Would it be possible for you to put out a note to Ministers urging them to seek and take every advantage of opportunities in these areas?

You may care to have a word with the Chancellor or Brendan Sewell. I am also copying to Mr. Lankester who, at my suggestion, asked Mr. Sewell on Friday to prepare a grid bringing out the extent to which Budget measures are in line with manifesto commitment. Mr. Sewell has this in hand.



B. INGHAM

24 March, 1980

cc Mr Lankester
Mr Gaffin

PAYMASTER GENERAL

BUDGET PRESENTATION

I held a meeting on Friday afternoon with the main economic Departments to:

- plug them into Treasury presentation plans;
- get a rundown from the Treasury on the arrangements for Budget Day and the following day; and to
- ensure that such good news as exists in the package of material to be published on Wednesday is not buried.

2. The substance of the Budget, the White Paper or the medium term monetary ~~tariffs~~ targets were not, of course, discussed.

3. The present media arrangements are set out at Annex I.

4. I emphasised the need to:

i Give Treasury Ministers a clear run on Budget Day;

ii Keep in close touch with No 10 on the broadcasting plans of their Ministers so that we might have a chance to co-ordinate the effort; and also to notify Treasury of their broadcasting plans;

iii Adopt a positive approach to requests from the media; it would be very important effectively to argue our case. The Prime Minister would not understand or appreciate a reluctance on the part of Ministers to put over Government policy, subject, of course, to the right format;

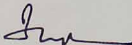
iv Ensure that Ministers, especially in the following Departments DHSS, Energy, DES and Employment (which should help to neutralise the trade union counter punch) - were on standby on Budget Day plus 1.

v Fully brief specialist correspondents if we are to get the good news out, given the sheer weight of material which would emerge at around 5.00 pm;

vi Arrange for D/Industry and the Scottish and Welsh Offices to make good regional use of the enterprise zones announcement;

vii Take stock soon after the Budget to identify strengths and opportunities and to repair weaknesses - eg 'Any Questions' and 'Newsnight' (Friday), 'World This Weekend' etc.

5. On the last point you might feel we should regroup, if possible, before lunch on Thursday, to assess the situation, especially as I shall have to leave for the Anglo/German talks at Chequers early afternoon.



B INGHAM
24 March 1980

ANNEX I

BUDGET MEDIA DIARY AS AT 21 MARCH 1980

Budget Day

i When the Chancellor has finished speaking, the Lobby will be given the Budget speech with a summary, the Public Expenditure White Paper, the Financial Statement Budget Report (Red Book), a full Treasury press notice on the White Paper and the departmental press notice - all as a package.

ii The Chancellor will brief the Lobby between 5.00 and 6.00 pm then return to No 11 Downing Street to make the Budget broadcast (goes out at 9.25 pm).

iii The Chief Secretary will do the ITN Budget Special programme (the wind-up) and then the 'Nationwide' Budget programme between 5.15 and 5.30 pm; IRN at 6.00 pm; ATV Midlands 'Today' programme; Granada Reports; BBC World Service and both BBC and ITN 9.00 pm and 10.00 pm news programmes.

iv The Financial Secretary will do 'The World Tonight' and 'Newsnight'.

v Mr Rees will take the press conference for overseas correspondents.

27 March

i The Financial Secretary will take the press conference at 11.30 am followed by briefing for specialist correspondents.

ii The Chief Secretary will be on 'Question Time'.

iii The Chancellor will give a reception at No 11 for financial and political correspondents, Treasury Ministers, economists etc.

iv Bid for Treasury Minister from the 'Today' programme.

28 March

The Chancellor is on the Jimmy Young Programme.

CONFIDENTIAL

File

D39

20 March 1980

CHILD TAX ALLOWANCES FOR NON-RESIDENT CHILDREN

The Prime Minister has read the Chancellor's minute on the above subject, and as I told you, she has agreed his proposals.

T. P. LANKESTER

Richard Tolkien, Esq.,
H.M. Treasury.

CONFIDENTIAL

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

PRIME MINSTER

CHILD TAX ALLOWANCES FOR NON-RESIDENT CHILDREN

You will wish to be aware of the fact that one of the measures I will be announcing in my Budget Speech will be the withdrawal of child tax allowances for overseas children. The allowances will be withdrawn over a two year period, starting in 1981/82 with a £200 reduction from the present level (£365, £335 or £300 according to age) in 1981/82 and complete withdrawal in 1982/83.

2. The withdrawal of these CTAs will complete the general process of the withdrawal of child tax allowances, and their replacement by child benefit, which was begun in 1977. The phasing out of child tax allowances for non-resident children was originally postponed by one year, but it was postponed indefinitely in the Finance Act 1978 so that representations could be considered. The continued existence of these allowances is anomalous and the Ministers concerned (Home Office, FCO and DHSS) agree that they should be abolished. The decision to defer phasing out until 1981/82, and then to withdraw the allowance over a two year period, should minimise the impact of abolition and reduce criticism from the immigrant community. The five year gap between the original phasing out announcement and its final implementation is long enough to ensure that virtually all the children who were in the immigration pipeline at the start will have had time to get to this country before abolition takes effect.

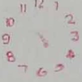
/3. David Lane

3. David Lane accepted, in an earlier discussion with Peter Rees, that the child tax allowances could not continue indefinitely, and I do not think we should have any difficulty in dealing with complaints about the decision from immigrant groups.

(G.H.)

19 March, 1980

19 MAR 1980



BUDGET - SECRET

Econ Pol

PRIME MINISTER

Meeting with the Chancellor

Although all the decisions have now been taken on the budget, I expect the Chancellor will want to discuss it - and in particular its presentation. He may bring with him a draft of his budget speech; if not, I have asked if he would go over its general structure and flavour with you. The Treasury have in any case promised to let us have a draft by tomorrow night so that, if you have any major comments, they can work on them over the weekend.

I think we are most vulnerable on the combination of: abolition of the reduced rate band, the indexation of short-term benefits, strikers' benefits, and child benefit. Although the capital tax package was modified (and of course very much smaller than the Chancellor had originally proposed) this too could cause trouble. On the other hand, there are certainly some good things: in particular, the public expenditure plans in total and the medium-term financial strategy. And, of course, there is another side to the social security cuts and strikers' benefits - the "why work" syndrome and reducing the taxpayer's burden for those who can't or won't work. It is crucial that these positive aspects are brought out.

I have not been warned of any specific points which the Chancellor wants to raise.

T.P.L.

19 March 1980

FILE SECRET RH 14

1. Mr Wolfson ✓
2. Mr Hoskyns ✓ Also seen by A Duguid ✓
3. Return to Mr Lankester

17 March 1980

Budget

This is to confirm that the Prime Minister has agreed the Chancellor's proposals on Capital Gains Tax and interest on Beneficial Loans as set out in his minute of 14 March.

T. P. LANKESTER

R I Tolkien Esq
HM Treasury

SECRET

1 13

PRIME MINISTER

BUDGET

There are just two outstanding decisions on the Budget. These are covered in the Chancellor's note at Flag A.

On Capital Gains Tax, you said that you would have no objection if he raised the threshold from £1,000 to £2,000. He has come back by proposing an increase to £3,000. His argument rests on a point which he did not explain to you before - namely, that he is intending to get rid of the existing marginal relief. In other words, in future all gains above the threshold will be subject to 30% - rather than the present complicated system of first 15%, then 50%, and finally 30%.

Paragraph 4 of his minute explains that if he increases the threshold to only £2,000, and gets rid of the marginal relief, many people will be worse off than at present; and that £3,000 is the lowest he can go for without having this perverse effect.

The argument for abolishing the marginal relief is to simplify the tax, to save staff and to provide a decent reduction in tax on large capital gains. The table which I have prepared at Flag B shows that the alternative of retaining the marginal relief and increasing the threshold to only £2,000 will have only a very small proportionate impact on large gains (see last column). On the other hand, it might be easier to present and defend.

Are you content for the Chancellor to go ahead on the basis of £3,000 as he proposes?

Yes md.

On interest on beneficial loans you were worried about increasing the rate of interest for calculating the taxable benefit from interest-free loans to as much as 15%. The Chancellor argues - fairly convincingly in my view - that this is reasonable. It does not affect loans for mortgages up to £25,000; there is a £200 maximum limit; and the cost of a bank overdraft is currently about 20% Moreover, a 15% rate can be reduced by Order.

/ Are you

Are you content with this?

Final decisions on both of these items are required by Monday morning in order to meet the Red Book printing schedule. The Chancellor is leaving for Brussels at 1030 a.m. on Monday; if you do not agree with his proposals, perhaps you could speak to him on Sunday night.

There are two other points which I should mention:

I The Chancellor has finally decided not to reduce the National Insurance Surcharge. He thinks industry will prefer a lower PSBR than the marginal help which a lower NIS would produce. (This was your own initial reaction when you discussed the matter with the Chancellor.)

II Bank Profits - The Chancellor has decided to do nothing in the Budget itself. But he will refer to the problem of windfall profits in his speech in a way which will not rule out some kind of levy at Report Stage. The Governor has agreed that further contingency work should be done. The Chancellor will minute you on this early next week.

14 March 1980

12

CH/EX. REF. NO. B(80)34

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

PRIME MINISTER

CAPITAL GAINS TAX AND THE RATE OF INTEREST ON BENEFICIAL LOANS

There were two points that you were concerned about when we discussed my Budget proposals this morning. The first was the increase in the capital gains tax threshold; the other was the increase in the notional rate of interest on beneficial loans.

Capital Gains Tax

2. You wondered whether it would not be better to move to a rather lower capital gains tax threshold than my proposed £5,000, and you suggested £2,000.

3. The difficulty about £2,000 is that we are proposing to change the form of the exemption. At present, no tax is charged where total gains do not exceed £1,000. Where total gains lie between £1,000 and £5,000, the tax is charged at half the rate on the amount by which the gains exceed £1,000. Thereafter, the full rate applies to the whole of the gain, except that there is a special marginal relief, which runs out at £9,500 of gains, to ease the transition.

i.e. i) 15% on £1,000-5,000 ii) 50% on £5,000-9,500 iii) 30% on £9,500+.

4. Under my proposals, the new exemption will apply to everyone, whatever the total amount of their gains. There would be no need for any marginal relief. But with an exemption of only £2,000, the effect would be that for gains between £3,000 and £6,500 the tax under the new system would exceed that payable with

/the present

the present exemption limit and the marginal relief. Clearly, we could not defend that.

5. An increase in the exemption to £3,000 is the absolute minimum necessary to avoid that problem, and to ensure that no-one is worse off. And we should still be saving 300 staff, while reducing the full year cost of the capital gains tax package from £110 million to £65 million.

6. There is also the fact that we shall want to present the new exemption as our considered response to the sustained pressure for introducing either indexation or tapering. Whilst I think we should be hard put to carry the argument with a figure as low as £2,000, we could probably do so if I could announce an exemption of £3,000.

7. I hope you will agree that £3,000 would be a reasonable compromise.

Interest on Beneficial Loans

8. You were worried that increasing to 15 per cent the rate of interest for calculating the taxable benefit from interest-free loans would be seen, and represented, as confirming the Government's expectations of continuing high interest rates. I think we can quite easily deflect this charge. After all, this rate is intended to measure the benefit to an employee from not having to pay normal commercial rates on a loan from his employer. When the 9 per cent figure was fixed in April 1978, that was broadly the minimum rate a personal borrower would have had to pay on a bank overdraft. Now he would have to pay in the region of 20 per cent. So 15 per cent still provides a margin below the commercial rate, and we can say so. When interest rates come down again, we can always reduce the rate at any time by a fresh Order.

/9.

9. To keep the rate at only 9 per cent would be substantially to under-value this particular benefit, and, since we have already in recent months made comparable increases in two other interest rates in the tax field, I think there would be general surprise if this rate were not now increased.

10. There are three other points to bear in mind. First, cheap or interest-free mortgages of up to £25,000 do not count as taxable benefits, because the interest would be tax deductible anyway. Second, I am proposing to increase to £200 the limit up to which the benefit is not taxed at all, and this will exclude entirely small loans for such things as season tickets. Third, the main people affected will be those who borrow substantial sums of money from their employers for their personal requirements and I see no good reason, by leaving the rate unchanged, for enabling them to continue to enjoy an increased benefit.

11. In short, an increase to 15 per cent will do no more than maintain the real value of the benefit for tax purposes. On that basis, I think it fits neatly within the general stance we are taking on fringe benefits this year.

(G.H.)

14 March, 1980

CAPITAL GAIN	TAX LIABILITY			
	At present	Chancellor's proposal:	Alternatives	
		ie £3,000 threshold, no marginal relief	£2,000 no marginal relief	£2,000 marginal relief retained in present form
£2,000	150	-	-	-
£4,000	450	300	600	300
£11,000	3,300	2,400	2,700	3,150

10 DOWNING STREET

1. MR. WOLFSON

2. MR. DUGUID

Pls. return to

me

T.

Econ Pol 11 DSG

FILE

b.c: Sir R. Armstrong
No copies for Master set of 2nd carbons

10 DOWNING STREET

From the Private Secretary

13 March 1980

At their meeting this morning, the Prime Minister and the Chancellor discussed various Budget matters.

Income Tax

The Prime Minister said she was grateful for the note which the Chancellor had sent over last night. The figures in this note seemed to indicate that his preferred income tax package would be reasonably fair as between different income groups. In contrast to her earlier impression, those on relatively low incomes would not do too badly. Although care would need to be taken with the overall presentation, she was now content with the package.

Capital Tax

The Prime Minister said that she noted from the minute referred to above that the Chancellor was proposing to stick to the main changes in capital tax which he had proposed in his earlier minute of 7 March. She was still worried about the proposal to raise the exemption limit from Capital Gains Tax from £1,000 to £5,000. She would have no objection to an increase to £2,000, but she did not believe the increase proposed by the Chancellor would be politically acceptable. She was prepared to agree the Chancellor's other capital tax proposals provided they were presented as an adjunct to the "enterprise package".

The Chancellor said that he would look again at his Capital Gains Tax proposal, but he would probably want to increase the exemption limit to more than £2,000.

Fringe Benefits

The Prime Minister had read the Chancellor's minute of 12 March. On cars, she noted that the Chancellor was proposing to increase the scale of benefit charged to income tax by 20 per cent with effect from April 1981, and also to reduce the qualifying mileage. While she would have preferred not to have increased the tax on car benefits, she accepted the point that by April 1981 the benefits charged to tax would have remained unchanged for three years while the cost of motoring was rising fast. She was therefore prepared to accept the Chancellor's proposals.

/Of the other

Of the other two proposals, the Prime Minister agreed with the proposal to increase from 10 to 20 per cent the annual value taken as the measure of the benefit of items such as suits and TV sets which are provided to employees by their employers. But she had doubts about the proposal to increase from 9 to 15 per cent the rate of interest by which the taxable benefit from an interest-free loan is measured. She was worried that the 15 per cent figure would give the impression that the Chancellor believed interest rates would stay as high as this; and if, as seemed likely, interest rates did begin to fall, a 15 per cent figure would seem inequitable. The Chancellor said that he would reconsider.

Stock Relief

The Prime Minister said that she had read the note explaining the "dips" scheme which the Chancellor enclosed with his minute of 12 March. She was still not entirely happy with the proposed scheme. In her view, it would be better to announce the end of the contingent liability and couple this with a smaller allowance for stock relief next year. The "dips" scheme would in effect involve double deferment, and it would be expensive in terms of staff time. The Chancellor responded that the question of contingent liability and the extent of the allowance for stock relief were being looked at as part of the review of Corporation Tax, and this would not be completed for some time. In addition the company sector needed the immediate liquidity relief which the "dips" scheme would provide. The Prime Minister's proposal would not provide a viable alternative.

The Prime Minister said that she would accept the Chancellor's judgment on this.

Charities Package

The Chancellor explained the main elements in his proposed charities package. The Prime Minister said she was well content with them.

Indirect Taxes

The Chancellor and the Prime Minister did not discuss indirect taxes this morning. However, the Prime Minister is aware that the Chancellor has now gone firm on his preferred package, which was designated b(vi) in his minute of 5 March. As you know, the Prime Minister commented on this package at their meeting last week; but she gave the Chancellor discretion to reach a final decision on this himself.

T. P. LANKESTER

John Wiggins, Esq.,
H. M. Treasury.

cc Press Office

Subject file Econ Pol. Pub Exp - Pt 9.

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

12th March, 1980

Dear Mr Chilcot

PRESS NOTICES RELATING TO THE BUDGET AND PUBLIC EXPENDITURE WHITE PAPER

I am writing to seek your and copy recipients co-operation in dealing with the press releases relating to the Budget and the Public Expenditure White Paper, which this year will be published on Budget Day. As far as the White Paper is concerned, this letter amplifies the guidance already given on press notices associated with it in PESC(N)(80)4.

I should be grateful if you and other recipients of this letter could let me know in writing by noon on Tuesday, 18th March:-

(a) what, if any, Budget press notices are proposed by your Department,

(b) what if any Public Expenditure White Paper press notices will be issued by your Department, and

(c) who in each Department might act as a contact point for those press notices.

Where appropriate, please send a nil return. Could you please also make arrangements for me to be informed if there are any subsequent changes to your Department's arrangements.

The Treasury (correct address: Treasury Chambers, Parliament Street) should receive 410 copies of each press notice, whether on the Budget or the Public Expenditure

/White

J. Chilcot, Esq.,
Private Secretary,
Home Department

White Paper, by close of play on Monday, 24th March at the latest. 60 of these should be send to Mr. D. Barton, room 82/2, and 350 to Mr. A. Batchelor, care of Committee Section, room 74/G. Additionally, 750 copies of Budget, but not, repeat not, Public Expenditure White Paper press notices, should reach the Treasury Parliamentary Section, room 128/2, by the same deadline (to be placed in the Vote Office for distribution with other Budget documents to Members of the House on Budget Day).

If this timetable looks likely to cause acute problems anywhere, could you or the Departmental contact point please contact me before 18th March. Otherwise we shall assume that the deadline will be met. This is obviously of great importance, given the huge volume of paper which will have to be handled.

All press notices will be distributed by the Treasury to bodies on their mailing list, including the major national and provincial press. If you need further details of our distribution, these can be supplied by Stanley Godfrey (233-7676). Your Department will need to make its own arrangements for informing specialist journalists, and of course, for putting copies of Public Expenditure White Paper press notices for which it is responsible in the Library of the House (Budget press notices will of course be distributed through the Vote Office).

We should be grateful if all press notices, both on the White Paper and on the Budget, could be cleared in draft with the relevant Treasury division. The final version of each press notice should be sent as a separate exercise to the relevant Treasury division.

I should be grateful if you could distribute this letter widely in your Department.

I am copying this letter to the Private Secretaries to all Cabinet Ministers, the Minister of Transport, and the Minister of State for the Civil Service.

Yours sincerely

L E Birnie

(MISS L.E. BIRNIE)

BUDGET - SECRET

PRIME MINISTER

Meeting with the Chancellor:
13 March

The Chancellor will be sending you a minute later tonight on his income tax package. I have seen this minute in draft, and the figures in it seem to show that people on low incomes won't do too badly. I suggest you should go over these carefully with the Chancellor before reaching a final view. By careful presentation, I believe the package can be presented as reasonably equitable. For example, someone on £50 a week will have a larger absolute reduction in tax than someone on £100 a week. And although at very high incomes, the reduction in tax in absolute terms is large, in percentage terms the extra burden of tax will be larger than at lower income levels. Nonetheless, you still might want to press the Chancellor to up-rate the top band by less than 11%.

The Chancellor may also come back to you on capital taxation. At present, he is still planning on the package he put to you last week; but in view of your remarks this evening, I suspect he will be having second-thoughts - particularly on CGT. It might be better to wait until he has firmed up some revised proposals before discussing this again.

At Flag A is a minute from the Chancellor on fringe benefits and the DIPS Scheme. I think the latter is reasonable enough; you will no doubt want to go through the fringe benfits proposals carefully. The Chancellor's basic argument is that he is simply moving to stop the present anomolies etc., from getting worse; and his proposed change on company cars will not take effect until April 1981. (John Hoskyns, who has written a general note at Flag B on the Budget, supports some move on fringe benefits.

There are two other things which the Chancellor may raise:-

(i) Issue of Shares by BP

You said today that, if BP were to issue additional shares, we should not allow the Government holding to fall below 25% - with the implication

/that we

that we would have to buy some additional shares. The Chancellor will dispute this on the grounds that: (a) it will cost money - perhaps £50 million if BP were to issue £200 million of new shares, and (b) it would look like intervention in their affairs. The expenditure point is well taken, but you will want to probe him on the alleged intervention point.

(ii) Public Expenditure on the British Council

Pressure is building up from the Foreign Office and other Backbenchers to exempt the British Council from its share of public expenditure cuts. Correspondence on this is at Flag C. The Chancellor wants your support against the Foreign Office. There are some separate papers in the box from Lord Carrington asking for exemption for the Foreign Office from the 2½% staff cuts. He is invoking the exception which Cabinet agreed for "very small departments". I do not think you ought to settle this - or the other Foreign Office bids - with the Chancellor bilaterally, i.e. without having Foreign Office Ministers in as well.

AJ for TL

12 March 1980

12 March 1980

PRIME MINISTER

Here are some comments on the points raised in your discussion with the Chancellor last Friday. I would like to have got it to you in time for your meeting with him this evening, but the PPB and Bournemouth preparations have put us rather behind.

1. WHAT ARE THE BUDGET'S OBJECTIVES?

1.1 The Budget must convey a clear message and sense of purpose. It must not appear to be a return to Healey-style ~~bickering~~. tinkering.

1.2 The main message must be the commitment, over time, to ending inflation. Our scope here is limited by our failure to de-index on an adequate scale in public expenditure.

1.3 The Budget must be seen as fair as well as firm. Its measures, its objectives, and measures we have already taken in the past, must all hang together coherently.

2. COMMENTS ON CHANCELLOR'S PROPOSALS TO DATE

2.1 For the above objectives, the most important of Geoffrey's proposals must be the proposal to set out a medium-term financial plan related to the PSBR and the growth of the money supply. It both demonstrates our commitment and also reminds people that the cure takes time. The Governor's objections last Friday don't add up to much. It's the old chicken-and-egg argument. The Government does not "take responsibility for continued slow growth", simply because it publishes its best forecasts on what will happen. When the Governor says that "wages might not accommodate to the declining monetary path" is he saying that it is better that we should not tell the operators in the economy too much about the path to which those wages have to accommodate? Is he forecasting the necessity for a freeze? Isn't a freeze more likely to be avoidable if the maximum information is given to ensure that behaviour within the economy is compatible with the monetary path? It's certainly true that we're finding it hard to stay within the existing one-year target - but is that surprising, with £18bn a year of auto-indexed public expenditure? This whole

exercise is presumably part of a bigger and properly worked out programme to get all that under control. Other colleagues may raise similar time-honoured objections, but they all amount to a sub-conscious desire to avoid announcing that you're going to try and do something difficult, in case you fail. And they completely overlook the effect of that announcement on, first steeling the Government's own resolve and, second, altering expectations in the economy.

2.2 You raised a number of points on Geoffrey's proposals. Here are some comments:

(a) Abolition of the reduced rate band may have undesirable distributional and incentive effects - though the latter are unavoidable if income tax is to be raised in real terms. Abolition would look divisive, especially since - I believe - the introduction of the reduced rate band followed a sustained campaign by the TUC.

(b) We believe there are compelling reasons of fairness, longer-term coherence and avoidance of anomalies in favour of some moves on fringe benefits. Any real increase in their taxation could be quite modest and therefore symbolic. (To abolish the reduced rate band of income tax and leave fringe benefits untouched would look very unfair when we are telling the country that we are going into some very rough weather.)

(c) Corporate liquidity indications look increasingly grim. I am sure Keith is right to press for reductions in NIS rather than the much slower and more indirect (and widely spread) benefits of a lower PSBR. Of course, pressure on the corporate sector to adjust to the harsh realities must be maintained, but there is a limit to how fast the adjustment can happen.

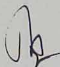
(d) We still feel that there is scope for extending the principle of partial de-indexation, though I realise that this would need fresh Cabinet consideration on public expenditure. There are two quite distinct purposes here. First, there is the need to reduce public expenditure in the short term. Second,

but quite different, is the need to start the process of matching the deceleration of money incomes to the deceleration of our monetary growth. To date, our thinking has been quite misconceived. We have assumed that the monetary deceleration would start in the private sector, under pressure of unemployment and bankruptcies (despite the tenuous connection between the actions taken by fiercely-competing unions, and the results of those actions). Meanwhile, the rest of the system (public sector pay under Government influence, and social security payments under Government's complete control) have remained fully indexed! We have tackled it completely the wrong way round. Everything that Government pays out should have been immediately partially-indexed (we can't now undo the commitment on pensions, though even those could have been de-indexed rather less, for symbolic purposes, than other social security payments, as part of a really purposeful package to cut inflation). After that comes heavy pressure on the public sector and then finally the private sector or what's left of it. I found Ken Berrill's minute of 27 February very disappointing. It presumably reflects Gordon Downey's view, who was on the Wass group. The penny never really dropped with that group; the need for the "change of gear" didn't seem to be grasped; confusion between cutting public expenditure on one side, the monetary deceleration on the other, was total; and there was vigorous ~~defence of~~ resistance to anything less than full comparability in public sector pay! Another boat missed.

(e) If it's too late to do any more de-indexing, it might be possible to squeeze a little more tax out of the oil companies so that the de-indexation of Rooker-Wise could be brought into line with the de-indexation on unemployment benefits. It seems sensible that they should both be at 5% so as to establish the pattern of equal treatment for extending de-indexation, as I am sure we will have to do as we find inflation coming down too slowly.

3. WILL WE NEED SOMETHING MORE?

3.1 I made the points in 2.2 (d) to Geoffrey on 20 February but it was probably already too late for any new insights to be useful. The problem was that the indexation study took place so late that its results could not be properly digested and it is probably now being put away in the files as an academic exercise. The result is that the public expenditure cuts have not created enough manoeuvring space for anything but a tinkering Budget - redeemed, I hope, by a medium-term forecast. There must be a strong possibility that we will have to do something else on more Hayekian lines some time in the next year (ie along the lines of the "shock package" I suggested in January).



JOHN HOSKYNS

8.

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

PRIME MINISTER

(Many continue but figures in paras 12 and 14 are correct) 13/3

INCOME TAX AND CAPITAL TAX PACKAGES FOR THE BUDGET

Mr. Lankester's letter of 10th March refers to your concern about the implications of my proposed income tax and capital tax packages. You also said you would find it helpful to have some clear figures on the distributional effects of my income tax proposals, and possible alternatives.

Income Tax

2. First, however, a word about the income tax package as a whole. There is a limit to what we can or should do to help individuals in this Budget. Over the last year, individuals have increased their after-tax incomes by 20 per cent in nominal terms, and by 3 per cent in real terms. As the minutes which I sent you by Mr. Burns and Mr. Middleton showed, they have benefited overwhelmingly both from the policies which we have pursued and the high pay settlements which they have extracted.

3. In order to retain the broad balance of the Budget and offer the prospect of declining interest rates over the coming year, I must aim for a PSBR of about £8½ bn or slightly lower. Even then, there can be no guarantee that interest rates will fall in the early months, given the present background of rising international interest rates and a continuing high level of bank lending.

/4. The

4. The money is simply not available fully to index the tax system. The Budget arithmetic allows me to spend only £1¼ billion on income tax next year. A 17.8 per cent change in the income tax system - the basic personal allowances (i.e. those covered by the Rooker/Wise provision) plus the lower rate band, and the basic and higher rate bands and thresholds - would cost £2 billion next year. This is what would be required to prevent any increase in the real burden of income tax between the two years. To find enough to do this full indexation would mean either putting up the basic rate of income tax or adding to indirect taxes and the RPI. This is clearly unthinkable.

5. So whatever shape the package takes, it cannot compensate fully for inflation. This is what lies at the heart of the distributional effects which you noted.

6. Perhaps I can try to illustrate this. Prices have risen by about 18 per cent over the past year. For a married couple whose earnings just keep pace with that, the effect of unchanged tax rates and allowances produces the following reductions in real take-home pay:

Gross Pay (£ per week)	50	80	100	120	180	360	600
Percentage reduction	-4.1	-3.3	-2.7	-2.4	-2.0	-4.7	-5.4

7. Those who suffer most from the interaction of inflation and tax are at the bottom and top ends of the income scale. This reflects the fact that, under our income tax system, these are the points at which people face the sharpest increase in tax on extra income.

/8. Only

8. Only if the tax system is fully indexed can these inflationary effects be completely offset for everyone in a particular year. To the extent that the personal allowance increases fall short of full indexation, we can mitigate, but never completely eliminate, the awkward distributional features of the effects of inflation shown in paragraph 6 above.

9. This is the problem this year. There are effectively only two ways of constructing a package costing no more than £1¼ billion:

(i) by increasing all the allowances and rate bands by a lower percentage than 17.8 per cent, while retaining the lower rate band; or

(ii) by increasing them by the full 17.8 per cent, but saving money through doing away with the lower rate band altogether and, at the top end, by providing something rather less for higher rate taxpayers.

10. The first option would forego the savings from removing the lower rate band. It would mean I could afford only a 10 per cent increase in the personal allowances. But this would also bear more heavily on the lower-paid, so we should not be giving any more to those with incomes between £2,500 and £5,000.

11. So my proposal is for the second option. This has the advantages that it would enable me:

(i) to meet the Rooker/Wise increase in allowances;

(ii) to stop inflation eroding the tax threshold, dragging people on low incomes into tax and

/creating

creating difficulties in the overlap between tax and social security;

(iii) to give rather more to married couples than to single people; and

(iv) to make major staff savings of over 1,200 in the Inland Revenue.

12. In distributional terms the package will go a fair way to restore the position of a year ago and so offset the effects of inflation shown in paragraph 6 above. But it cannot do so fully. Consequently, the reductions in real take-home pay will be as follows:

Gross Pay (£ per week)	50	80	100	120	180	360	600
Percentage reduction in real take-home pay	-1.8	-1.5	-1.2	-1.2	-1.2	-1.6	-1.9

13. I have been considering how to present this package in the light of these figures and your comments on them. The first point to make is that the newspapers are unlikely to make sophisticated calculations of the sort I have just described - though we may have to face some of these in the House. The Press will show the changes in simple money terms, comparing the tax paid before the Budget with that paid immediately after. This represents a true picture of the impact of the Budget on family living standards on the day after the Budget, even if it becomes increasingly unrealistic as prices and incomes continue to rise during the following twelve months.

/14. On

14. On this simple basis, our press notice issued on Budget Day will show the following cuts in income tax as a result of the Budget:

Gross Pay (£ per week)	50	80	100	120	180	360	600
Reduction in tax (per year)	64	61	61	61	61	380	686

15. The cash gains to those on the highest incomes look large, even though they represent only an 11 per cent increase in the higher rate threshold and bands, and not the full 17.8 per cent. But we can nevertheless say that, when account is taken of inflation, this group is being asked to shoulder the largest real increase in their tax burden - as the figures in paragraph 12 show.

16. My conclusion is that, since we cannot fully compensate this year for inflation, I have identified the best possible package, and one which, in the circumstances, we can defend.

Capital Taxation

17. So far as capital taxation is concerned, I also believe that we ought to stick to the main changes I proposed in my minute of 7th March. They fall well short of those provisionally agreed at the beginning of the year, which were in turn less than I should have wished to have put forward and less than we have led our supporters to expect. If we now make no major changes in the tax at all - not even to take account of inflation - it will be severely damaging to the enterprise theme in the Budget and undo much of the good which my enterprise package should otherwise achieve.

18. The CGT proposals I put to you provide the only way we can see of dealing with the serious distortions and inequities caused by taxing paper gains: while the overlap between that tax and CTT is seen as an unreasonable double charge. The CTT proposals are also designed to take account of inflation and check the rapid increase in the weight of the tax which it has brought about. If we make no changes at all, the number of taxpayers will rise from less than 30,000 at the time of the last change to nearly 60,000 next year. Simply to allow for inflation and get the number back to the previous level would require an increase in the threshold to £35,000 and increases in the rate bands all the way up the scale. By proposing, at considerably lesser cost, a rather larger increase in the threshold and no changes further up, I am concentrating the benefit on the smallest estates and doing little for the really wealthy.

19. There are also considerable staff savings which can be achieved here. The CGT package would realise a saving ultimately of 550 staff. In the case of CTT, no increase

/in the

in the staff complement has yet been allowed to cover the increase in cases brought about by inflation. That in itself would call for an increase of some 200. By contrast, with a threshold of £50,000 we could cut the present complement by 220. Hence the gross staff saving which my capital taxation proposals would secure as a whole would fall only a little short of 1,000.

20. In short, while this is not the time to help the rich, we must do something now to ease the oppressive burden of these taxes, if only a first step to compensate for the effects of inflation. I am deliberately foregoing major structural changes for this year. In this respect, the proposal for 10 year cumulation, although it can have no cost until at least 1984, could be construed as structural and therefore dropped from my proposals with less damage than the other, main items. This apart I should much prefer not to water down yet further the proposals I put to you.

GH

(G.H.)

R 12 March, 1980

ANNEX I

DISTRIBUTIONAL EFFECTS

"STATIC" COMPARISON

Multiples of Average Earnings (£ p. week)	50	2/3x 80	100	1x 120	1½x 180	3x 360	5x 600
"Preferred" Income Tax							
SINGLE PERSON							
Change in Take Home Pay (£ p. week)	0.50	0.50	0.50	0.50	0.50	6.60	11.80
Change in Take Home Pay (%)	+1.1	+0.8	+0.7	+0.6	+0.4	+2.8	+ 3.4
MARRIED COUPLE							
Change in Take Home Pay (£ p. week)	1.20	1.20	1.20	1.20	1.20	7.75	13.20
Change in Take Home Pay (%)	2.5	+1.8	+1.5	+1.3	+0.9	+3.2	+ 3.7
MARRIED PLUS TWO CHILDREN							
Change in Disposable Income* (£ p. week) - CB at £1.50	2.70	2.70	2.70	2.70	2.70	9.25	14.70
Change in Disposable Income (%)	+4.8	+3.7	+3.1	+2.7	+1.9	+3.7	+ 4.2
Change in Disposable Income (£ p. week) - CB @52p **	1.70	1.70	1.70	1.70	1.70	8.25	13.70
Change in Disposable Income (%)	+3.0	+2.3	+2.0	+1.7	+1.2	+3.3	+ 3.8
"Alternative" Income Tax Package							
SINGLE PERSON							
Change in Take Home Pay (£ p. week)	0.77	0.77	0.77	0.77	0.77	5.75	10.30
Change in Take Home Pay (%)	+1.7	+1.3	+1.0	+0.9	+0.6	+2.4	+ 3.0
MARRIED COUPLE							
Change in Take Home Pay (£ p. week)	1.15	1.15	1.15	1.15	1.15	6.35	11.00
Change in Take Home Pay (%)	+2.4	+1.7	+1.5	+1.2	+0.8	+2.6	+ 3.1
MARRIED PLUS TWO CHILDREN							
Change in Disposable Income (£ p. week) - CB at £1.50	2.65	2.65	2.65	2.65	2.65	7.90	12.55
Change (%)	+4.7	+3.6	+3.1	+2.6	+1.9	+3.1	+ 3.4
Change in Disposable Income (£ p. week) - CB @ 52p	1.65	1.65	1.65	1.65	1.65	6.90	11.55
Change (%)	+2.9	+2.3	+1.9	+1.7	+1.2	+1.2	+ 3.2

* Although Child Benefit will not be paid until 24 November, the full figure of 2x75p = £1.50 is shown as benefitting families as from April.

** Here the value of the £1.50 increase in CB is averaged over the year i.e. (18/52) x £1.50 = 52 pence.

ANNEX II

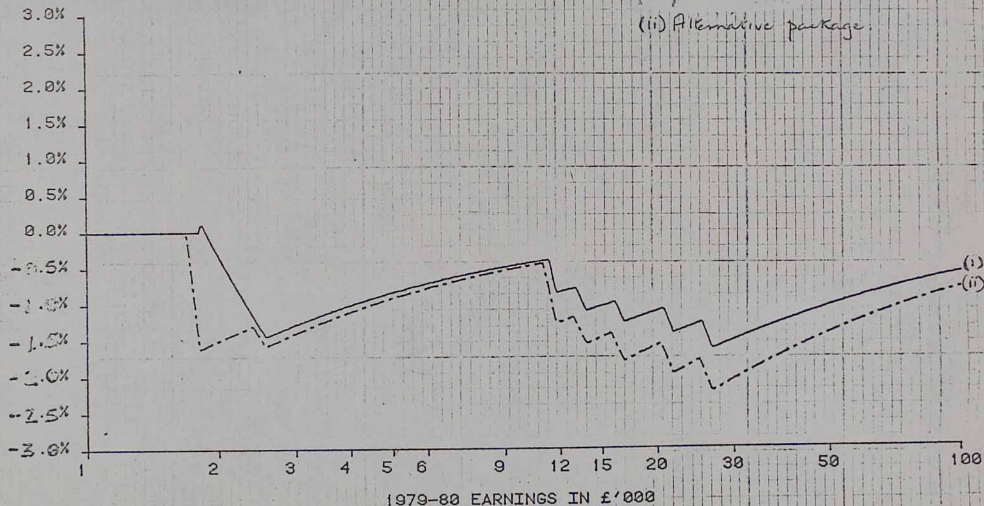
'DYNAMIC' COMPARISON

Multiples of Average Earnings (£ p. week)	50	⅔x 80	100	1x 120	1½x 180	3x 360	5x 600
'Preferred' Income Tax							
% Change in Real Household Disposable Income							
Single Person	-2.0	-1.7	-1.4	-1.3	-1.2	-1.7	-1.9
Married Couple	-1.8	-1.5	-1.2	-1.2	-1.2	-1.6	-1.9
Married plus two children	-2.9	-2.5	-2.1	-1.9	-1.7	-1.9	-2.0
'Alternative' Income Tax Package							
% Change in Real Household Disposable Income							
Single Person	-1.4	-1.3	-1.0	-1.0	-1.0	-2.1	-2.3
Married Couple	-1.8	-1.6	-1.3	-1.2	-1.2	-2.2	-2.4
Married plus Two Children	-3.0	-2.5	-2.1	-2.0	-1.7	-2.4	-2.6

BUDGET - SECRET.

PERCENTAGE CHANGE IN INCOME AFTER TAX

IN REAL TERMS
RESULTING FROM A 17.5% INCREASE IN PRE-TAX INCOME
BETWEEN 1979-80 AND 1980-81
MARRIED



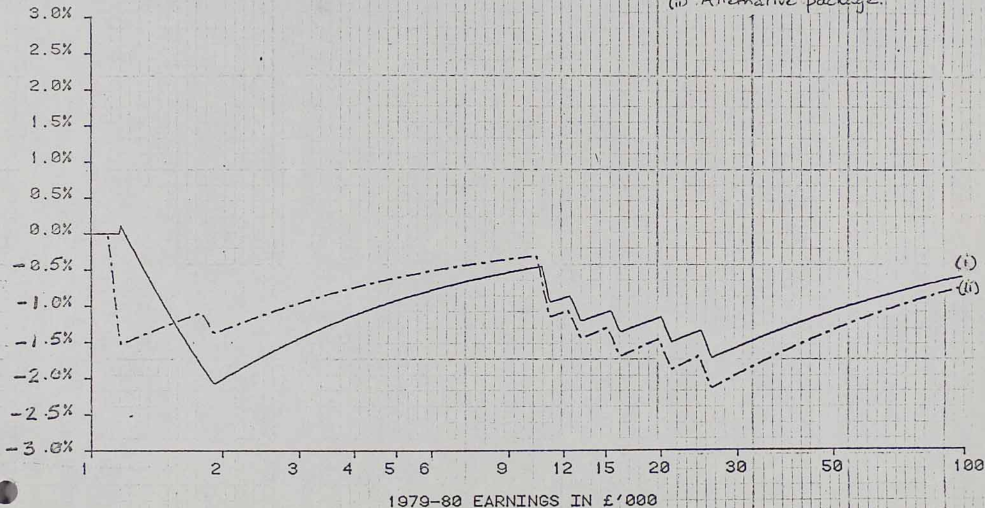
12 MAR 1980

BUDGET - SECRET.

PERCENTAGE CHANGE IN INCOME AFTER TAX

IN REAL TERMS
RESULTING FROM A 17.5% INCREASE IN PRE-TAX INCOME
BETWEEN 1979-80 AND 1980-81
SINGLE

(i) Preferred package
(ii) Alternative package.



12 MAR 1980

TABLE 1

SINGLE PERSONS - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1979/80		Proposed charge for 1980/81		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
1,500	84	5.6	37	2.5	46
2,000	213	10.7	187	9.4	25
2,500	363	14.5	337	13.5	25
3,000	513	17.1	487	16.3	25
3,500	663	18.9	637	18.2	25
4,000	813	20.3	787	19.7	25
4,500	963	21.4	937	20.8	25
5,000	1,113	22.3	1,087	21.8	25
6,000	1,413	23.6	1,387	23.1	25
7,000	1,713	24.5	1,687	24.1	25
8,000	2,013	25.2	1,987	24.8	25
9,000	2,313	25.7	2,287	25.4	25
10,000	2,613	26.1	2,587	25.9	25
12,000	3,296	27.5	3,187	26.6	109
15,000	4,588	30.6	4,344	29.0	244
20,000	7,030	35.2	6,687	33.4	342
25,000	9,722	38.9	9.256	37.0	466
30,000	12,663	42.2	12,050	40.2	614
40,000	18,663	46.7	18,050	45.1	614

TABLE 2

MARRIED COUPLES - INCOME ALL EARNED - ANNUAL FIGURES

Income	Charge for 1979/80		Proposed charge for 1980/81		Reduction in tax after proposed changes
	Income tax	Percentage of total income taken in tax	Income tax	Percentage of total income taken in tax	
£	£	per cent	£	per cent	£
2,000	46	2.3	0	0	46
2,500	171	6.9	106	4.3	64
3,000	318	10.6	256	8.5	61
3,500	468	13.4	406	11.6	61
4,000	618	15.5	556	13.9	61
4,500	768	17.1	706	15.7	61
5,000	918	18.4	856	17.1	61
6,000	1,218	20.3	1,156	19.3	61
7,000	1,518	21.7	1,456	20.8	61
8,000	1,818	22.7	1,756	22.0	61
9,000	2,118	23.5	2,056	22.8	61
10,000	2,418	24.2	2,356	23.6	61
12,000	3,036	25.3	2,956	24.6	80
15,000	4,296	28.6	4,017	26.8	279
20,000	6,705	33.5	6,302	31.5	402
25,000	9,364	37.5	8,833	35.3	531
30,000	12,273	40.9	11,588	38.6	686
40,000	18,273	45.7	17,588	44.0	686

cc A Duguid

7

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

PRIME MINISTER

COMPANY CARS AND OTHER FRINGE BENEFITS

This is the last of the notes I promised to send you when we discussed the Budget on 29 February. The first part explains the proposals I have in mind for some modest increase in the taxation of fringe benefits. The second deals with the so-called "Dips" scheme for stock relief.

Fringe Benefits

2. I start with the tax treatment of company cars provided as a benefit for employees. Of the present 14½ million cars on the road, 4½ million are owned by companies and 10 million are in private ownership. 70 per cent of all new car registrations relate to company cars. Of the 4½ million company cars, hardly any are thought to be for exclusive business use. Almost all of those with a company car enjoy the benefit of having it also for private use. But through successive years of neglect, the scale of the benefit charged to income tax has fallen far behind any reasonable measure. The present figures are about 1/3 of the estimated cost (in June 1979) to a private individual of running his own car based on the AAs valuation, and they barely cover the current cost of tax, insurance and maintenance calculated on the same basis. For example the scale figure

/for a

for a car in the 1300-1800cc range is now £250 a year as against the AA figure of £695 last June (the present figure would, of course, be higher). For bigger cars the disparity would be substantially greater between the scale figure and a realistic estimate of the cost. Consequently, those with company cars are shielded from the rapid increases in motoring costs faced by the other 10 million car owners; and these 10 million - not to mention those who cannot afford to run a car at all - naturally feel strongly about the continued leniency of the tax treatment of company cars. Moreover, the more the scale falls behind, the greater is the incentive for companies to provide employees with cars for purely personal use. That goes against our stated objectives.

3. Whilst I recognise the difficulties of moving in this area, this is not a situation which, in fairness, I think we should allow to continue. Despite your reservations, and those of the Chief Whip, I believe there is another side to the political case - in the form of criticism of unfairness from the large majority of people who do not have company cars. For this reason I believe there is a good case for taking some action, provided it is well-balanced and can be clearly defended.

4. What I propose is no more than to stop the problem getting worse. I am planning no increase in the scale of taxable car benefits this coming year. The changes I should like to announce would only take effect in a year's time from April 1981. I would increase the scales in such a way

/that there

!! that there would be a 20% increase in the car benefits charged to tax. By April 1981, those benefits will have remained unchanged for three years. Meanwhile the cost of motoring has increased by more than 20% in the last two years and is still rising. A middle manager with a car in the 1300 to 1800 cc range, typically a Ford Cortina, would pay less than 30p a week in extra tax - no more than £15 a year - assuming he pays income tax at the 30% basic rate. My proposal would still fall a long way short of restoring the real value of the tax, but is something I believe we could defend. The change would be made by Order rather than in the Finance Bill.

5. In one respect I propose to take action that will help some company car users. Those who use their company cars largely for business are taxed on only half the scale amount. The qualifying mileage for this relief is at present 25,000 a year. To meet legitimate complaints that this is too high, I propose at the same time to reduce the qualifying mileage to 18,000 miles a year. This too would take effect in 1981-82.

6. For this coming year I am proposing to introduce changes in two other fringe benefits. First, on beneficial loans, I am increasing from 9% to 15% the rate of interest by which the taxable benefit from an interest-free loan is measured, to keep in line with interest rates generally. I am at the same time increasing from £50 to £200 the de minimis limit of notional interest below which no charge on the benefit is raised. This will enable modest interest-free loans, such as those to allow employees to purchase season tickets, to continue to escape tax.

/7. Second,

7. Second, I propose to act to discourage the practice of providing as a benefit for employees the use of items such as suits of clothing and television sets for a period, at the end of which they are acquired by the employee for a derisory sum. I shall increase from 10 to 20% the annual value taken as the measure of this benefit and impose a more effective tax charge when the asset is ultimately acquired by the employee.

8. You will see that I am not singling out cars for specially harsh treatment. On the contrary, some might say that I am not doing enough on cars, especially since the modest uprating will not take place for another year - though I have to announce the change this year so that the necessary preparatory work can be completed in good time. I hope, on reflection, you will feel that the package to be announced on Budget Day is a reasonable compromise. It is, of course, only a beginning in rolling back the inducements to widen the coverage of perks. The treatment of suits, TV sets and so on, is clearly sensible, and should provoke little, if any, opposition. But there is no question of any significant move on fringe benefits until we can reduce income tax again generally.

Stock relief: dips

9. I also promised to send you a note explaining how a "dips" scheme would assist firms, particularly in manufacturing, that were having to de-stock as a result of the steel strike.
... This is enclosed.

/10. I have

It looks very extravagant on staff time. It is really - I should [illegible] clearly [illegible]. We could have [illegible] the end of a [illegible] 'charge' [illegible] to have coupled with a smaller stock relief allowance for the year next year after it. Much more economical on staff

10. I have considered whether, at the same time, I could directly tackle the Tesco abuse, but I have had to conclude, essentially for the reasons given in paragraph 11 of the attached note, that this is simply not possible this year. But the dips scheme does not apply where stocks are increasing and so does not aggravate the Tesco situation.

11. There has been much pressure for a dips scheme of this sort in the representations I have received on the Budget, including those from the CBI, and I am convinced that it is something which is urgently needed in present circumstances.

[signature]
for (G.H.)
12 March 1980

(approved by the Chancellor & signed in his absence.)

STOCK RELIEF : DIPS

<u>The problem</u>

1. Under the present rules, stock relief is calculated on the change in value (including the volume element) of stocks over the business trading year. The effect is that the scheme:

a. gives tax relief, to the extent that the increase in stock values exceeds 15 per cent of the company's taxable profits

b. claws back relief - imposes a charge to tax - to the extent that stock values fall in any year.

2. As the Prime Minister has said, there has been much criticism of the fact that, because the present scheme extends relief to increases in stock volumes, it can encourage companies to build up their stock levels. The 15 per cent restriction is designed to filter out of relief the total increase in the volume of stocks over the economy as a whole. It is, however, a very rough and ready restriction and, as it applies to individual businesses, imperfect.

3. By the same token, the present clawback can operate harshly - for example, when a company has:

a. been forced to reduce stock holdings for reasons beyond its own control (as in the current steel strike), or

b. run down its stocks in order to help finance short-term liquidity pressures (of the kind which we expect many companies to face in 1980).

In each case, a company may have to face a clawback tax change, just at the point when it is having to finance the necessary rebuilding of its stocks.

4. There can be no question of simply abolishing the clawback charge - making stock relief permanent - so long as the present scheme continues. Any scheme that gives relief for increases in stock volumes must impose a charge to tax when stock volumes fall. Otherwise it would be even more vulnerable to abuse.

The proposal

5. The proposed "dips" scheme has a much more limited objective. It would allow a company to defer the recovery charge for one year. Thus, very broadly speaking, it would allow a company to bridge a temporary "dip" in stocks - hence its name - without facing a heavy tax charge at the point at which it seeks to rebuild them. However, it is only a deferment of tax:

a. If a company restores its stocks in year 2, it would have new stock relief to claim for year 2, to set against the clawback charge for year 1; and it would have to pay a clawback charge only to the extent (if any) that the latter exceeds the former.

b. If the company does not restore its stocks, the clawback charge will then crystallise in year 2, in precisely the same way that it would otherwise have crystallised in year 1.

Abuse

6. There are 2 main problems here.

7. First, the volume effect in the present scheme of stock relief can encourage companies to build up their stock levels. There are, of course, provisions in the scheme which deny relief, where stock levels are artifically inflated at the accounting date. However, the Revenue can review critically only a tiny minority of company accounts. In practice, a good many companies get away with some abuse - provided that they are not too greedy - and some companies probably get away with serious abuse.

8. Second, a company can get stock relief, even though its stocks are wholly financed by credit from its suppliers, and the costs of inflation are accordingly borne by its creditors, rather than by the company itself. This is the so-called "Tesco" situation.

9. It is not possible to tackle these problems in this year's Finance Bill.

10. There is a fairly straightforward technical solution to the first problem. It involves terminating the present stock relief scheme, and substituting a specific relief for stock appreciation (the effects of inflation on stock values). Under such a scheme, companies would no longer get stock relief for increases in stock volumes, and they would no longer suffer clawback when stock volumes fall. In present circumstances - with the current rapid rate of inflation and pressure on company liquidity - a scheme of this kind would be likely to cost several hundred million £s per annum more than the present scheme of stock relief. Even leaving that aside, it would hardly be possible to introduce a radical change of that kind, more or less simultaneously with the publication of the new accounting standard on inflation accounting at the end of this month, without the promised consultation with the accountancy profession and industry.

11. The second problem raises much more difficult technical problems, which are still being discussed with Treasury Ministers. A simple restriction for trade credit would be almost wholly ineffective. A company can - and given a sufficient tax incentive certainly/- shift its finance between trade credit, bank overdraft and term loans; and there is also almost limitless scope for shifting of sources and patterns of finance within a group of companies. Any of the approaches so far considered raises formidable problems both at a technical and at a political level. Again, we have promised full consultation before changes are introduced.

/would

12. The proposed "dips" scheme does not tackle these abuses. However, it provides no new scope for abuse. It is not concerned with stock increases; and, it allows a company to defer a possible clawback charge for at most one year.

Summary

13. So far as can be judged, a scheme of this kind would be very helpful for manufacturers and steel stockholders affected by the current steel strike, and for other companies - particularly in the manufacturing sector - affected by current liquidity pressures. It would apply only where stocks have fallen. It would not benefit the company increasing its stocks artificially to get a tax advantage (one of the worrying aspects of the so-called Tesco situation).

	YEAR 1	YEAR 2	Alternatively, YEAR 2
Opening stocks	2,000	1,000	1,000
Closing stocks	1,000	2,300	1,500
Recovery charge	1,000	Relief* 1,300	Relief* 500
	The 1,000 would normally be taxed as part of the profits of Year 1.	Less deferred charge from Year 1 1,000	1,000
	A "dip" scheme would allow it to be deferred to Year 2.	Net relief 300	Net charge 500 which would be taxed in Year 2

*Ignoring the 15% profit restriction

SECRET

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

11th March, 1980

CHILD BENEFIT

Further to our conversation of this morning, I enclose a note which Peter Kemp has prepared for the Chancellor about the current state of play on child benefit, including the amendment which Mr. Jenkin expects will be put down to his current Social Security Bill at the Report Stage and the scope for making changes at this stage to the Public Expenditure White Paper. The Chancellor thought that the Prime Minister might find this note useful.

Mr. Jenkin apparently intends to raise this matter at Cabinet on Thursday. The Chancellor had thought that a decision would have to be made today about whether to remove from the Public Expenditure White Paper the current statement about the uprating of child benefit. In the event, however, officials have advised that the statement could be excised after Thursday's discussion, if that were to prove necessary. For obvious reasons, the Chancellor would strongly prefer it if this fact were not to be revealed before Cabinet.

Yours,

Richard

(R.I. TOLKIEN)
Private Secretary

T.P. Lankester, Esq.,
Private Secretary,
10, Downing Street

SECRET

CHANCELLOR OF THE EXCHEQUER

cc Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Bailey
Mr Battishill
Miss Brown
Mr F E R Butler
Mr Unwin
Mr C D Butler
Miss Peirson
Mr Ridley
Mr Cardona
Mr Cropper
Mr White

CHILD BENEFIT

The state of play is as follows. Mr Jenkin now expects that a reasoned amendment will go down to his current Social Security Bill for report stage (which is next Tuesday or Wednesday). This reasoned amendment will call for a restoration of the £4 so as to give price protection next November, and for continued annual price protection thereafter. Mr Jenkin will want to report to Cabinet on Thursday that this happening, and that this amendment (unlike Mr Andrew Bennett's somewhat similar amendment) is likely to get quite a lot of support, including Government backbench support. His officials tell me that he is minded nevertheless to resist, but he will want to seek his colleagues' views on the chances of defeat and, presumably, if the Government feel that these chances are too great to be risked, what alternatives might be open. Presumably the alternatives are either simply to accept the amendment, or to table some alternative Government amendment; for instance one might think in terms of the amendment as proposed but coupled with an a "Rooker-Wise" type override, or an amendment which allowed less than full price protection in November 1980, but went for full price protection thereafter; or a combination of the two; or some other variant.

2. A complication is that there is a further amendment going down which will make death grant non-contributory. This again, Mr Jenkin feels, is going to attract a lot of support and again the Government might be defeated on it. The

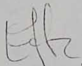
cost here is about £2½ million in a full year, though there may be some staff savings. Again Mr Jenkin is disposed to try to resist this, but again he will want advise colleagues' of the risk that exists here. On this matter, however, there is really no half-way house; the Government either accepts the amendment or it is defeated.

3. Ministers will want to consider the problem this presents. There is no doubt that there is a very big head of steam behind the wish for at least a £1 increase in child benefit next November, and indexing thereafter. What we should like, of course, would be the present position - 75p next November and no indexing; all this for the reasons set out in my minute of 3 March and supported by Sir Anthony Rawlinson in his advice dated 4 March. It is worth noting that if the Government cannot resist this amendment on child benefit, there must be serious doubt whether it would be possible to secure the necessary legislation for the other social security proposals built into the public expenditure savings - thus the 5 per cents off certain benefits and the abolition of ERS, for instance. From this and many other points of view it is clearly of the utmost importance that Government supporters should support the Government. Of course one can think of possible packages which might help avert a potential defeat next week - for instance a change of mind on the 75p and announcement in debate that child benefit will go up to, say, £1 in November; and/or acceptance of the death grant amendment. But we must advise against both these.

4. Meanwhile there is the question of the Public Expenditure White Paper. This at the moment actually refers to the 75p. Action, set out in paragraph 6 of my note of 3 March - simple deletion of references to 75p etc in the White Paper text but letting the arithmetic otherwise run - is still open, and remains open until the "read at press" stage of the White Paper which takes place on Thursday and Friday next. It would just be possible, therefore, in the light of the Cabinet discussion to make a change to the White Paper to delete the actual 75p. I attach the text of possible amendments. As I pointed out, however, the arithmetic remains built around 75p, so it could become known fairly quickly that an assumption of 75p had been made and (if some other figure were given) altered. But of course this would not become clear until after the other figure, whatever it was, had been announced and arguably could be seen then as a matter of only academic interest. You will want to consider urgently after

Cabinet on Thursday or not to get the attached changes made.

5. One point your colleagues will want to weigh is whether the notes on child benefit sent to you by the Chief Whip yesterday are having any effect.



E P KEMP

11 March 1980

PUBLIC EXPENDITURE WHITE PAPER

Page 6, line 1:

at present reads :-

"increase next November of 75p a week in child benefit and 50p a week in the"

alter to read :-

"increase next November in the rate of child benefit and also in the rate of"

Page 108, para 8, lines 1-3:

at present reads :-

"8. Child benefit will be increased in November 1980 from £4.00 to £4.75 for each child, and the additional payment for single parent families (child benefit increase) will go up from £2.50 to £2.80 a week."

alter to read :-

"8. Child benefit will be increased in November 1980 from the present £4.00 for each child, and the additional payment for single parent families (child benefit increase) will also go up from £2.50 a week."

Ck

Econ Pol

P.a.

10 DOWNING STREET

Tim

Thanks. I see some advantage in increasing allowances by 5 percentage points less than full indexation – to coincide with the treatment of the unemployed + other short-term benefit recipients.

This would not save the full £900m, but it could be topped up with a small increase in indirect taxes or perhaps the scheme to levy VAT on imports at the point of entry (said to be worth £500m on PSBR)

It looks as though the P.M. did accept para 9 of the Chancellor's note on capital taxes, and a bit of 6.

D.

10 DOWNING STREET

From the Private Secretary

10 March 1980

Dear John,

The Prime Minister considered the Chancellor's minute of 5 March about the distributional effects of his proposed income tax package over the weekend, and also his minute of 7 March setting out his proposals in respect of capital taxation.

As I told you on the telephone, the Prime Minister is most concerned about the distributional implications of both sets of proposals. As regards income tax, she does not believe a package which will bear most heavily on those in the £2½-£5,000 income bracket is tenable; for in her view, it would severely aggravate wage pressures in the next pay round.

For similar reasons, she believes it would be most unwise to make significant concessions on capital taxes this year. Even if the income tax package can be made more equitable, she thinks that even the relatively modest proposals put forward by the Chancellor will be widely criticised as favouring the rich at a time when the less well off are having to face higher prescription charges, charges for school transport, higher charges for school meals, etc. The Prime Minister therefore suggests that the Chancellor should drop his main proposals on CGT and CTT, and confine his proposals to the minor changes mentioned in paragraph 7 of his minute of 7 March.

The Prime Minister agrees that the stamp duty proposals should not be scored as a capital tax measure, and she agrees with the proposal to raise the thresholds by £5000.

The Prime Minister would like to have an early discussion with the Chancellor. As I mentioned to you, she would find it helpful to have some clear figures on the distributional effects of both the Chancellor's preferred income tax package, and possible alternatives.

Yours ever,

Tim Lankester.

John Wiggins, Esq.,
HM Treasury.

5a

COPY NO. 1 OF 22 COPIES

CHANCELLOR OF THE EXCHEQUER

cc: Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Ryrie
Mr Middleton
Mr Battishill
Mr Kemp
Mr C D Butler
Mr Corlett
Mr Griffiths
Mr Folger
Mr Hood
Mr Ridley
Mr Cropper

PS/Inland Revenue

DISTRIBUTIONAL EFFECTS OF TAX PACKAGES

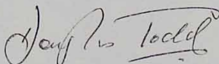
There is a small error in paragraph 1 (a) of my minute of last night on the above. The RPI impact effect of package A(iii) is 0.9 per cent.

... 2 I am attaching a further table showing distributional effects on the same basis as before but combining income tax package D with indirect tax package B (vi) - RPI impact effect of 1.1 per cent.

3 The new tables describe essentially the same profile; in summary:-

(i) for single persons and married couples the effects are progressive up to the top of the basic rate band;

(ii) for married couples with children the indirect tax impact is regressive but the package overall is progressive - again up to the higher rate threshold.



DOUGLAS TODD
FP3
7 March 1980

BUDGET SECRET

1. Income Tax Package D; Indirect Package B(vi)
Base: 1979/80 Income Tax; NIC change included

				£ per week and %	
Gross Pay	80.00	120.00	165.00	180.00	360.00
Single Person					
1979/80 take-home pay	58.04	83.34	111.80	122.30	225.98
Net change due to income tax	0.49	0.49	0.49	0.49	6.20
Net take-home pay	58.53	83.83	112.29	122.79	232.18
% change due to income tax	0.8	0.6	0.4	0.4	2.7
% effect of indirect tax changes	0.87	1.05	1.15	1.18	
Real household disposable income	58.03	82.96	111.01	121.36	
% RHDI change	-0.0	-0.5	-0.7	-0.8	
Married Couple					
1979/80 take-home pay	61.79	87.09	115.55	126.05	232.23
Net change due to income tax	1.19	1.19	1.19	1.19	7.33
Net take-home pay	62.98	88.28	116.74	127.24	239.56
% change due to income tax	1.9	1.4	1.0	0.9	3.2
% effect of indirect tax changes	1.08	1.16	1.21	1.22	1.29
Real household disposable income	62.31	87.27	115.34	125.70	236.51
% RHDI change	0.8	0.2	-0.2	-0.3	1.8
Married Couple with Two Children					
1979/80 household income £	69.79	95.09	123.55	134.05	240.23
Net change due to income tax £	1.19	1.19	1.19	1.19	7.33
Net change due to CB	1.50 (0.52)	1.50 (0.52)	1.50 (0.52)	1.50 (0.52)	1.50 (0.52)
Net household income	72.48	97.78	126.24	136.74	249.06
% change due to income tax and CB	3.9	2.8	2.2	2.0	3.7
% effect of indirect tax changes	1.29	1.20	1.14	1.13	1.04
Real household disposable income	71.56	96.62	124.82	135.22	246.49
% RHDI change →	2.5 (70.58) (1.1)	1.6 (95.65) (0.6)	1.0 (123.84) (0.2)	0.9 (134.25) (0.1)	2.6 (245.52) (2.2)

Income Tax Package D ; Indirect Package B (VI)

Base : 1979/80 Income Tax ; NIC change excluded

				£ per week and %	
Gross Pay	80.00	120.00	165.00	180.00	360.00
Single Person					
1979/80 take-home pay	58.24	83.64	114.16	124.66	228.34
Net change due to income tax	0.49	0.49	0.49	0.49	6.20
Net change due to NIC	-0.20	-0.30	-2.36	-2.36	-2.36
Net take-home pay	58.53	83.83	112.29	122.79	232.18
% change due to income tax and NIC	0.5	0.2	-1.6	-1.5	1.7
% effect of indirect tax changes	0.87	1.05	1.15	1.18	
Real household disposable income	58.03	82.96	111.01	121.36	
% RHDI change	-0.6	-0.8	-2.8	-2.6	
Married Couple					
1979/80 take-home pay	61.99	87.39	117.91	128.41	234.59
Net change due to income tax	1.19	1.19	1.19	1.19	7.33
Net change due to NIC	-0.20	-0.30	-2.36	-2.36	-2.36
Net take-home pay	62.98	88.28	116.74	127.24	239.56
% change due to income tax and NIC	1.6	1.0	-1.0	-0.9	2.1
% effect of indirect tax changes	1.08	1.16	1.21	1.22	1.24
Real household disposable income	62.31	87.27	115.34	125.70	236.51
% RHDI change	0.5	-0.1	-2.2	-2.1	0.8
Married Couple with Two Children					
1979/80 household income	69.99	95.39	125.91	136.41	242.59
Net change due to income tax	1.19	1.19	1.19	1.19	7.33
Net change due to NIC	-0.20	-0.30	-2.36	-2.36	-2.36
Net change due to CB	1.50 (0.52)	1.50 (0.52)	1.50 (0.52)	1.50 (0.52)	1.50 (0.52)
Net household income	72.48	97.78	126.24	136.74	249.06
% change due to income tax, NIC and CB	3.6	2.5	0.3	0.2	2.7
% effect of indirect tax changes	1.29	1.20	1.14	1.13	1.04
Real household disposable income	71.56	96.62	124.82	135.22	246.49
% RHDI change	2.2	1.3	-0.9	-0.9	1.6
	(70.58)	(95.65)	(123.8[illegible])	(134.25)	(245.52)
	(0.8)	(0.3)	(-1.6)	(-1.6)	(1.2)

I share David's misgivings particularly in the light of the I.T. effects on people in the £2½ - £5000 income range. To leave them worse off - & those with capital gains better off is unacceptable. Suggest stamp duty reliefs go ahead but otherwise only technical changes in [illegible] taxes.

Prime Minister

I rather agree with this - though I would still raise the thresholds on stamp duty and IIS.

Do you wish to discuss with the Chancellor?

They will discuss very quickly.

PRIME MINISTER

I have seen the Chancellor's memo on capital taxation and hope it is not too late to look at it from the other side.

To the vast majority of people in this country anyone who has capital gains of £5,000 in a year is rich. Likewise an estate of £25,000 and certainly £50,000 is evidence of considerable wealth. It is therefore quite certain that the proposed changes will be presented as another give-away to the rich, and the costs quoted would probably be the full year costs of £250 million.

Even at the first year cost of £60 million, comparison will be drawn every time we have a measure which appears to create financial hardship for any group. Let me put forward a few instances:

If they hadn't given £60/250 million to the rich,

- they would not have needed to charge for school transport
- or increase the charges for school meals
- or raise prescription charges
- or they could have increased the child benefit allowance earlier or by the full amount of inflation

I believe that it will be very damaging for there to be practically any give-away to the better off at this time. We are facing recession. We are having to do a lot of unpleasant things. Most people feel that life is going to get tougher and may well go along with us. But the charge that life does not have to get tougher for the well off, who did very well out of the last budget, will do damage to our social cohesion far beyond the £60 million or even £250 million cost.

I know this has been discussed time and again and the result has been a watered-down measure. The point I am making is that the amount of the give-away to the better off is not important. If there is any give-away we will risk immense damage to our position as the Party for all the people, the family and so on.

/ Surely

Surely these relatively minor ameliorations of capital taxation can wait until we are able to make tax changes benefiting the whole of the community in two years' time.

David.

PS:-

In paragraph 3 of the Chancellor's minute, he says:-

"It would be unwise to appear to be giving too many concessions to the wealthy..."

I would suggest it would read more accurately:-

"It would be political suicide to give any concessions to the wealthy..."

If that sentence is a better judgement of reality, the rest of the memo would have to change completely.

The present proposals are a lamb, for which we shall be hung just as if they had been a sheep!

7 March 1980

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CH/EX. REF. NO. B(80)22

COPY NO. 1 OF 27 COPIES

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

PRIME MINISTER

CAPITAL TAXATION

Following our meeting this morning and that on 29th February, I can now let you know my final conclusions on the capital taxes. Your Private Secretary recorded on 4th January that you agreed with the conclusions which my colleagues and I had provisionally reached and which I put to you on 12th December. However I then suggested that for both Budgetary and presentational reasons it might not be possible to go as far as I had hoped, and so it has proved.

Flag A

2. The main elements in the package I put to you in that minute were the abolition of the investment income surcharge (IIS); an increase in the exemption limit from capital gains tax (CGT) to £5,000 in any year; an increase in the capital transfer tax (CTT) threshold to £60,000 or £70,000 and a cut in the rates; to abandon lifetime cumulation; to give relief for agricultural landlords; and to remove the CGT/CTT overlap.

3. This package would cost some £600 million in a full year and, even though only around £125 million would arise in 1980/81, it is more than we can reasonably justify committing this year. Moreover it would be unwise to appear to be giving too many concessions to the wealthy in a Budget in which in real terms we are going to have to increase the burden of income tax, and

/in which

in which we are not increasing child benefit to the extent to which we are being pressed, by many of our supporters as well as by the usual pressure groups. However I am sure that it would be equally wrong to go the other way and do nothing, bearing in mind the commitments we have given and the expectations of our supporters. Accordingly as I mentioned last week I have looked again at the proposals on capital taxation to see which seem to be the most pressing and should be done this year and which could reasonably be left until a later year when we shall be getting greater revenue from the North Sea.

4. I have little doubt that against this background we should leave for another year any question of abolishing the IIS. We increased the threshold very substantially last year and, unlike the other taxes, we have no commitments to honour. I propose that we should do no more than increase the threshold in line with the increase (around 11 per cent) we are making elsewhere in the higher rate threshold and bands, i.e to £5,500.

5. The balance of consideration between the CGT and CTT changes previously proposed is much finer. I have concluded however that it is better to give full effect to our CGT proposals and to trim the CTT package for this year. This is firstly because the CGT costs arise far more slowly - there is no cost in the first year and only about 30 per cent of the full year cost arises in the second year - and partly because, since we cannot deal directly (for the reasons I gave in paragraph 12 of my previous minute) with the very unfair impact of the tax on paper gains, it is all the more important to relieve the burden in another way. Moreover there are greater staff savings here than in the CTT package.

6. Nevertheless I do not think we should do nothing on CTT this year. The effect of inflation has been to bring many

/more

more estates into the charge to the tax and it would be right not only to restore the value of the threshold in order to cut them out, but also to increase it in real terms. This would reduce the numbers affected by the tax still further by removing the cases where the liability is comparatively small. I propose therefore that we should increase the threshold from £25,000 to £50,000, so reducing the number of estates caught from around 40,000 to some 18,000 and giving a staff saving of 220. I do not propose, however, that we should reduce the rates of tax above the new threshold so the starting rate of CTT will become 30 per cent.

7. There is also a structural change we should make. We should retain our intention to abandon lifetime cumulation and cumulate gifts for ten years only. This will here and now remove one of the oppressive features of the tax but, since the tax was introduced in 1974, can have no cost until 1984. The only other CTT changes I propose are on the heritage - in line with our commitments and for which there is at least some bipartisan support in the House, on gifts to charities as part of a much wider package to encourage the voluntary movement; and a few tidying measures to relieve the administrative burden on taxpayers and the Revenue.

8. Against the general background, I believe it would be unwise to introduce any relief for agricultural landlords this year. We can justify the delay by the failure of the agricultural interests to reach any agreement on the question of land tenure; it may be desirable here, as elsewhere, to promise consultation with those concerned.

9. Finally, we should remove the overlap between the taxes. It seems particularly oppressive that a lifetime gift should attract a charge to both and we can remove it at little cost.

/10.

10. In sum the main elements of the package are now thus:-

	Cost			Staff Saving
	1980/81	1981/82	Full year	
	£m	£m	£m	
CGT - exempt first £5,000 gains in each year (£2,500 for trusts)	Neg	35	110	550
CTT - £50,000 threshold, no changes in rates	60	115	140	220
CGT/CTT overlap - remove		small		

Since I regard the increase in the threshold to the IIS as more a matter of personal, than of capital, taxation, I have not scored it here.

11. For completeness, I would also mention stamp duty, though I do not think it would be sensible to score this as part of the capital tax package. I mentioned last week that I was considering raising the stamp duty thresholds for houses, etc., by £5,000, and you said you were attracted by this proposal. I now propose to go ahead with it. It is a modest change, considerably less than would be needed to take account of the movement in house prices since the thresholds were last raised

/in 1974

in 1974. Even so, the move will cost £85 million in 1980/81, £95 million in 1981/82 and £95 million in a full year. The staff effects are negligible.

12. I should be grateful to know whether you are content that we should proceed on this basis: I am, of course, very ready to discuss it with you.

(G.H.)

7 March, 1980

ES 50/014

MR UNWIN

cc PS/Chancellor
PS/Chief Secretary
PS/Financial Secretary
PS/Minister of State (C)
PS/Minister of State (L)
PS/PMG
Mr Lankester
Sir Douglas Wass
Sir K Couzens
Mr Ryrie
Sir A Rawlinson
Mr Burns
Mr Davies
Mr Mower
Mr Browning
Mr Godfrey
Mr Monaghan
Mr Unwin
Mr Folger
Mr MacAuslan
Mr Clayton
Miss Deyes
Mrs Duffy
Mr Way

cc Mr Ingham (or get a separate copy for him). R

PRE-BUDGET BRIEF

I attach a copy of the pre-Budget brief. This covers the economic background to the Budget and provides a round-up of the Government's present economic policies. It is mainly for the use of IDT in the run-up to the Budget, but copies are also being sent to others closely involved in the Budget and with the presentation of policy.

2. I am grateful for contributions from other divisions. You will note that we have taken the opportunity this year to try to sort out at an early stage some of the background material e.g. on economic developments and tax comparisons. I hope that much of this material can be incorporated in the Budget day brief with only minor alterations. This will free us and others in the next fortnight to concentrate on the Budget measures and forecasts etc.

A Bottrill

A BOTTRILL
EB
6 MARCH 1980

PRE-BUDGET BRIEFING

A ECONOMIC SITUATION AND PROSPECT

A1 World economy
A2 UK economy - present situation
A3 North Sea oil

B PUBLIC BORROWING AND MONEY SUPPLY

B1 PSBR outturn
B2 Present monetary policy and performance
B3 Techniques of monetary control

C COMPANY SECTOR

C1 Industrial performance, productivity, import penetration
C2 Output prices, costs and competitiveness
C3 Profits and liquidity
C4 Investment and stockbuilding
C5 Industrial policies: present position

D PERSONAL SECTOR

D1 Earnings, real incomes and Real Personal Disposable Income (RPDI)
D2 Employment and unemployment

E EXTERNAL SECTOR

E1 Present position on current and capital accounts
E2 Exchange rate policy
E3 Reserves and debt management
E4 European Community Budget
E5 Import controls: present position

F TAXES

F1 Income tax (including Investment Income Surcharge)
F2 Capital taxes (including Investment Income Surcharge)
F3 Company taxation (including PRT)
F4 Indirect taxes (including National Insurance Surcharge)
F5 Tax burden and balance of taxation
F6 International tax comparisons

G PUBLIC EXPENDITURE

G1 Public Expenditure
G2 1980-81 Cash Limits
G3 Social security benefits: present position
G4 International comparison of public expenditure
G5 Asset sales

H OUTSIDE REPRESENTATIONS

H1 Union Representations
H2 CBI Representations
H3 Other business groups
H4 Other pressure groups

J OUTSIDE COMMENTATORS

J1 London Business School
J2 National Institute for Economic and Social Research
J3 Other Commentators

A1 WORLD ECONOMY

Factual

(i) Oil

Average price of oil doubled in 1979. In real terms increase since end 1978 has been similar to that of 1973-74. OPEC yet to agree on a price structure and cuts in production or other disruptions to supplies cannot be ruled out. Market pressures seem to be easing with spot rates only slightly above contract prices.

(ii) Growth

Growth in major OECD economies together lower in 1979 that in 1978, but activity, particularly in US, holding up better than expected. Prospects of much slower growth in 1980 due to last round of oil price rises, possible loss of business and consumer confidence and tighter policies to control inflation. Falls in US and UK output not to be offset by growth in other major economies.

Table 1 GNP Growth

percentage change from previous year

	Weight in major 7	1978	1979	1980 (WEP forecast)	
USA	425	4.4	2.3	- 1.1	see (vii) below
Canada	42	3.4	2.8	0.8	
Japan	198	6.0	5.9	3.5	
West Germany	129	3.8	4.4	2.1	
France	95	3.5	3.6	2.3	
Italy	48	2.6	4.1	1.8	
Major 7 (above plus UK)	1000	4.2	3.3	0.4	

(iii) Unemployment

In OECD area around 16 million persons for last 18 months. Likely to rise in 1980.

(iv) Prices

Rate of inflation rose in all major OECD countries except Japan in 1979 and all expect increases in 1980. Rises due mainly to increases in crude oil prices (directly adds 4 per cent to OECD average rate over 1978-80) and reactions to them. Spread of rates could widen; only in UK and Italy are real wages being maintained.

Table 2 Inflation rates

(consumer prices: percentage change from previous year)

	1978	1979	1980 (WEP forecast)
USA	7.7	11.3	12.4
Canada	8.9	9.2	9.9
Japan	3.9	3.6	9.4
West Germany	2.6	3.9	5.7
France	9.2	10.7	11.7
Italy	12.4	14.8	21.1
Average above (plus Netherlands and Belgium)	6.9	9.1	11.5

Cont.

(v) Current balances

Current balance of OECD countries deteriorated sharply in 1979 as OPEC surplus rose. Deficit more widely distributed than in 1974-75; Germany and Japan in substantial deficit while the USA is close to balance. The LDCs have been hit hard. Further rise in OPEC surplus expected in 1980. There may be difficulties in recycling as some banks may have overstretched themselves, and uncertainty induced by the US/Iran dispute.

Table 3 Current account balances $ billion

	1978	1979	1980 (WEP forecast)
USA	- 13.5	0.1	- 2.4
Canada	- 4.6	- 4.3	- 3.9
Japan	16.7	- 8.5	- 19.8
West Germany	8.8	- 5.0	- 11.2
France	3.8	2.1	- 6.6
Italy	6.4	4.0	- 5.0
Major 7	19.6	- 16.7	- 56.9
Total OECD	11.3	- 26.7	- 87.7
OPEC	1.0	60.1	116.1
LDCS	- 25.4	- 38.0	- 50.0

(vi) World Trade

World grade growth slightly faster in 1979 than in 1978 but forecast to fall sharply in 1980. Deceleration should be less marked for UK exports. World trade in manufactures (UK weights) rose 6 per cent in 1979; 4 per cent rise in 1980 expected.

(vii) WEP forecasts

These are prepared in the Treasury. May be drawn on in briefing but are not for attribution.

Contact point: M Mercer 233 4696

A2 UK ECONOMY - PRESENT SITUATION

Demand and output

GDP rose by 1½ per cent in 1979; by ½ per cent if North Sea oil is excluded. Rise in domestic demand was not matched by a rise in output. Consumers' expenditure rose by 4 per cent reflecting growth in real personal disposable income due to income tax cuts, increased transfer payments and earnings rising faster than prices, but its growth slowed and had probably stopped by the middle of the year. Stockbuilding contributed to the growth of demand but total fixed investment declined and is probably in a cyclical downturn. Investment in dwellings fell 14 per cent (17 per cent in private sector, 8 per cent in public); other public sector investment (including nationalised industries) was broadly unchanged. Private investment in manufacturing and distribution and service industries taken together was 5 per cent higher. The rise in general government consumption was modest. Imports of goods and services rose much faster than exports.

Employment and unemployment

Total employment appears to have levelled off last summer after a two-year rise during which increases in service and construction industries more than offset a fall in manufacturing, which fell by a further 50,000 in 3 months to December. Unemployment fell slowly until September but has since risen by 119,000 to 1,383,000. This is 50,000 below the post war peak in November 1977. Notified vacancies unfilled fell in February for eighth successive month.

Earnings, prices and profits

Average earnings rose by 15-16 per cent in 1978-79 pay round; latest figures (Dec) show 19½ per cent rise on year ago but this probably overstates underlying increase (see D1). With continuing slow productivity growth most of this increase is reflected in unit labour costs. Manufacturers' input prices rose by 27 per cent in year to January and output prices by 17½ per cent. In last six months input prices rose twice as fast as output prices. This combined with slow output growth has squeezed company profits. Gross trading profits (excluding stock appreciation and profits from North Sea oil) were 5 per cent lower in first nine months of 1979 than in same period of 1978. RPI rose 18.4 per cent in year to January, but underlying rate is lower, allowing for VAT and mortgage interest changes. Tax and price index rose 16.1 per cent in twelve months to January 1980 (see D1).

Balance of payments, reserves and the exchange rate

Visible trade deficit of £3.3 billion in 1979, more than twice that of 1978. Invisible surplus fell to £0.9 billion in 1979 from £2 billion in both 1977 and 1978. Current account deficit £2.4 billion; surplus of £0.9 billion in 1978. January current account deficit of £0.3 billion. Reserves rose by over $8.3 billion in 14 months to February 1980 after debt repayments of over £2 billion; three quarters of the increase due to revaluations. Sterling's effective exchange rate at end of February was 16 per cent higher than average of 1977 and 1978 rates (see E2).

PSBR, money supply and interest rates

PSBR £10 billion (seasonally adjusted) in first three quarters of 1979-80; for outturn see brief B1. Sterling M3 grew at an annual rate of 12.2 per cent in seven months to mid January, above target range. MLR at 17 per cent since 15 November (see B2).

Contact point: M J Clayton 233 7064

A3 NORTH SEA OIL

Factual

	1976	1977	1978	1979
Ouput (million tonnes)	12	37	53	76
Balance of trade in oil (£ billion)	-3.9	-2.8	-2.0	-0.8

(ii) GDP

Direct contribution of oil and gas to the rate of growth of GDP in 1979 was about 1 per cent, bringing total share to 3.3 per cent of GDP.

(iii) Government revenues from North Sea royalties, petroleum revenue tax (including advance payment of £0.7bn) and Corporation Tax totalled about £2 billion in 1979-80.

(iv) Balance of trade in oil in deficit of £0.8 billion in 1979. In 1980 oil imports and exports likely to be close to balance.

(v) Employment directly increased by less than one tenth of one per cent by North Sea oil; about 20,000 jobs on rigs and in on-shore facilities.

(vi) Investment in North Sea oil accounted for about 5 per cent of total investment in 1979. Contribution has been higher but is falling as development slows.

(vii) Depletion policy Government considering the matter; decision yet to be taken.

Positive

(i) UK's position as an oil producer is one factor underlying strength of sterling, so contributing to lower domestic inflation (see E2).

(ii) Income so far has gone to private sector at least partly to repay their investment costs.

(iii) Government revenues from North Sea oil will rise rapidly as investment allowances are used up, but important not to exaggerate effect on total Government revenues. At peak, North Sea oil revenues will be only about 7 per cent of total tax receipts. Nevertheless North Sea oil should make it easier in medium term to melt PSBR targets, reduce inflation and lower burden of taxation.

(iv) Government open to views of CBI and TUC on how to secure lasting benefits from North Sea oil.

(v) Decision to abolish exchange controls was taken in its own right, but appropriate perhaps that some of North Sea benefits should be invested overseas to secure a source of income for when oil runs out.

Defensive

(i) Benefits of North Sea Oil must be kept in perspective. Need for strutural adjustments to improve economic performance not removed.

(ii) UK not immune to higher oil prices which add to manufacturer's costs and reduce growth in export markets.

(iii) Exchange rate - see E2.

(iv) Depletion policy is an important issue and the Government is giving it the consideration it deserves.

(v) Prices for North Sea oil set by the market and reflect OPEC prices. Government keen to see that prices for North Sea oil follow and do not lead the market.

(vi) To extent that North Sea revenues are spent on non-traded goods, there may be tendency for resources to switch to this sector. But important also to halt underlying deterioration in manufacturing performance which began well before North Sea oil.

Contact point: M J Clayton 233 7064

B1 PSBR OUTTURN

Factual

(i) PSBR in first three quarters of financial year 1979-80 was £11.1 billion (£10.0 billion seasonally adjusted). Later information for central government borrowing (CGBR) shows large repayment of £2.5 billion in January by central government.

(ii) Local authorities borrowed £1.4 billion in first three quarters of 1979-80, roughly equally from central government and from private sector and overseas. In same period public corporations borrowed £2.8 billion from central government and further small amount from other sources.

(iii) Expectation of large net repayments by public sector in last quarter has persuaded financial journalists PSBR for 1979-80 is likely to be about £9 billion - as suggested by Chancellor (TUC Press Conference 31 January).

Positive

(i) PSBR of £9 billion, although higher than £8.3 billion forecast at Budget time would still be slightly less than in 1978-79 in cash terms - and well below if inflation taken into account.

(ii) As percentage of GDP at market prices, PSBR of £9 billion would be 4½ per cent, compared with 5½ per cent in 1978-79.

Defensive

(i) Always expected that PSBR would be high up to December - main benefits from increased rate of VAT and from special sales of assets coming through in last part of year.

(ii) PSBR for first part of year affected by Post Office computer strike and delayed receipts of VAT. Much of Post Office outstanding revenue expected to be received by end of year.

(iii) Possibility of local authorities and public corporations borrowing more than forecast at Budget time was taken into consideration at time of Industry Act forecast. Proceeds from advance of PRT announced will also reduce need for public sector borrowing in March.

Contact point: J V Carter (GEA) 233 7468

B2 PRESENT MONETARY POLICY AND PERFORMANCE

Objective

To reduce rate of inflation by progressively reducing rate of money supply growth.

Factual

(i) Present target: £M3 growth of 7-11% (annual rate) for 16 months to mid-October 1980.

(ii) Supplementary Special Deposits scheme ('corset'): currently extends to mid-June 1980. Guideline allows penalty-free growth of banks' interest-bearing eligible liabilities (IBELS) of one per cent per month: on average banks have exceeded guideline for last 7 months.

(iii) Recent movements in monetary aggregates and interest rates shown in Annex.

Positive

(i) £M3 growth at annual rate since mid-June (12.2 per cent) still above target range, but action already taken to restrain monetary growth inevitably takes time to have effect. (Preliminary indication of banking February figures given by publication on 11 March of banks' eligible liabilities. Full figures on 20 March.)

(ii) Government shown itself ready to use fiscal and monetary restraint to make sure target kept (eg public spending cuts, asset sales, MLR increases in June and November).

(iii) Reasonable wage settlements imperative. Tight monetary target inevitably puts pressure on company sector, but the quicker wages adjust, the quicker will inflation be reduced, and less will be loss of output and jobs.

Defensive

(i) Interest rates: difficulty of securing fiscal policy adjustment in short term means high interest rates unavoidable if monetary growth to be reduced. Emphasises need to reduce public spending and borrowing.

(ii) Future interest rates: Wait for Budget. Generally, some prospect of lower rates as policies reduce rate of inflation and monetary growth. Must however be sure monetary growth is under control.

(iii) Bank lending: Recent increases substantial (average over £700m for last 8 months). But action taken to restrict monetary growth will in due course reduce growth of bank lending. Moreover as companies respond to current financial pressure by eg adjusting stock levels, the pressure on bank lending could ease somewhat.

(iv) Excessive monetary growth: Monthly figures fluctuate and should not be interpreted in isolation. Must look at underlying trend, have regard to lags following policy changes, etc.
(Note also that over last 3 months other indicators grown more slowly than £M3).

(v) Disintermediation: Recognise that one effect of SSD scheme has been to increase non-bank holdings of acceptances. (Equivalent to 2-3% of £M3 but small in last 3 months). Take account of this "bill leak" in assessing underlying rate of monetary growth.

(vi) Debt instruments: Authorities keep under constant review range of debt instruments (and sales techniques) with view to minimising cost of funding PSBR. /IF PRESSED: Indexed gilts could offer advantages but have to consider in a wider context/.

Cont.

(vii) Monetary market pressures: Action taken (including sales and repurchase of gilts from clearers) to ease upward pressure on interest rates does not represent weakening of commitment to control. Monetary control depends on combination of fiscal and interest rate policy; wrong to prejudge balance between them so close to Budget.

(vii) Exchange rate: Recent appreciation reflects number of factors, eg attractions of sterling as "petro-currency" as well as tight monetary policy. But higher exchange rate is one route through which tight monetary policy reduces inflation.

(ix) Corporate sector: Companies facing difficult financial position. Makes reasonable wage settlements all the more imperative. To relax monetary policy would risk renewed inflation, far more harmful to output and employment.

(x) Consumer credit: Recent figures suggest that consumer credit been growing more slowly than bank lending as a whole. Anyway small part of bank lending (even including consumer credit indirectly financed by banks). (Bank lending figures include indistinguishably credit card lending figures). Consumers, like other borrowers, affected by high interest rates.

Contact point: M L Williams (HF3) 233 4533

Monetary growth to mid-January

% seasonally adjusted

	last 3 months (annual rate)	current target ie last 7 months (annual rate)	last 12 months	Objective
Non interest-bearing M1	-5.0	+8.0	+8.3	-
M1	-7.6	+7.4	+7.7	-
£M3	+9.4	+12.2	+11.4	7-11%(annual rate) for 16 months to mid-Oct 1980

Interest rates

%

	MLR	Clearers' base rate	3 month interbank	5 year gilts*	20 year gilts*
2 March 1979	13	$13\frac{1}{2}$	$12^{7}/16$	12.26	13.04
13 June 1979	14	12	$13^{3}/4$	12.65	12.85
16 November 1979	17	17	$17^{3}/16$	15.91	15.21
31 January 1980	17	17	$17^{13}/16$	15.10	14.67
27 February 1980	17	17	$17^{15}/16$	15.07	14.58

* Yield curve rates as calculated on the nearest convenient date.

Counterparts to £M3 growth

£billion (seasonally adjusted)

	7 months to mid-January	
CGBR	+6.01	
Purchase of central government debt by non bank private sector (increase:-)	-5.19	(of which gilts: -5.61)
Net other public sector	+0.20	
Sterling bank lending to private sector and overseas	+4.97	
DCE	+5.98	
External and foeign currency finance adjustment	-1.89	
Net non-deposit liabilities etc	-0.44	
£M3	+3.66	
		%
Percentage increase over 7 months	6.9%	(at annual rate: 12.2 per cent)

B3 TECHNIQUES OF MONETARY CONTROL

Objective

To meet current target and to secure sustained medium term control of money supply as only sure way to achieve a reduction in rate of inflation.

Factual

(i) Fundamental elements of money supply control are fiscal policy and the level and structure of interest rates.

(ii) SSD scheme (currently extended to mid-June 1980) penalises banks whose interest-bearing eligible liabilities grow in excess of the permitted rate of 1 per cent per month.

(iii) Forthcoming consultative document will review techniques; including consideration of the merits of monetary base control as a supplement to the main methods of monetary control. (Paper to be published "shortly").

Positive

(i) Interest rates affect both the demand for credit by the private sector and the Government's ability to finance the PSBR outside the banking system (ie in a way which does not add to money supply).

(ii) Fiscal policy - both tax and public expenditure decisions - affects the demand for credit by the private sector and by the public sector, through its effects on the PSBR.

(iii) Use of direct controls on bank lending does not avoid need for appropriate interest rate and fiscal policies. In any sophisticated financial system, direct control inevitably leads to development of alternative channels if underlying determinants of monetary demand not consistent with it.

(iv) Fluctuations in monthly monetary figures inevitable but this does not destroy effectiveness of monetary control. Although important to meet current target it is medium term control that is crucial.

Defensive

(i) Fiscal policy: Relationship between fiscal policy and monetary expansion not simple or mechanical; affected by economic cycle, inflation and structure of tax and expenditure flows. But in long run, unless there are to be steadily increasing interest rates, monetary restraint can only be achieved through fiscal control.

(ii) Interest rates: Limit to the extent immediate reductions in public expenditure or borrowing can be achieved, hence need at present for high interest rates to reduce monetary growth. Emphasises need for firm fiscal policy.

(iii) Effectiveness of interest rates: Interest rates changes affect bank lending, sales of public sector debt and exchange rate, although there tends to be a delay before bank lending responds. Can have immediate impact on expectations in financial markets and hence gilt sales.

(iv) SSD scheme: Government aware of limitations and do not see it as permanent. (Probably further announcement in Budget Speech).

(v) Exchange control: £M3 adopted as target because it is well understood and linked to other elements of policy, in particular fiscal policy. But authorities take notice of other aggregates in assessing policy.

Contact point: M L Williams (HF3) 233 4533

C1 INDUSTRIAL PERFORMANCE, PRODUCTIVITY AND IMPORT PENETRATION

Objective

To improve flexibility and responsiveness of supply side of economy.

Factual

(i) Recent growth set out in following table:

	1979	1978	1973-78	1964-73
	percentage change on previous year		Annual average percentage change	
	%	%	%pa	%pa
GDP (output)	1½	2¾	¾	2½
GDP (O) excluding NS oil	½	2	½	2½
Manufacturing output	no change	½	-1	2¾

(ii) Output per head

Recent movements set out below.

Average annual percentage changes in output per head

	Whole Economy	Whole Economy excluding NS oil	Manuf. Industry	Non.Manuf. Industry
	%pa	%pa	%pa	%pa
1964-73	2¾	2¾	3¾	3½
1973-78	¾	½	¾	0
1979	1	¼	1½	0

Growth slowed in mid seventies in UK and major industrial economies probably reflecting a number of factors including rise in oil prices, recession and relatively low investment.

(ii) Import penetration

Rapid increase during 1970s

	1970	1978	1979
	%	%	%
Imported manufactured goods in GDP	10	17¾	20
Imported consumer goods in consumer spending on durables, clothes, footwear etc.	13	34	41¾
Imported capital goods in investment in plant, machinery, vehicles	15¾	27½	31¾
Imported cars in new car registrations	14¾	49¾	56

Cont.

Positive

(i) Government's measures to reduce size of public sector will prevent it diverting resources from private sector.

(ii) Government has removed restrictions on workings of market economy; pay, price and dividend controls allowed to lapse, exchange controls abolished.

(iii) Industrial policies - see C5.

Defensive

(i) Policies will take time to have full beneficial effects; cannot reverse a decade of decline overnight.

(ii) Alternative policies (reflation) will not work; problem is lack of supply not lack of demand.

(iii) See briefs A2 (UK economy - present position) and E5 (import controls).

Contact point: J S Hibberd 233 7334

C2 OUTPUT PRICES, COSTS AND COMPETITIVENESS

Objective

To bring about a substantial and lasting reduction in the rate of inflation. /This is a necessary condition for meeting other objectives/.

Factual

(i) Manufacturing input prices in January 27½ per cent up over January 1979; about ⅘ due to higher crude oil prices. Average earnings in December were about 19½ per cent higher than a year ago; low productivity growth implies most reflected in unit labour costs. Manufacturing output prices rose 17½ per cent in year to January.

(ii) RPI in January 18.4 per cent higher than a year earlier and 2½ per cent above December. January's increase, due in part to higher mortgage rates (1 per cent); rise in underlying rate rather less after allowing for 3½ per cent due to Budget tax changes. Sterling's rise since end 1978 has lowered RPI by about 2 per cent other things being equal.

(iii) GDP deflator in Q4 1979 about 14½ per cent higher than a year ago.

(iv) Retail prices rising more rapidly in the UK than in any major OECD competitors except Italy.

Table 1 Increase in Consumer Prices

percentage change on twelve months earlier

	December 1978	December 1979
USA	9.0	13.3
Canada	8.4	9.8
Japan	3.5	5.8
Germany	2.4	5.4
France	9.7	11.8
Italy	11.9	19.8
Weighted average	7.2	11.1
UK (RPI)	8.4	17.2

(v) Competitiveness in terms of relative unit labour costs has deteriorated sharply in 1979 due partly to rapid rise in earnings not matched by productivity increases and partly to strength of sterling. Deterioration of 15 per cent on a year ago in Q4 1979 and of 38 per cent since 1976 Q4 (when UK most competitive).

Table 2 Competitiveness

		Relative unit labour costs	Relative export prices
		(1975=100)	
1976 (4) (best)		85.2	95.2
1978	1	99.4	109.3
	2	95.6	102.6
	3	97.9	106.3
	4	102.3	107.6
1979	1	104.5	108.6
	2	110.2	113.4
	3	120.5	119.7
	4	117.2	115.9

Cont.

Positive

(i) Government's policies tackle inflation at its roots. Strict adherence to monetary targets and improved supply side only way for lasting reduction in rate of inflation.

(ii) Controls on prices scrapped; added substantially to business cost with little long term effect on prices.

(iii) Competition Bill increases powers of Director General of Fair Trading to promote competition and to examine nationalised industries.

Defensive

(i) Indirect tax increases in 1979 Budget gave once-for-all increase in RPI (of 3½ per cent). Excluding these underlying increase in RPI is probably 14½-15 per cent.

(ii) Effects of higher interest rates on RPI regrettable. But MLR increase necessary if monetary growth to be curbed. Consequences of alternative policies much worse.

(iii) Effect of Government policy measures on inflation cannot be measured (eg as ITEM attempt) by direct effects alone. Indirect effects important and may offset direct effects.

Contact point: R I G Allen 233 4158

C3 PROFITS AND LIQUIDITY

Factual

(i) Profitability in British industry has fallen sharply in recent years. In mid-1960s average pre-tax real rate of return on trading assets of non-oil industrial and commercial companies was about 12 per cent. In every year since 1974 it has been less than 5 per cent. Average returns in manufacturing industry about 1 percentage point lower.

(Note: these rates of return are adjusted for inflation. Capital equipment is valued at replacement cost. Profits are after stock appreciation and depreciation on assets at replacement cost.)

(ii) Gross trading profits (net of stock appreciation) of non oil industrial and commercial companies in first three quarters of 1979 (latest figures) were 5 per cent lower than in same period of 1978. Some of this due to industrial disputes in 1979 but implies substantial drop in real terms.

(iii) It is more difficult to assess current financial position of company sector. Useful measures are "net acquisition of financial assets NAFA," (broadly equal to undistributed income less investment in stocks and fixed axxets), 'net borrowing requirement' (amount by which internal funds fall short of companies' investment in fixed assets, stocks, securities and trade credit) and companies "liquidity ratio", (total current assets as a percentage of total current liabilities).

(a) In 1979 industrial and commercial companies (including oil companies) are expected to acquire net financial liabilities of nearly £6 billion equivalent to about 4 per cent of GDP (at current prices). In 1960s companies were broadly in financial balance; since mid-1970s usually in deficit equivalent to 1-2 per cent of GDP except in 1974 when deficit equivalent to 6.2 per cent of GDP. /Note for information: North Sea Oil companies add to deficits; up to £1 billion in 1979/.

(b) Net borrowing requirement of industrial and commercial companies likely to be £7 billion in 1979, nearly three times that of 1978, and about £1 billion higher than in 1974. However requirement as a percentage of GDP is smaller in 1979 (4½ per cent) than in 1974 (8 per cent).

(c) Liquidity ratios of companies in Department of Industry's survey of 230 largest industrial companies fell sharply in 1979 but still well above 1974 low of 47.

1976	1977	1978				1979			
Q4	Q4	Q1	Q2	Q3	Q4	Q1	Q2	Q3	Q4
86	114	126	138	127	122	97	104	93	71

Positive

(i) Profits obviously too low now. Adequate profits are key to increased investment, output and employment. Need to moderate wage settlements and improve productivity if sustainable economic growth to be achieved.

Defensive

(i) Companies usuall borrow to finance investment and so would expect them to be in deficit. Companies balance sheet position much sounder now than in 1974.

(ii) See C3, C5, F3.

Contact point: J S Hibberd 233 7334

C4 INVESTMENT AND STOCKBUILDING

Factual

(i) Total investment (gross domestic fixed capital formation) fell about 4 per cent in 1979 and appears to be in cyclical decline from mid 1978 peak. Investment in dwellings, shipping and North Sea most depressed sectors; investment in distribution and service industries (excluding shipping) buoyant.

(ii) Investment in dwellings fell nearly 14 per cent in 1979. Private investment in dwellings fell 17 per cent due to severe weather early in the year and high interest rates later in the year; public investment in dwellings fell by 8½ per cent. Other investment by public sector unchanged between 1979 and 1978.

(iii) North Sea investment fell by 20 per cent after smaller falls in 1978 and 1977 reflecting shift from development of fields to production.

(iv) Manufacturing investment (including assets leased from service sector) provisionally estimated to have increased by 1½ per cent in 1979 and by 8 per cent in 1978. Excluding leased assets, investment flat in 1979 following a 6 per cent increase in 1978. Latest Department of Industry investment intentions survey (published January 1980, answered in November 1979) indicated a fall of 6 to 10 per cent in direct investment by manufacturing sector in 1980. CBI survey (February 1980) indicated a 5 per cent fall in manufacturing investment in 1980.

(v) Investment by distributive and service industries (excluding shipping and assets leased to manufacturing) provisionally estimated to have risen 7 per cent in 1979. Intentions survey suggests an increase of not more than 5 per cent in 1980.

(vi) Stockbuilding rose £1.4 billion in 1979 (equivalent to about 1½ per cent of GDP) with distributors increasing stocks far more rapidly than manufacturers. Distributors stock/sales ratios rose further during the year while those of manufacturers fell back from high 1978 levels. November Industry Act forecast suggests substantial de-stocking in 1980, equivalent to about 2 per cent of GDP. /Note: Discrepancy between expenditure and other measures of GDP suggests that stockbuilding in 1979 may be under-estimated./

Positive

(i) CBI supports Government's drive to create right economic conditions for industry to thrive.

(ii) Chancellor is aware of effects of possible fall in levels of stocks on stock relief for tax purposes.

Defensive

(i) High interest rates necessary to curb monetary growth and inflation. Companies will benefit in longer term from reduction in inflation.

(ii) Enterprise zones are one among a range of possibilities being considered.

(ii) Selective Investment Scheme continuing but resources being directed to areas most in need (see C5).

Contact point: J S Hibberd 233 7334

C5 INDUSTRIAL POLICIES: PRESENT POSITION

Objectives

(i) Create conditions in which industry can flourish.

(ii) Promote flexibility and responsivness of supply side of economy.

(iii) Government support for industry to be cost effective; resources concentrated where most needed.

Factual

(i) Support for Industry

Most of previous governments sectoral schemes closed for applications. Outstanding applications for Selective Investment Scheme processed against stricter interpretation of criteria. Micro-electronics Industry Support Programme continuing at reduced level. R and D support for new products and processes broadly stabilised at present levels.

(ii) National Enterprise Board

Powers and functions reduced in current Industry Bill. Board to dispose of large part of assets; target of £100 million for 1979-80 now spread over current and next year. ICL shares already sold, netting £37 million.

(iii) Regional Support Schemes

Changes, spread over three years, in assisted area boundaries and levels of support. Corby and Shotton upgraded following steel closures. Special factory building programmes announced for Shotton and South Wales.

(iv) Employment and Training

Previous administrations 1979-80 programme cut by £170 million in June 1979 Budget. Youth Opportunities Programme to be expanded in 1980-81. Temporary Short Time Working Scheme and a reduced Job Release Scheme to be continued until March 1981. Small Firms Employment Subsidy to end next month.

(v) Small Firms

Measures to help with provision of finance, premises and specialist advice announced on 7 November. Burdens imposed by legislation reduced - eg amendments to Employment Protection Act; abolition of Office Development Permits; collection of statistics reduced.

(vi) Competition Policy

Competition Bill promotes competition by strengthening means of dealing with restrictions or distortions arising from abuse of market power in both public and private sector. New powers of investigation into efficiency, standards of service and possible abuses of monopoly power by nationalised industries.

Positive

(i) Continuing and substantial Government support for industrial training.

(ii) Government attaches great importance to thriving small firms sector. Tax cuts in last budget will have helped. Possibility of further fiscal changes being studied.

(iii) CBI have expressed continued support for the Government's policies.

Cont.

(iv) Government support for industry continuing but on a more selective and cost effective basis.

(v) The Government fully supports the tripartite sectoral approach to improving industrial competitiveness.

Defensive

(i) Policies will take time to achieve results. Improvements in industrial efficiency depend primarily on action at company and plant level.

(ii) Need to reduce public expenditure does mean a considerable reduction in industrial support in the medium term but precipate changes have been avoided.

Contact point: M Prescott 233 3200

D2 EMPLOYMENT AND UNEMPLOYMENT

Factual

(i) Total employees in employment rose by 150,000 in year to June 1979 but then levelled off. Rise in employment in service industries and construction more than offset falls in manufacturing.

(ii) Manufacturing employment in Great Britain fell by 150,000 in year to December 1979; fall of 70,000 in the previous twelve months.

(iii) Public sector employed nearly 30 per cent of all employees at mid 1978 (latest figures).

(iv) Total working population, (sum of employees in employment, self employed, HM forces and registered unemployed) virtually flat between September 1977 and September 1979.

(v) Unemployment (UK seasonally adjusted excluding school leavers), which had been falling since end of 1977 rose early in 1979, (mainly due to industrial disputes and severe weather conditions), but fell again until September. Between September 1979 and February 1980 rose by 120,000, probably in response to continuing flat output. February count 50,000 below post war peak in November 1977.

(vi) 191,000 notified vacancies unfilled at February count; numbers have been falling for eight months.

(vii) Special employment measures

YOP expanded from 210,00 to around 260,00 places in 1980-81; other programmes (Special Temporary Work Programme (STEP), Community Industry (CI) and Temporary Short Time Working scheme (TSTW)) extended.

Positive

(i) Government's policies aimed at achieving sustainable economic growth and high level of employment in medium-term. Best prospects for secure employment lie in realistic wage settlements, improved productivity and flexible working of labour market.

(ii) Government proposes to correct the balance in industrial relations by:

(a) removing immunity for specific forms of secondary picketing and restoring the law on immunities to what it was thought to be before Express v McShane case;

(b) amending law on closed shops;

(c) providing public funds for postal ballots.

(iii) Burden of Employment Protection Act on small firms has been reduced. (see C5).

(iv) Various measures taken to reduce size of Civil Service employment; numbers have fallen 25,000 since Government took office.

Defensive

(i) Government is keeping question of immunities under review; a Green Paper will be published in the summer. Recent rise in unemployment follows flat output over past 18 months.

(ii) Recent rise in unemployment follows flat output over past 18 months. Biggest threat to employment comes from wage increases not matched by increased productivity.

(iii) Some special employment schemes cut back after careful and critical review in light of stance on public expenditure and industrial policy (see C5).

Contact point: J S Hibberd 233 7334

D1 EARNINGS, REAL INCOMES AND REAL PERSONAL DISPOSABLE INCOME (RPDI)

Objectives

Create a climate in which wage bargains are struck by responsible negotiators who have regard to Government's monetary policy and employers' ability to pay.

Factual

(i) Index of average earnings rose 19.6 per cent in year to December; underlying rate (adjusting for back pay etc) slightly lower.

(ii) Earnings increasing faster in UK than in major OECD countries (except Italy).

Table 1: Increase in Earnings

	percentage change in twelve months to December 1978	percentage change in twelve months to	
USA (hourly earnings)	9.0	7.6	(Dec)
Canada (hourly earnings)	6.8	8.8	(Nov)
Japan (monthly earnings)	6.3	6.2	(Nov)
Germany (hourly earnings)	6.2	4.8	(July)
France (hourly rates)	12.9	13.0	(Oct)
Italy (hourly rates)	14.9	22.7	(Nov)
UK (average earnings)	13.3	19.6	(Dec)

Source: OECD Main Economic Indicators

(iii) Tax and Price Index (which reflects changes in direct tax and prices) rose 16.1 per cent in year to January suggesting taxpayers' real earnings have risen by around 3 per cent in last year.

(iv) RPDI about 5 per cent higher in 1979 due to increases in earnings, direct tax reduction and increased transfer payments.

Positive

(i) Government will not set pay limits or norms. Government intervention in pay bargaining, by introducing distortions, may increase inflation in long run.

(ii) Nationalised industries must operate within agreed financial targets and borrowing limits.

(iii) Public sector pay negotiations should be conducted within framework of cash limits.

(iv) Real incomes have risen considerably over the last year. But wage increases of nearly 20 per cent are well in excess of growth in productivity.

Cont.

Defensive

(i) Government's firm control over the money supply means unrealistic increases in earnings lead to loss of output and jobs.

(ii) The Industry Act forecast was for a small fall in real incomes in 1980. Situation would be far worse if the Government relaxed it fiscal and monetary stance.

(iii) Would expect a wide spread of settlements. Earnings increases this year not a test of efficacy of Government's policies.

(iv) Government looking into arrangements for index linked civil service pensions. Contributions must be fair and seen to be fair.

Contact point: R I G Allen 233 4158

E1 PRESENT POSITION ON CURRENT AND CAPITAL ACCOUNTS
(see also A3 North Sea oil E2 Exchange rate policy)

Factual

(i) Current account in £2.4 billion deficit in 1979 after surplus of £0.9 billion in 1978. Visible balance deteriorated by £1.8 billion and invisibles by £1.6 billion.

(ii) Trade volumes moved adversely. Exports of manufactures were flat while imports grew by 18 per cent. Terms of trade improved slightly.

(iii) Oil balance improved from deficit of £2 billion in 1978 to deficit of £0.8 billion in 1979.

(iv) Fall in invisible surplus was result of higher profits earned by foreign oil companies in UK; higher UK expenditure on travel abroad; higher contributions to EEC budget.

(v) Capital account showed substantial increases in sterling balances (£4.3 billion) more than offsetting current account deficit.

(vi) Treasury forecast, November 1979, £2 billion deficit in 1980.

Positive

(i) In longer-term Government's policies on restoring a better balance in economy, improving supply side, and abolishing controls on operations of markets should help to improve current position.

Defensive

(i) In short-term, particularly as economy adjusts to lower money supply growth, a deficit may be inevitable.

(ii) Probably inevitable that rising oil production should be matched by some deterioration in balance of trade in manufactures. Oil makes us better off in terms of national income but does produce some structural changes within economy.

(iii) Declining invisible surplus is not a reflection of poor performance by our invisible exporters. It is result of a rise in debits on the invisibles account (especially foreign oil company profits).

(iv) Increases in sterling balances should not be regarded as "hot money". They represent rebuilding of real value of balances which had been eroded by inflation. In real terms balances are lower than for most of first half of 1970s.

Contact point: A C S Allan (EF1) 233-3496

E2 EXCHANGE RATE POLICY

Objectives

Monetary policy determines exchange rate policy in all but very short run. Rate set primarily by market forces. Authorities intervene in market to moderate excessive fluctuations and preserve orderly conditions.

Factual

(i) Sterling has appreciated strongly since beginning of 1979, rising over 11 per cent against dollar and 14 per cent in effective terms. Currently stands around $2.24, 72 effective (5 March).

(ii) Sterling derives strength from UK's favourable status as oil producer, high domestic interest rates relative to rest of world and market confidence in Government's commitment to firm monetary and fiscal policies.

Positive

(i) Appreciation of sterling has helped to contain inflation.

Defensive

(i) High exchange rate is consequence of tight monetary stance and important channel through which effects of monetary and fiscal policies are transmitted to price level.

(ii) Scale of inflows not jeopardising monetary targets. No case for imposition of inflow controls which distort markets and are often ineffective.

(iii) Manipulating exchange rate not way to improve exports. Right way is by raising productivity and curbing growth of domestic costs.

(iv) We cannot tell when conditions will permit us to take decision about joining EMS exchange rate mechanism. This must take account of all factors affecting position of sterling.

Contact point: M O'Mara (EF1) 233 4621

E3 RESERVES AND DEBT MANAGEMENT

Objectives

(i) To maintain adequate reserves for authorities to intervene to moderate excessive fluctuations in exchange rate and preserve orderly conditions.

(ii) To reduce burden of external debt substantially during this Parliament.

Factual

(i) Official reserves at end-February stood around $24 billion.

(ii) Total public sector foreign currency borrowing outstanding at end-February was about $21 billion, compared with $22½ billion at end-April 1979 and a peak of over $25 billion at end-December 1977. (Schedule of capital and interest repayments in Bank of England Quarterly Bulletin).

Positive

(i) Gross reserves slightly exceed our official short and medium-term debt and are equivalent to about 3 months of visible imports.

Defensive

(i) Since Government took office, UK has repaid $2.9 billion gross ($1.4 billion net).

Contact point: M O'Mara (EF1) 233 4621

E4 EUROPEAN COMMUNITY BUDGET

Objective

To secure a substantial and lasting reduction in the UK's net contribution to the Community Budget, with effect from the 1980-81 financial year.

Factual

UK net contribution - less than £150 million in 1976 - is now running at around £1,200 million a year. This makes Britain by far largest net contributor to Community Budget. Contribution could rise to twice as much again by 1985 unless something done to cut it back. By contrast, UK is seventh in Community in terms of GNP per head -the generally accepted measure of relative prosperity. This state of affairs is grossly inequitable and politically unacceptable.

Positive

(i) Government has campaigned vigorously in the Community for a substantial reduction in UK net contribution; there is now a widespread recognition that this constitutes a problem for Community as well as for UK.

(ii) Our Community partners have already in effect offered to revise 1975 Financial Mechanism so as to remove that part of the problem (about ⅓) that arises from the UK's excessive gross contribution. They are now considering ways of tackling the remaining ⅔ by increasing Community expenditure in UK, on the basis of proposals from the Commission.

Defensive

(i) Offer of revised Financial Mechanism was great improvement on anything previous government achieved. But present government is looking for substantially greater cut in net contribution that revised Financial Mechanism would produce.

(ii) Burden is still intolerable in spite of benefits to UK economy from North Sea Oil. (These are fully reflected in the GNP per head calculation).

Contact point: J A Thomson (IG2) 233 5582

E5 IMPORT CONTROLS: PRESENT POSITION

Objectives

Government supports free and fair trade within framework of international agreements. This offers best prospects to both producers and consumers through allocating resources efficiently and widening choice.

Factual

1. Present UK tariff regime

(a) Since transitional arrangements for UK entry to EEC expired in 1977, trade in all goods between UK and EEC countries is free of tariffs.

(b) EEC Commission and not national governments has competence in trade matters. UK tariffs towards rest of world same as those of EEC.

(i) imports from EFTA countries virtually free from tariffs except agricultural goods, where Community levies generally apply

(ii) imports from Lome Convention countries (mainly former British and French colonies) have virtually free access, including many agricultural products

(iii) imports of non-agricultural goods from rest of world subject to Common External Tariff, which averaged 9.8 per cent on dutiable industrial goods (equivalent to 6.6 per cent averaged over all non-agricultural imports)

(iv) preferential tariffs accorded some developing countries under Generalised Scheme of Preferences (GSP).

(c) Two thirds of UK imports of industrial goods are from countries against whom no tariff is levied.

2. Results of the Multilateral Trade Agreements

MTAs provide for staged reductions in tariffs over eight years from 1 January 1980. EEC (and hence UK) tariffs on dutiable industrial goods will be cut on average from 9.8 per cent to 7.5 per cent. Average reduction in tariffs against US exports is around 30 per cent, and 20 per cent against those from Japan. There will be minor reductions in agricultural tariffs. US will reduce average tariff against EEC industrial exports by around 30 per cent, and Japan by some 20 per cent. Major steps also taken towards reducing non-tariff barriers to trade, such as import licensing procedures, technical standards and customs valuation. Specific measures to liberalise government procurement and trade in civil aircraft.

3. Present Quantitative Restrictions and Voluntary Restraint Agreements

(i) Textiles: Multi-Fibre Arrangement provides for QRs on low cost imports of yarn, fabric, and finished garments from many countries. Further agreements with other suppliers not parties to MFA provide for similar restrictions. In total, 98 per cent of UK low cost imports of textiles subject to QRs or safeguard provisions. Two quotas, introduced from January 1980, on synthetic fibres mainly from US and Canada.

(ii) Monochrome portable TVs: Quotas on imports from Korea and Taiwan VRAs on imports from Japan and Singapore. Colour portable TVs from Japan subject to VRA.

(iii) Cutlery from Japan and Korea subject to VRA.

(iv) Leather shoes from Eastern Europe subject to quotas or VRAs. Non-leather shoes from Taiwan subject to quota. Shoes from Korea subject to VRA.

Cont.

(v) Cars, special steels, pottery, consumer electronics from Japan subject to VRAs.

(vi) EEC has negotiated VRAs with major iron and steel exporters outside Community.

4. Dumping

EEC now responsible for investigating alleged dumping. Exporters have mostly given satisfactory undertakings on price. Anti-dumping duties have not been imposed.

5. Recommendations of import controls

(i) Cambridge Economic Policy Group (director Wynne Godley) argues for policy of co-ordinated world demand management coupled with discriminatory trade restrictions to achieve growth without external payments constraints. (CEPG alternatively argues for general unilaternal UK import tariffs or quotas and claims ensuing domestic growth would mean no absolute reduction in import levels.)

(ii) TUC Economic Review argues for "selective and temporary" import controls to protect core industries - cars and steel cited as examples. TUC also wants increased efforts by NEDC and Sector Working Parties to monitor and counter import penetration.

(iii) Mr Alan Clark, Conservative MP, suggested (Times 7 March) that controls on 60 per cent of imports, coupled with a rising import surcharge over time, would allow faster economic growth and a lower PSBR.

Positive

(i) Government believes free and fair trade in best interest of both producers and consumers.

(ii) Government is prepared to protect particularly hard-hit UK industries from unfair and disruptive imports. Current protective measures are all selective and temporary. They are either voluntary or internationally agreed. They are designed to allow domestic industry time to adjust.

(iii) Government also seeks to ensure no unfair obstacles against UK exports - includes both tariff and non-tariff barriers.

(iv) Best way to limit import penetration is to improve UK productivity and industrial performance.

Defensive

(i) Government opposed to general import controls on grounds likely to breach international obligations, risk retaliation and no guarantee that they would lead to extra domestic output rather than higher inflation.

(ii) UK exports 30 per cent of GDP and has particular interest in free access to world markets.

(iii) General and permanent import controls would foster inefficiency among domestic producers and limit choice of consumers.

(iv) Newly Industrialised Countries' (NICs) account for only 10 per cent of UK's manufactured imports. We have large manufactures surplus with NICs, one of UK's fastest growing markets. But Government vigilant against unfair trade by NICs and pressing them to open their markets.

(v) Recent action against US synthetic textile imports and possible US action against European steel not part of an Atlantic trade war. Isolated and unconnected issues. Firm grounds needed for such action and must comply with international obligations. Textiles action was taken by EEC Commission.

Contact point: A R H Bottrill 233 5886

F1 INCOME TAX (including Investment Income Surcharge)

(i) Personal Allowances 1978-80

	£pa
Single (and wife's earned income relief)	1,165
Married	1,815
Additional personal allowance	650
Age allowance, single	1,540
Age allowance, married	2,455
Age allowance, income limit	5,000
	£
Mortgage interest relief ceiling (max. mortgage)	25,000

(ii) Rates of Tax 1979-80

Bands of Taxable Income (£ pa)	%
0 - 750	25
751 - 10,000	30
10,001 - 12,000	40
12,001 - 15,000	45
15,001 - 20,000	50
20,001 - 25,000	55
Over 25,000	60

(iii) Investment Income Surcharge 1979-80

Rate: 15 per cent
Threshold: £5,000pa

(iv) Child Tax Allowances

Were phased out during 1978-79 in favour of Child Benefit payments

(v) Indexation

Section 22 of Finance Act says that the main personal allowances (the single, married and age allowances) should be increased each year by not less than increase in RPI during previous calendar year. Treasury may, however, overrule these provisions by making an Order (subject to House of Commons approval). Increase in RPI for 1979 calendar year (12 month rates to January 1980 and to December 1979 averaged) 17.8 per cent. Increasing the main personal allowances by this amount would cost on its own about £2 billion in full year. Indexation of the allowances, basic rate threshold, higher rate threshold and higher rate bands would cost around £2.6 billion in a full year.

(vi) Finance (No. 2) Act 1979

Income tax was cut by £4½ billion (full year) by increasing all main allowances and substantially reducing rates at all levels. Main personal allowances were increased by 18 per cent (twice that required by indexation). Basic rate was reduced by 3p. Burden of higher rate tax was cut substantially - top rate on earned income coming down to 60 per cent. Threshold for Investment Income Surcharge was increased to £5,000.

(vii) Estimated yield - £19,655 million in 1979-80 (FSBR 1979-80 estimate); more recent estimate made public £20,500 million.

Contact point: J E Mortimer 233 7393

F2 CAPITAL TAXES (including Investment Income Surcharge)

(i) Objective

To make capital taxation simpler and less oppressive.

(ii) Capital Transfer Tax

Slice of transfer (£)	Lifetime rate %	Rate upon death %
0 - 25,000	nil	nil
25,000 - 30,000	5	10
(rising to)		
Over 2,010,000	75	75

- Annual exemption for gifts: £2,000
- Business and agricultural reliefs: Asset values reduced by 50 per cent

(iii) Capital Gains Tax

Rate - 30 per cent
Marginal relief (individuals) -

Slice of annual gain (£)	%
0 - 1,000	nil
1,001 -5,000	15
5,001 - 9,500	50

Thereafter, on gains of £9500 and over, rate is 30 per cent on the full amount.

(iv) Investment Income Surcharge

Rate - 15 per cent
Threshold: £5,000pa

- Finance (No. 2) Act 1979 increased annual thresholds from £1,700 (under 65s) and £2,500 (over 65s) and abolished 10 per cent rate.

(v) Development Land Tax

Rate - 60 per cent
Annual Exemption: £50,000

- Finance (No. 2) Act 1979 reduced rate from 80 per cent (66⅔ per cent on first chargeable £150,000 for transitional period expiring 31 March 1979) and increased annual exemption from £10,000.

(vi) Stamp Duties

Rate - 2 per cent
Concessionary rates for house purchases

£	%
0 - 15,000	nil
15,001 - 20,000	½
20,001 - 25,000	1
25,001 - 30,000	1½
Over 30,000	2

(vii) Estimated yield in 1979-80 (latest figures made public)

	£m
CTT	400
CGT	625
IIS	230
DLT	35
SD	590

Contact point: J Stuart 233 8719

F3 COMPANY TAXATION (including PRT)

Company taxation is under review as announced by Chancellor in Budget statement last June.

(i) Corporation Tax

1. Rate - 52 per cent

   Small Companies Rate - 42 per cent where profits are £60,000 or less with intermediate rates where profits are up to £100,000.

2. Capital Allowances -

Plant and machinery	100% in first year
Industrial buildings	50% in first year
Hotels	20% in first year

3. Stock Relief -

   Equivalent to increase in value of inventories less, broadly speaking, 15 per cent of trading profits.

4. Estimated yield -
   £4,850m (including Advance Corporation Tax) in 1979-80 (FSBR 1979-80 estimate).

(ii) Petroleum Revenue Tax

1. Rate - 60 per cent
2. Uplift - 35 per cent

   In general, costs of finding a field and bringing it into production qualify for a 35 per cent uplift in addition to the 100 per cent allowance. The total allowance of 135 per cent - which compensates for the fact that interest payments are not allowed against PRT - is intended to help companies recover their capital early in the life of a field.

3. Estimated yield - £1,430 million in 1979-80, including payments of £700 million brought forward two months underthe Petroleum Revenue Tax Act 1980.

Contact point: J Stuart 233 8719

(i) Value Added Tax

1. Rate - 15 per cent.

2. Reliefs - Apply to basic necessities (accounting for just over half of the total consumer expenditure) and render the tax mildly progressive. They consist of:

(a) The zero-rate (applicable to exports, most foods, heating and lighting, public transport, books, construction, young children's clothing etc).

(b) Exemptions (applicable to land, insurance, finance, education, health etc).

3. Estimated yield - £8,325 million 1979-80

4. Finance (No.2) Act 1979 - The Standard Rate of 8 per cent and Higher Rate of 12½ per cent were unified at 15 per cent, increasing the yield by about £2 billion in 1979-80 (£4.1 billion in full year).

(ii) Oil

1. Rates -	Petrol (and other light hydrocarbon oils)) Petrol substitutes)	37p per gallon
	Derv	42p per gallon
	Kerosene (other than AVTUR)	1p per gallon
	Other rebated heavy hydrocarbon oils (mainly gas oil, fuel oil, AVTUR)	3p per gallon
	Liquified petroleum gas for use as road fuel	18½p per gallon

2. Reliefs - Oil used in fishing boats, lifeboats; heavy oil for ships and certain horticultural purposes;
Oil used in manufacturing other products (other than as fuel or lubricant).

3. Estimated yield - £2900 million in 1979-80 (Petrol £1960 million; Derv £650 million; Rebated Oil £290 million)

4. Finance (No.2) Act 1979 - Yield was increased by about £300 million in 1979-80 (£525 million in full year) by increasing rates on:

(a) petrol - about 23 per cent; and

(b) derv and rebated oil (other than kerosene) - about 20 per cent

Tobacco

1. Rates - (a) Cigarettes
Basic rate - 21 per cent of retail price + £11.7 per 1000
(typical duty per packet of 20 : 37½p)
High tar additional rate - £2.25 per 1000

(b) Handrolling Tobacco	57p per oz.
(c) Cigars	59p per oz.
(d) Pipe Tobacco	45p per oz.

2. Estimated yield - £2550 million in 1979-80

3. Finance (No.2) Act 1979 - Marginal changes in cigarette duty rates to increase specific and reduce ad valorem element.

(iv) Alcohol

(a) Spirits

1. Rate/Incidence - £3.16* bottle Scotch 70° proof (27.09 per proof gallon)

2. Reliefs - spirits used for domestic heating, cleaning etc. or for industrial, medical or scientific purposes.

3. Estimated yield - £1115 million in 1979-80.

Cont.

*illustrative figures.

4. Last increase - 1.1.77.

(b) Beer

1. Rate/incidence - 7.5p* per pint (17.424 per bulk barrel at 1030°)

2. Estimated yield - £930 million in 1979-80

3. Last increase - 1.1.77.

(c) Wine and made-wine

1. Rates/Incidence - (54p* - 73.5p*) per bottle (Wine - £3.25 - £4.415 per gallon, Made-wine £2.11 - £3.475 per gallon)

2. Estimated yield - £342 million in 1979 - 80

3. Last increase - 1.1.77.

(d) Cider

1. Rates/Incidence - 3p* per pint (£0.242 per gallon)

2. Estimated yield - £15 million in 1979-80

3. Last increase - 1.1.77.

(v) Betting and Gaming Duties

1. Consist of general betting, pool betting, gaming licence, gaming machine licence and bingo duties.

2. Estimated yield - £410 million in 1979 - 80.

(vi) Customs Duties and Agricultural Levies

1. Accountable to EEC as 'own resources'

2. Estimated yield - £1145 million in 1979-80.

(vii) Car Tax

1. Rate - 10 per cent of wholesale value

2. Estimated yield - £510 million in 1979-80

(viii) Vehicle Excise Duties

1. Rates - £50pa on cars
£50 - 84pa on light vans
£449* - 914*pa on heavier goods vehicles.

2. Estimated yield - £1148 million in 1979-80

3. Last change - 1.4.77.

(ix) National Insurance Surcharge

1. Rate - 3½ per cent based on employees' gross earnings between £19.50 and £135 per week.

2. Estimated yield - £2952 million in 1979-80.

3. 1.4.80 Increases - to 3½ per cent based on employees' gross earnings between £23 and £165 per week.

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*illustrative figures.

Contact point: Mrs F R Boardman 233-5692

F5 TAX BURDEN AND BALANCE OF TAXATION

Table 1 INCOME TAX AS PERCENTAGE OF TOTAL PERSONAL INCOME

1973/4	1974/5	1975/6	1976/7	1977/8	1978/9	1979/80
11.2	13.3	15.1	14.8	13.5	12.8	11.8 (estimate)

Table 2 TAX YIELDS AS PERCENTAGE OF TOTAL TAX REVENUE

	1963/4	1969/70	1973/4	1974/5	1975/6	1976/7	1977/8	1978/9	1979/80 (estimated)
Direct tax	48	49	50	53	52	52	49	48	45
on income: persons	27	30	31	34	38	37	33	32	28
PRT	-	-	-	-	-	-	-	0	2*
other	9	9	8	8	5	6	6	7	6
on capital	3	4	4	3	2	2	2	2	1
employees' NI contributions	8	6	8	7	7	8	7	7	7
Indirect tax	52	51	50	47	48	48	51	52	55
on expenditure	45	45	41	37	37	37	40	42	45
employers' NI contributions	7	7	9	10	11	11	11	10	10

Definitions - based on National Accounts

Tax on personal income comprises income tax and surtax.
Other tax on income: comprises Income tax on organisations, surtax, profits tax, excess tax etc, corporation tax, overspill relief.

Tax on capital comprises death duties, capital transfer tax, capital gains tax, betterment levy, development land tax, special charge.

Taxes on expenditure comprise customs and excise duties, motor vehicle duties, royalties, etc from seaward activities; selective employment tax, national insurance surcharge, stamp duties, local authority rates, miscellaneous other.

Note: numbers may not add up to 100 due to rounding to nearest 1 per cent.

Positive

(i) Table 1 illustrates clearly the increased burden of income tax in mid '70s and subsequent decline.

(ii) Table 2 shows how the share of direct taxation in total taxation increased in 1974/5 and stayed relatively high until 1979/80, when income tax was reduced in the June Budget. The switch is reflected most clearly in the proportions of total taxation gained from tax on personal income and from tax on expenditure.

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* distorted by advance of PRT payments from following year.

Contact point: W Hood (FP3) 233 5930

F6 INTERNATIONAL TAX COMPARISONS

Factual

(i) Following tables show for selected countries comparative burden and balance of taxation (Table 1), main tax categories as percentages of total taxation (Table 2), average (Table 3) and marginal (Table 4) rates of income tax and social security contributions combined, at multiples of average earnings of a male manual worker in manufacturing industry (APW ie average production worker), and effective rates of value added tax in the European Community (Table 5).

(ii) Local income tax is included where appropriate in Tables 3 and 4. 1980 tax rates have been used for Germany, Netherlands and USA, and 1979 or 1979/80 rates have been used for rest.

(iii) In 1978 both burden of taxation and balance between direct and indirect taxation in UK were around average for OECD countries.

(iv) Proportion of total taxation contributed in 1978 by taxes on household income was higher in UK than in any European Community country except Belgium and Denmark (not shown in Table 2) but lower than in Sweden or US. Proportion contributed by taxes on corporate income and profit in UK was highest in European Community except Luxemburg (not shown) and higher than in Sweden though lower than in US. Proportion contributed by taxes on goods and services was lowest in European Community except Luxemburg and Netherlands though higher than US. Proportion contributed by taxes on wealth and property (comprehended under 'other' in Table 2 and including local authority rates) was highest of all OECD countries. Social Security contributions were relatively low in UK.

(v) Average rate of income tax and social security contributions combined for APW (married) in UK is lower than in Germany, Netherlands or Sweden but higher than in France, US or Japan.

(vi) Marginal rates in UK are closer to those overseas following 1979 Budget.

(vii) In 1978 UK revenue from VAT as proportion of total taxation (not isolated in Table 2) was lowest of all Community countries. Unification of VAT at 15 per cent in 1979 brought UK more into line with rest, but effective rate still remains below other Community countries.

Contact point: W Hood (FP3) 233 5930

Table 1 TAX BURDEN AND BALANCE OF TAXATION 1978 (provisional figures)

	UK	F	G	N	Sweden	US
Total taxation as % of GDP at market prices	35.2	39.4	38.0	46.7	53.1	30.4
Direct taxation as % of total taxation	49	37	53	54	47	57
Indirect taxation as % of total taxation	51	63	47	46	53	43

source: OECD Revenue Statistics

Table 2 DIFFERENT TYPES OF TAXATION AS PERCENTAGE OF TOTAL TAXATION (provisional figures)

	UK	F	G	N	Sweden	US
Household income and profit	32	13	30	27	42	34
Corporate income and profit	8	5	6	6	3	11
Employees' social security contributions	8	12	16	20	1	10
Employers' social security and pay roll taxes	14	32	19	17	29	15
Taxes on expenditure on goods and services	26	32	26	25	24	17
Other taxes	12	6	4	5	1	12

source: OECD Revenue Statistics

Table 3 AVERAGE RATES OF INCOME TAX AND SOCIAL SECURITY CONTRIBUTIONS FOR MARRIED MAN WITH NON-EARNING WIFE AND NO CHILDREN

Multiples of APW earnings*	UK 1979/80	F	G	N	Sweden	Japan	US
x 1	26.5	14.6	27.5	34.3	32.8	16.8	18.7
x 2	28.9	18.4	28.2	38.9	53.3	22.7	28.3
x 3	33.7	22.3	33.5	46.3	63.0	28.6	35.6
x 4	38.1	25.3	37.5	51.3	68.5	34.1	40.6
Sterling equivalent+ of APW earnings	5798	5525	8320	8230	6940	6825	6665

* forecast for 1.4.80 + at 22.2.80 exchange rate

Table 4 MARGINAL RATES OF INCOME TAX AND SOCIAL SECURITY CONTRIBUTIONS FOR MARRIED MAN WITH NON-EARNING WIFE AND NO CHILDREN

Multiples of APW earnings*	UK 1979/80	F	G	N	Sweden	Japan	US
x 1	36.5	20.7	34.2	44.1	60.0	26.2	31.1
x 2	30.0	29.2	39.3	50.0	80.0	33.6	41.0
x 3	50.0	32.6	48.0	64.0	85.0	47.1	54.0
x 4	55.0	36.0	50.7	70.0	85.0	51.5	54.6
Sterling equivalent of APW+ earnings	5798	5525	8320	8230	6940	6825	6665

Table 5 AVERAGE EFFECTIVE RATE OF VAT IN EUROPEAN COMMUNITY COUNTRIES IN 1977

	VAT average effective rate
UK	5.1
UK wef 18.6.79 (estimate)	(8.0)
France	13.4
Germany	9.4
Netherlands	12.6
Belgium	11.5
Luxembourg	8.3
Denmark	14.4
Italy	8.5
Ireland	9.2

Notes

(i) Table 5 shows average effective rate for each Community country, calculated by taking VAT revenue as proportion of consumers' expenditure, on basis of OECD statistics for 1977.

(ii) Rates have since changed in some of the countries; these changes have all been of a minor nature except for UK increase to 15 per cent in June 1979 (current effective rate in UK shown in brackets in Table 5).

(iii) Multi-rates apply in many countries (all of them when zero-rating counted as a rate).

* forecast for 1.4.80

\+ at 22.2.80 exchange rate

G1 PUBLIC EXPENDITURE

Factual

(i) June 1979 Budget cut previous administration's planned increase in spending for 1979-80 (£1½ billion cuts in programmes, £1 billion cash limits squeeze, £1 billion asset sales). November White Paper (Cmnd 7746) cut previous administration's plans for 1980-81 by £3½ billion (1979 survey prices).

(ii) A Public Expenditure White Paper setting out Government's medium-term plans to 1983-84 and final plans for 1980-81 will be published around the date of the Budget. Announcement in due course.

(iii) Cuts in expenditure on housing programme announced by Secretary of State for Environment on 21 February, consistent with other public expenditure reductions.

Positive

(i) The Government is committed to reducing the level of public expenditure. Essential to reduce public borrowing if interest rates and rate of inflation to come down.

(ii) Government committed to increasing spending on law and order and defence and to maintaining level of spending on the health service. Actions to date and plans reflect these commitments.

(iii) No charge will be introduced for staying in hospital or visiting GPs'. Government pledge to protect pensioners against rises in prices will be honoured.

(iv) Part of reduction to be sought in lower contribution to EEC.

(v) 3 month ban on recruitment introduced when government took office, numbers down 25,000 since then. Further measures will save £212 million a year for the next 2-3 years. Equivalent of about 40,000 posts. Studies now in progress will lead to further savings.

Defensive

(i) Budget cuts and November White Paper stabilised public spending. Forthcoming White Paper makes substantial reductions effects of which will be felt in medium term.

(ii) The White Paper giving details of plans for 1980-81 and subsequent years being published later than usual because of extra work involved in changing previous administration's plans.

(iii) The timing and amount of any future uprating of child benefit will be announced in due course.

Contact point: T Burr 233 8082

G2 1980-81 CASH LIMITS

Factual

(i) Rate Support Grant (RSG) for 1980-81, announced on 16 November 1979. Cash limit provided for 13 per cent increase over 1979-80 in current expenditure costs (prices and pay). Separate provision for outstanding comparabilities awards.

(ii) External financing limits for nationalised industries announced on 16 November. They reflect circumstances of each industry - but broadly consistent with provision in R&G cash limit.

(iii) Remaining cash limits for 1980-81 (mainly for local authority capital expenditure and external financing limits for regional water authorities) will be published on Budget day probably in Financial Statement and Budget Report. Provision for future cost increases will be published alongside cash limits in question.

(iv) Following full assimilation of cash limits and votes, cash limits on voted expenditure are published as part of Main Estimates.

(v) General presumption that cash limits once set are revised only if specific policy decision taken to increase expenditure on a service.

(vi) If cost increases exceed those allowed for in cash limits, volume of service provided squeezed.

(vii) /Announcement soon that civil service remuneration vote will be included in 1980-81 main estimates and will be treated as a cash limit./

Positive

(i) Experience shows that cash limits are a firm and effective control on spending. Spring Supplementary Estimates suggest possibly only four overspends in 1979-80.

(ii) Detailed examination of breaches of limits. Presumption that offsetting adjustment in following year's limit (as with overspends in defence, aid, Welsh housing and Welsh Water Authority in 1978-79).

(iii) Central vote on civil service pay enables ministers to consider results of pay research - normally available in February - before determining cash limit.

(iv) It is government policy that cash limits should provide a firm framework for pay negotiations.

Defensive

(i) Public sector pay negotiations should be conducted with in framework of cash limits.

Contact point: K J Valentine 233 3855

G3 SOCIAL SECURITY BENEFITS: Present position

Note: Changes in social security benefits will be announced in Public Expenditure White Paper and referred to in Budget speech. Results of uprating review (effective in November 1980) should be announced in Budget Speech or shortly thereafter. This brief records position to date.

Factual

(i) Details of main benefits are shown in table overleaf.

(ii) Pensioners Payment Acts 1979 provided for payment of 1979 Christmas bonus to retirement pensioners and other groups of long term beneficiaries.

(iii) Social Security Bill now before Parliament provides for uprating of retirement pensions and certain other long term benefits to be linked to prices, not higher of earnings or prices.

(iv) Plan for making employer responsible for payment of a minimum level of sick pay during the first few weeks of sickness to be published for consultation.

(v) National Insurance contributions are due to increase from 6 April. Measures were announced towards the end of last year. Contribution rates for 1980-81 will go up by ¼ per cent to 6¾ per cent for those contracted in and to 4¾ per cent for those contracted out. Lower earnings limit will be increased to £23 and upper earnings limit to £165pw.

Positive

(i) Pensioners Xmas bonus to be paid in future years.

(ii) Assistance with fuel costs for winter of 1979-80 was extended in November 1979 to certain beneficiaries. Extension of extra heating allowances as of right to supplementary benefit householders aged over 75 years and all supplementary benefit householders with child under five years old. In addition all on FIS were given an extra £1 a week entitlement over and above the already announced uprating.

Contact point: A M White 233 4342

	Average Numbers receiving benefits 1979-80	Total Expenditure 1979-80	Rates of main benefits	
		£ million (1979 Survey prices)		
	000's		£ per week	
Retirement pensions	8660	8804	23.30	(single)
			+ 14.00	(wife or other dependants)
NI invalidity benefits	630	1009	23.30	(single)
			+ 14.00	(wife or other dependants)
Widows pension, industrial death benefit and disablement pension	680	778	23.30	(widow)
			32.60	(industrial death benefit)
			38.00	(disablement 100 per cent rate)
War pension (including widows)	370	379	38.00	(disablement)
			30.20	(widow)
Child benefit	13300	2820	4.00	
Family income supplement	80	25	Various	
Sickness and injury benefit and maternity allowance	650	866	18.50	(sickness: single) (wife or other dependants)
Unemployment benefit	540	719	18.50	(single)
			+ 11.45	(wife or other dependants)
Supplementary benefit				
- pensions	1730	745)	29.70	(short-term, husband and wife
- allowances	1240	1464)	37.65	(long-term, husband and wife)

G4 INTERNATIONAL COMPARISON OF PUBLIC EXPENDITURE

Factual

(i) Customary to make comparisons of general government expenditure as a percentage of GDP.

General government expenditure (current disbursements and gross fixed capital formation) as percentage of GDP at market prices

	1977
Japan	28
USA	34
Canada	40½
France	44
UK	44½
Germany	44½
Italy	46
Belgium	46½
Netherlands	56

Source: OECD National Accounts 1960-1977.

(ii) Later information for EEC countries only, suggests that by 1979 UK ratio was 43 per cent; lowest in Europe.

Positive

(i) UK ratio has fallen from peak of 46½ per cent in 1975 while ratios for most other major countries have remained constant or increased slightly.

Defensive

(i) Need to cut public expenditure as a proportion of GDP not determined by international comparisons. Level of public expenditure must be consistent with Government's other policies, eg government's long term objective of reducing burden of taxation.

(ii) International comparisons of the kind given should be treated with caution - differences in classification can distort the ratio.

Contact point: J V Carter 233 7468

G5 ASSET SALES

Objective

Reduce PSBR by asset sales totalling £1 billion in 1979-80 and £½ billion in 1980-81.

Factual

(i) Sales include shares in British Petroleum (£0.3 million), National Enterprise Board and Suez Finance Company; new town and Property Service Agency property, and advance sales of BNOC oil.

(ii) £0.95 billion raised to date, over £1 billion expected in financial year. In some cases proceeds will be counted as revenue offsets to public expenditure.

(iii) Full details of sales in 1979-80 will be in Public Expenditure White Paper. 1980-81 sales still being discussed.

Positive

(i) Government's commitment to reducing size of the public sector being discharged.

Defensive

(i) Government and Bank of England together hold 46 per cent of BP's shares and so have controlling interest.

(ii) Proceeds from all sales reduce PSBR; some sales directly reduce expenditure. Others are revenue offsets to expenditure.

Contact points: N Thornton 233 8051 (Oil, BP BNOC)
H J Bush 233 4076 (Other)

H1 UNION REPRESENTATIONS

General Objectives

TUC Economic Review calls for expansionary Budget to combat recession; move away from dependence on monetary control and free play of market forces.

Specific Representations

(i) Income tax lower rate band to be retained and widened to £1000 and rate reduced to 20 per cent.

(ii) Higher rate thresholds not to be raised

(iii) Progressive system of capital taxation to be retained (including CTT, IIS and DLT)

(iv) Reconsider policy of cutting public spending (not least because it rebounds on private sector activity as well) and in particular provide 3 per cent pa growth in NHS finance and rescind action affecting family budgets eg school meals/transport.

(v) Raise NI pensions by more than increases in earnings or prices; increase child benefit to level of child dependency allowances payable with short term insurance benefits.

(vi) New £1 billion lending facility for industry jointly financed by Government and institutions.

(vii) Additional funds for NEB, and nationalised industry investment; wider guidelines for Scottish and Welsh development agencies.

(viii) Restore spending on special employment measures and Manpower Services Commission to previous planned level and introduce additional 'regional employment expansion payment.'

(ix) Increase overseas aid in 1980.

(x) No target given for PSBR; TUC claims it can be financed at acceptable levels of interest rates if money supply target relaxed.

(xi) Apply selective and temporary import controls to protect British industry.

Contact point: M M Deyes (EB) 233 7426

H2 CBI REPRESENTATIONS

General Objectives

(i) CBI give first priority to reducing inflation; Government's monetary and fiscal policies are endorsed; they need to be complemented by reduction in unit costs through improved productivity and realistic pay settlements.

(ii) Further cuts needed in income tax designed to improve personal incentives and take more people on low incomes out of tax. Capital taxes should be reduced. Small businesses need more help. Measures needed to relieve financial position of companies.

Specific Recommendations

(i) Current money supply limits to be extended to end of financial year 1980-81. (But interest rates should be allowed to fall as soon as possible and efforts should continue meanwhile to ease the financial strain on trade and industry).

(ii) PSBR of £10 billion - on assumptions (iii) and (iv).

(iii) Cuts in public expenditure of £2 billion in 1980-81 - inclusive of reduction in EEC contributions; preferred to fall on current rather than capital spending; no decrease in support for industry.

(iv) Direct tax cuts worth £1½ billion in 1980-81 (£2½ billion full year) involving:

		Cost 1980-81 £m	Cost Full year £m
1.	Real increase in personal allowances	900	1100
2.	Abolition of investment income surcharge; abolition or easing of CTT; indexation or tapering of CGT	200	800-900
3.	Improvements in stock relief	300	300
4.	Reliefs for small companies and "technical" improvements	100	200-300

(v) No change in indirect taxation this year - unless income tax cuts would produce higher PSBR than £10 billion on assumptions (iii) and (iv).

Contact point: Miss M M Deyes (EB) 233 7426

H3 OTHER BUSINESS GROUPS

General Objectives

Continuation of anti-inflation policies, reduced total public expenditure, reduction and simplification of income tax, reform of capital taxation, encouragement of small business.

Specific Recommendations

Key to organisations:

AA Automobile Association; ABCC Association of Independent Businesses; BIM British Institute of Management; EEF Engineering Employers' Federation; GCBS General Council of British Shipping; ID Institute of Directors; JTC Joint Taxation Committee of the Construction Industry; LOA Life Offices Association; LS Law Society; SE Stock Exchange; SMMT Society of Motor Manufacturers and Traders; WSA Wine and Spirit Association; WSOC Wider Share Ownership Council.

(i) Monetary/Fiscal policy

PSBR increase if attributable to tax cuts would be tolerable provided it is funded by long-term debt (ID).

(ii) Public expenditure

Spending on defence and law and order not to be reduced (ID). Ensure consistent investment in roads through a 5-year programme (AA). Previous administration's capital cuts should be restored and capital investment programmes maintained (JTC).

(iii) Income and Corporation Tax

Continue to reduce basic rate (ID, SE, ABCC, BIM). Give first priority to increasing tax thresholds (JTC). Raise higher rate thresholds and widen bands (ID and BIM); top rate should drop to 50 per cent when basic reduced to 25 per cent (ABCC). Restore lost relief for interest on borrowing (ID, ABCC); raise mortgage interest limit (JCT). Abolish investment income surcharge (ID, SE, ABCC, AIB, WSOC). Tackle overlap between tax and social security (AIB, EEF) in such a way as to make effective marginal rate on earnings above 25 per cent a rarity (ABCC). Defer plans to change taxation of 'perks' (ID); assess 'perk' car values realistically (SMMT). Improve provisions for share incentive and option schemes (ID), profit sharing schemes (SE, WSOC). Revise rules affecting the self-employed (AIB). Improve/extend investment allowances for buildings (JTC, ABCC). Reduce Corporation Tax rate to 30 per cent for small companies (JCT), 35 per cent (NCT); reduce ordinary rate and index profit thresholds (NCT); widen band above small company threshold (AIB). Remove National Insurance Surcharge (EEF, NCT).

(iv) Capital taxation

CTT: raise threshold(s) and index (ABCC, SE, GCBS), revise rules (NCT, IDAIB), revalorise (WSOC).

CGT: increase tax-free allowance (SE), index (ABCC, WSOC), taper WSOC, JCT), revise rules (ID, NCT), abolish (AIB, SE).

DLT: restrict application (JCT), abolish (ABCC, ID).

(v) Specific duties

Leave alone (ID), equalise rates for petrol and diesel oil (SMMT), leave alone duties on alcoholic drinks (WSA); no additional burdens on motorists (AA).

Cont.

(vi) Car tax

This year remove from caravans; when possible abolish entirely (SMMT).

(viii) VAT

Leave repayment machinery unaltered and zero-rate house repair and maintenance (Construction Industry), raise registration limit (NCT).

(ix) Stamp duty

Reduce burden on house purchase (JCT, LS), share purchase (SE), pension policies (LOA), stock transfers (WSOC).

Contact point: M M Deyes (EB) 233 7426

H4 OTHER PRESSURE GROUPS

General Line of Recommendations

(i) Poverty pressure groups desire mitigation of 'poverty trap'; child benefit increase urged by many of these and by groups concerned with family welfare (including Conservative Women's Advisory Committee and church organisations). Child Poverty Action Group recommend increase of £1 in CB.

(ii) Charities concerned about effect of shift from direct to indirect tax on their expenditure and of lower tax rates on rebates received on covenanted income, and about impact of capital taxation.

(iii) Feminist groups concerned to see reform of tax system to make it less oriented to male breadwinners.

Contact point: M M Deyes (EB) 233 7426

J1 LONDON BUSINESS SCHOOL

Factual

(i) London Business School (LBS) has called for a "neutral" Budget after adjusting tax system for inflation. LBS also call for monetary target for 1980/81 of around 8 per cent growth in £M3, which they say would require £10 billion PSBR, though PSBR could be higher if recession more severe than LBS forecast.

(ii) LBS have previously called on Government to publish a medium-term financial plan.

(iii) LBS distinguish between "policy-induced" changes in PSBR - these increase money supply - and "autonomous" changes - eg from recession - these hardly affect money supply.

(iv) Main points of LBS' February forecast for 1980 are: GDP fall of 1¾ per cent, consumer price inflation dropping to 16 per cent by fourth quarter, slight fall in real personal disposable incomes, ¾ per cent fall in consumption, 4 per cent fall in investment, balance of payments current account deficit of £1.7 billion, money supply growth of 7.8 per cent, PSBR £10.7 billion in 1980/81 (assuming full indexation of tax allowances).

Positive

(i) LBS medium-term outlook is less gloomy: by 1982, inflation is in single figures, and GDP grows by 2½ per cent.

(ii) Government is committed to firm control of money supply. PSBR for 1980-81 announced in the Budget will be consistent with monetary policy.

Defensive

(i) It should be recalled that likely margins of error in any forecast can be large, eg probably some £2-3 billion for PSBR forecasts, 1½ per cent for GDP, and £2 billion for balance of payments current account.

(ii) Government's aims are long-term and lasting reduction in inflation and improvement of supply side of economy. Government has always stressed that its policies will take time to take effect.

(iii) On PSBR see B1. On monetary policy and control methods see B2, B3.

Contact point: L A Duffy (EB) 233 4524

J2 NATIONAL INSTITUTE FOR ECONOMIC AND SOCIAL RESEARCH

Factual

(i) National Insitute for Economic and Social Research (NIESR) has suggested tax cut in Budget of £2 or 3 billion. Former, they say, would be consistent with £M3 growth of 9 per cent and would allow PSBR to remain constant as proportion of GDP in market prices. Latter would be consistent with £M3 growth in 9-11 per cent range, and "marginal" rise in PSBR as proportion of GDP.

(ii) NIESR call for reform of wage bargaining process. Frequently in past NIESR has called for establishment of a permanent incomes policy with adequate machinery and flexibility to deal with problems of relativities and "special cases".

(iii) Main points of NIESR's latest forecast for 1980 are: GDP fall of ½ per cent, consumer price inflation dropping to 15½ per cent by fourth quarter, 3 per cent rise in both real personal disposable incomes and in consumption, 4 per cent fall in investment, balance of payments current account deficit of £1.8 billion, £M3 growth of 9 per cent, and PSBR of £9 billion in 1980/81. NIESR's outlook for 1981 is brighter: 2 per cent GDP growth, and price inflation down to 13 per cent. NIESR projects relatively buoyant assumption reflecting growth in earnings faster than rise in prices, partly as a result of high exchange rate. But this does not feed through in to the external resource balance.

Positive

(i) Margins of error are large in any forecast (see J1).

Defensive

(i) NIESR have overlooked inflationary impact of fiscal and monetary relaxation.

(ii) Government has called for responsibility in pay bargaining process. Excessive pay settlements in context of firm monetary and fiscal policies will ultimately result in lost jobs, or bankruptcies: money is simply not available to meet such claims. Incomes policies in past have had only short-lived success which has been undone subsequently.

Contact point: L A Duffy (EB) 233 4524

J3 OTHER COMMENTATORS

Factual

(i) Phillips and Drew have predicted that PSBR for 1980/81 is likely to rise to £10½-11 billion on unchanged policies. They advocate a deflationary package to yield about £2 billion in extra (net) revenue and call for reduction in employers' National Insurance Surcharge (NIS) to help company sector. Phillips and Drew specifically expect (a) some £1¾ billion in public expenditure cuts, (b) indexation of income tax allowances and specific duties (c) abolition of reduced income tax band (d) 1 per cent reduction in NIS.

(ii) Wood Mackenzie believe that higher revenues, particularly from North Sea, should hold 1980/81 PSBR to about £9 billion without seriously deflationary Budget.

(iii) CBI forecast is broadly similar to those of other outside forecasters: 2 per cent fall in GDP, price inflation drops to 14½ per cent by fourth quarter, PSBR of £9.8 billion for 1980/81. CBI broadly approves of present Government policies.

(iv) Economist Intelligence Unit (St James's Group) latest forecast is based on assumption of a "U-turn" to fiscal and monetary relaxation, and wage controls. Variant forecast produced by EIU (which uses Treasury model) suggest present government policies would lead to slower growth, and nearly 10 per cent unemployment by 1983. Import controls would improve outlook but lead to higher inflation. "U-turn" yields by 1983: 3 per cent growth in GDP, 8 per cent unemployment, and 7½ per cent inflation.

Defensive

(i) On PSBR see B1. On forecasts see J1. On public expenditure see G1. On NIS see F2. On CBI Budget representations see H2. On incomes policies see J2.

(ii) Import controls provide no long-term answer; they merely allow the build-up of inefficiency behind artificial barriers and fuel inflation.

(iii) Government's aims are long-term and lasting solutions of inflation and of problems on supply side of economy. Government has always stressed that its policies will take time to take effect. (see also J1, J2)

Contact point: L A Duffy (EB) 233 4524

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Prime Minister

The analysis in these papers is clear and penetrating: worth reading, especially the second paper.

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

6th March 1980

Dear Tim,

THE BUDGET AND THE COMPANY SECTOR

Your letter to me of 3 March records the Chancellor's undertaking to provide the Prime Minister with a note prepared by Treasury officials showing the substantial shift of resources currently taking place out of manufacturing and into the oil and personal sectors.

I now attach two notes by Messrs Burns and Middleton, the first of which sets out the overall approach, while the second puts some figures on the extent of the transfer from the manufacturing sector.

I should perhaps add that although there is general agreement in the Treasury with the broad thrust of the Burns/Middleton analysis, the balance of opinion suggests that we should not be facing a crisis on the scale of 1974. This judgement seems to be broadly shared by the Bank of England, and liquidity problems have received little attention in representations from the CBI and indeed from industry generally.

As the outline of the Budget which the Chancellor gave the Prime Minister at the end of last week will have indicated, we are tending to the conclusion that there is little we can do on this occasion actually to help the company sector - all we can try to do is to avoid taking action which would add to the difficulties companies will be facing. Moreover there is relatively little in the fiscal field which will be of particular advantage to the manufacturing sector. The best possibility seems to be a reduction in the national insurance surcharge, but we may well find ourselves in the position that we could only afford this in 1980 if it were balanced by additional

/taxation on the

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SW1.

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taxation on the personal sector - and this in its turn would mean either further increasing the real burden of income tax, or adding to the pressure on the price level and so on the level of wage settlements.

Yours

John

A.J. WIGGINS
Private Secretary

TAX MEASURES TO ASSIST INDUSTRY

Note by Mr Burns and Mr Middleton

1. Mr Middleton's minute of 12 February set out the principles which might guide decisions concerning assistance to industry in the forthcoming Budget. This note considers the amount of assistance which might be justified; it should be read in conjunction with the earlier minute.

The Forecast

2. The Treasury forecast shows the company sector moving into an unprecedented deficit - some £8½ bn in 1980-81. Company liquidity declines sharply, recalling the financial crisis of 1974-75. A higher output would bring down the PSBR but would leave the financial problem facing companies much the same. It would still show a sharp fall in companies' gross and net liquidity. This suggests that companies are likely to find themselves squeezed to an extent which could do excessive damage to their productive capacity. Bank lending would remain high and the upward pressure on short term interest rates could continue, even if the general level of interest rates declines.

3. The difficulty is to arrive at the scale of assistance which might be warranted, consistent with maintaining monetary discipline on the company sector. One approach is to ask to what extent the problems, particularly those in manufacturing industry, result from pressures on costs other than those they have suffered as a result of conceding high pay settlements.

The Oil Price Increase

4. The most obvious of these burdens has been the increase in the world oil price. This has hit companies much harder than was anticipated when the Government set its 7-11% target for monetary growth.

5. An increase in the world oil price is just like a new expenditure tax. The Government eventually collects extra revenue from PRT and from parallel rises in the prices of nationalised energy undertakings. This tax is in principle levied on consumers, but its effective

incidence depends on Government policy and the exchange rate.

6. Since the fourth quarter of 1978 the oil price has increased by $14 a barrel, and the effective exchange rate has risen by 13% with virtually no change in the underlying rate of monetary growth. A very rough estimate of the effect of these two factors is:

a. Consumers lose because oil prices go up - the scale of the oil price increase is about £5 bn. But they are compensated by lower import prices due to the high exchange rate. These roughly offset each other - though on balance consumers are probably a bit worse off.

b. Companies are affected very unevenly:

i. The oil companies gain. They have a permanent benefit of about £1½ bn - the amount they are left with after tax is paid. But because tax is paid late they have a further temporary windfall gain of £3-4 bn.

ii. Non exporting companies also gain - possibly by up to £1 bn - from lower prices of imported capital goods.

iii. The losers are exporting companies who are hit by the high exchange rate. They suffer to the extent of about £5 bn.

c. The Government will benefit eventually by about £3½ bn, but in the next two financial years the revenue is held by the oil companies.

Assistance to Exporters

7. This places the Government in something of a dilemma. The obvious course is to try to extract more revenue sooner from the oil sector to pass to the non-oil sector. But oil tax options seem to have been exhausted for the purposes of this Budget - though may be some further thought should be given to seeing if there are ways of bringing forward the tax due on this windfall gain. It is not in the realm of practical politics to suggest that the PSBR should be increased in order to help manufacturing companies - perhaps financed by debt instruments aimed at the oil companies - until the oil revenues accrue. So if it is desired to relieve some of the burden on exporters, there are only two options:

a. look for revenue elsewhere in the company sector

b. look for revenue from the personal sector

Taxing Non-Exporting Companies

8. There are difficulties in the way of both these options. Some obvious candidates for taxation in these circumstances, such as the banks, who benefit in almost every way from present policies, seem to have been ruled out. And this makes it difficult to contemplate raising large amounts of tax from non-exporting parts of the company sector. Even so, some measures such as VAT blocking, increased VED, the Derv increase - and of course the yield from the PRT increase - could however go someway to financing measures of particular help to exporters.

Taxing Persons

9. The scope for taxing persons without large increases in the RPI - which are undesirable for the reasons set out in paras 11 and 12 of Mr Middleton's minute of 12 February - is also limited. The sort of options available are shown in Mr Unwin's minute of 22 February. Even though persons may have been, on balance, a little worse off as a result of the oil price rise, the personal sector has certainly benefitted from the combination of events and policies pursued over the past year. We therefore consider that there is a case for the personal sector contributing to the provisior of assistance to exporting companies.

The Nature of Assistance

10. The problem which has been identified is one in which exporting companies, and output in general, is suffering from the loss of competitiveness which results substantially from an increase in the world oil price - even though, with North Sea oil, the UK as a whole does not lose real income as a result. Exporting companies, almost by definition, are not the ones who pay substantial amounts oi corporation tax - so they cannot be relieved by that route. One scheme under consideration which would help is the Dips Scheme to defer clawback of stock relief. But this does not get to the heart of the problem. All companies have to pay the National Insurance Surcharge. This tax is an imposition on costs, and furthermore it cannot be rebated on exports. If assistance is to be given - as we believe it should be - the best way might be in a substantial reducti

in the NIS together with the Dips Scheme. A 1% reduction would cost £350 million this year and £750 million in a full year. Complete abolition would cost £1½ bn and £2½ bn respectively.

11. There is a further argument for reducing the NIS. Unemployment will increase quite sharply as companies shake out labour in response to the financial difficulties which we envisage. There is little logic in maintaining a tax on employment in these circumstances. Some reduction would ease the situation considerably.

Timing

12. The timing of NIS reductions is not ideal. It would not begin to help companies till late in the year. So there is some risk that it may simply be used to finance a further round of high pay increases. This is essentially a matter of judgement. All assistance to companies runs the risk that only employees will benefit, but there are also risks in leaving companies to live with the dual burden of high interest rates and a high exchange rate.

13. Help to companies by the NIS route would not relieve the pressure on bank lending which might continue over the next few months. Indeed, it may cause more companies to bridge the gap before assistance arrives by bank borrowing. This seems to us to be a risk which should be accepted. There is nothing which can be done by fiscal means which will have much effect on bank lending in the immediate future. And there is no way in which we can influence the course of internationl interest rates. If bank lending does remain very high and if international interest rates do continue to rise, the upward pressure on short term interest rates will be there for some months irrespective of policy action in the Budget.

Conclusions

14. Companies are notoriously poor at predicting liquidity crises in advance. In 1974, it was not until they had got into the most serious difficulties that they started to complain. Yet it is a fact that both they and the City are a good deal more optimistic about the future than the forecasters. They may take measures - such as lay offs to ensure that the deficit is not as large as the forecast suggests. But on any view, we think that there will be very strong financial pressure on exporters.

15. Exporting companies have received an arbitrary, unexpected,

decline in competitiveness and profitability because of the exchange rate consequences of the rise in world oil prices. In time market process would bring about an adjustment. But this would be a very painful process in the short term, given that they are also adjusting to a tight monetary policy.

16. To ease this adjustment process, we think that there is a good case for relieving the financial pressure by means of a significant reduction in the National Insurance Surcharge. If the revenue cannot be raised from the oil companies, it will have to come from other companies and persons. We do not think in these circumstances that it would be possible or wise to relieve exporting companies to the full extent that they suffer - but the reduction in the NIS which we have proposed will help them over the next two difficult years. After that, as the medium term financial strategy shows, oil revenues begin to build up in the Government's hands, much of which is on present policies destined to go to persons.

TB/PEM
22.2.80

Chancellor

c.c. Chief Secretary
Financial Secretary
Minister of State (C)
Minister of State (L)
Sir Douglas Wass
PCC
Mr Battishill
Mr Unwin
Mr Dixon
Mrs Heaton
Mr Corlett
Mr Mortimer
Mr Seebohm
Mr Cropper
P S Inland Revenue
P S Customs & Excise

TAX MEASURES TO ASSIST INDUSTRY

1. Mr Hall's minute of 11 February to Mr Isaac said that you would like some ideas about measures to assist industry before E Committee. You might therefore find it helpful to have some thoughts on the principles which might guide your decisions in this area.

2. Concern about industry is an aspect of a more general concern about the position of the company sector. This has two aspects:

a. Reaching a judgement about the extent of the financial difficulties which companies face.

b. The attitude which the Government adopts in the light of this

You will wish to consider (a) when you have an assessment taking into account the forthcoming forecasts. But it can safely be assumed that on any forecast, the position of companies will be poor. So we can examine the considerations which are relevant to fiscal policy decisions against this background.

Monetary Targets

3. The Government's economic strategy depends on :

a. Sticking to the monetary targets.

b. Ensuring that targets begin to affect the general level of inflation as soon as possible.

Both these considerations are relevant to the question of whether special help should be given to the company sector by means of fiscal relaxations. If the present target is to be maintained, let alone reduced, in the coming year it seems unlikely that there will be any scope for any overall relief in taxation.

4. The first and most obvious point to make is that concessions in one area cannot be financed by a net addition to the money supply. So there have to be offsetting measures elsewhere. These could either be measures which reduce public expenditure, tax increases in other sectors or higher interest rates generally - or a combination of the two. Unless they are accompanied by offsetting fiscal measures, suggestions for tax relief for companies have to be balanced against their interest rate effects. Interest rate effect are very difficult to gauge precisely. Though these may appear small in relation to individual proposals, the cumulative effect can be much bigger than the sum of particular measures. The already unbalanced relationship between the PSBR and interest rates, given the target, would appear to the market to have been worsened - and the market might take interest rates up in anticipation of a heavy funding programme.

5. In deciding whether it wishes to risk higher interest rates or obtain revenue from elsewhere, the second question set out in para 2 is crucial. A tight monetary policy subjects the private sector as a whole to some degree of liquidity shortage. If the pressure to secure large increases in money incomes is great, monetary policy reacts by reducing activity. This is the ultimate way in which it holds back domestic inflationary forces. Some degree of stringency on companies is an unavoidable part of this strategy. The monetary discipline on companies is the only one available on present policies.

6. But monetary discipline has not prevented companies setting wage claims in a particular year which are vastly in excess of the target rate of growth of the money stock. Over the past year, this is exactly what has happened. Companies have been hit by high interest rates, and by the high exchange rate which accompanie a tight monetary policy; their costs have also suffered as a result of the high pay claims they have conceded. So far, companies have been protected by monetary growth in excess of the target; the squeeze seems now to be intensifying and much of it is still to come.

7. The gains - both nominal and real - go to the personal sector. It benefits from the high exchange rate, is not so affected by high interest rates, and of course people receive the pay. Those who lose their jobs receive indexed social benefits. Real incomes have continued to grow over the last year though output has been flat. It is tempting therefore to say that the correct policy is to tax persons and relieve companies.

8. But things are not quite so simple as this:

a. It is important that companies should continue to feel that monetary policy is a discipline. It would not advance the policy much if they were relieved in such a way as to finance a further round of high pay settlements.

b. On the other hand, it is to no-one's advantage to precipitate a financial crisis in companies of the sort we saw in 1974-75 - ie something of such a magnitude as to do great harm to the productive capacity of the economy.

c. The timing of any relief to companies will be important. It is not easy to get money into the company sector. If monetary growth is brought within the target range, companies may have adjusted their operations to the financial difficulties they face. Fiscal relief arriving late in the ye may simply finance another high pay round without doing much to sustain an adequate productive capacity.

9. This is one of the crucial judgements which will have to be made in the forthcoming Budget. There must be some degree of pressure on the company sector if the monetary transmission mechanism is to work. This is bound to involve risk to the solvency of some employers.

The Scope for Adjustment between Sectors

10. Within a given monetary target, the scope for adjusting the relative burden between sectors is, in any case, not very great:

a. We do not know very much about the implications of putting more weight on the personal sector for wages and prices. A cut in consumer demand could have a direct effect on prices, although there is not much evidence that markets for finished goods respond at all rapidly. Meanwhile wage-earners might respond to a squeeze on their take-home pay, or even on the cost of borrowing, by pressing for higher pay.

b. Profits and cash flow are very sensitive to the general level of activity - whether this is seen in the form of consumer goods for the personal or investment demand by the company sector.

c. The Government's aim to stimulate the supply side of the economy limits the possibilities of using direct taxation to raise revenue from the personal sector.

d. Indirect tax increases which have a large impact on the RPI, could do much greater damage to monetary policy at this conjuncture than almost any other factor.

The RPI

11. This last point requires perhaps a bit of explanation. It follows from the thought in paragraph 5. The extent to which the monetary target has to work through a fall in activity and through financial pressure on companies - depends on the extent to which wage bargainers are influenced by the target.

The more the policy succeeds the more they will be so influenced as financial markets are already influenced. But it is idle to think that people will start taking note of the monetary target to the exclusion of everything else. The most important other influence is probably the perceived rate of price increase. So RPI effects of measures designed to raise additional revenue could be crucial to the policy. The higher the RPI, the higher the nominal level of interest rates and the higher the level of pay settlements. If inflationary expectations are not geared down before the wage negotiations next autumn and winter, the current set of policies could come under such great strain that they would be faced with collapse. There is a limit to the number of short run increases in prices that a given target can stand without the elastic breaking.

12. This does not of course mean that no measures should be taken which have an "impact" effect on the RPI. There are powerful resource allocation arguments for adjusting public sector prices to take account of inflation. And there is also a very strong case for letting energy prices rise an appropriate. But as a general rule in measures designed to raise revenue, where the resource allocation arguments are not strong, the RPI effect must be the dominant consideration.

Conclusion

13. The conclusions of this analysis, so far as general help in the Budget to the company sector is concerned, are therefore:

a. The scope for relieving the company sector is limited by both the need to exert monetary discipline and because of the difficulties of finding alternative ways of raising revenue from the personal sector which do not have an adverse effect on the next round of pay claims, and thus on inflationary expectations and interest rates.

b. The extent to which relief can be given depends on finding sources of revenue from the personal sector which

we do not have a strong impact on the RPI. For example, if the personal allowances were less than fully revalorised and the proposed increase in the Vehicle Excise Duty went ahead, this might be used to help the companies - perhaps by financing a reduction in the national insurance surcharge.

c. Timing is likely to be important. It is undesirable to arrange things so we simply finance another high pay round.

More generally, even if it proves difficult to assist companies the aim must be to avoid any increase in the tax burden on business next year.

Selective Help

14. Whatever the general position, there is a case for considering changes in the taxation of businesses which are designed to redistribute the existing burden, without great cost, in ways which would help certain kinds of activity. It may be that particular sectors should be singled out: manufacturing industry and traded goods sectors are, for example, more heavily affected by the high exchange rate which accompanies a tight monetary policy. Some measures can be particularly helpful - such as the dips scheme to defer clawback of stock relief - which would help to take the pressure off businesses with tight liquidity or who have to draw down stocks for other reasons eg the steel strike. With a broadly revenue neutral package for industry it might make sense to finance a dips scheme by, for example, increasing the PRT rate by 10 percentage points, or by blocking VAT on the business use of petrol.

15. The enterprise package is another example of a series of measures which will be of particular help to small firms without a large revenue cost. The latest state of play on this package is summarised in Annex A.

P.E. MIDDLETON
12 February 1980

ENTERPRISE PACKAGE

A Small Firms Measures

1. Venture capital scheme (income tax relief for individuals' capital losses from investment in unquoted companies).

A FASE proposal. Formerly known as "losses" scheme.

2. Retirement annuity contributions: more generous tax relief for the self-employed.

A FASE proposal. Revenue are suggesting going even further.

3. Stamp duty - relief to assist the marketing of unlisted companies.

A FASE proposal.

4. Apportionment of close company trading income.

A FASE proposal.

5. Interest relief for borrowing for investment in family companies.

A FASE proposal.

6. De-mergers.

Probable announcement of a consultative document.

7. Tax deduction for the cost of raising loan finance.

8. VAT registration and de-registration package.

Raising the registration and de-registration limits, roughly in line with inflation. Approved in principle. New to E Committee.

9. Sub-contractors deduction scheme.

Relaxations likely, in light of consultative document. New to E Committee.

B Profit Sharing

No decisions yet - previous E Committee meeting left it to the Chancellor. Possibilities: (a) improving the 1978 limits; (b) something on share options.

C Capital Taxation Measures

6 MAR 1980

Mr [illegible]

10 DOWNING STREET

1. Mr [illegible] ✓

~~2. Mr [illegible]~~

Andrew Said

thank you and this

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out on Fri. [illegible] me

[illegible] by

[illegible]

events

[illegible]

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Note: Mr Hoskyns
also seen.

AD.

NOTE FOR THE RECORD

cc Sir Robert Armstrong
No copy for Mark Set.

The Chancellor called on the Prime Minister at 0900 hours today.

They first discussed the specific duties package in the Budget. (They had before them the Chancellor's note of last night.) The Chancellor said that he had decided not to proceed with VAT blocking as this would have an undesirable impact on business costs. Of the three packages set out in his minute, he intended to go for the package entitled B(vi). This would raise £250 million more in 1980/81 than package A(iii), and the total RPI effect would be no more than 1.1% - which ought to be manageable.

The Prime Minister said she was concerned about the large increase in the price of petrol which would follow from this package, and she suggested that it would be worth considering doing rather less on petrol and more on beer. She was worried about the effect of the proposed 10p increase on petrol on rural motorists in particular. The Chancellor said that he would certainly look at this, but pointed out that petrol duty was less "RPI heavy" than the duty on beer. A switch on the lines proposed by the Prime Minister would mean a bigger RPI impact in total for the same revenue. The Prime Minister said that the Chancellor had discretion to take a final decision on this without coming back to her.

The Chancellor made the following further points on the Budget:

(i) He intended to raise the higher rate thresholds by a uniform 11 per cent. In this way, the abolition of the lower rate band would be distributionally about neutral. The Prime Minister wondered whether it was necessary to raise the thresholds at the top at all in view of the very large reductions in tax for higher income earners in the last Budget. The Chancellor replied that it would be inconsistent with the Government's strategy to deny this group any relief this year: he thought an 11 per cent up-rating,

/which

which could be presented as considerably less than full indexation, would strike about the right balance. The Prime Minister agreed.

(ii) In reply to a question from the Prime Minister on where he was looking for extra revenue, the Chancellor said that the PRT increase to 70 per cent would yield £330 million and he hoped for more from advancing PRT payments again; he also intended to raise £10 million, albeit a small sum, from increased taxes on casinos. He also was proposing to tighten up tax arrangements on leasing, but this would only yield revenue (about £90 million) in 1981/82.

The Chancellor then raised the question of disposals. This and other matters are recorded separately.

6 March 1980

SECRET

CC EconPol (Disposals) Pt 2
" " (Domestic Monetary) Pt 3
(both copies to item 1 blanked out)

Econ Pol

4

PRIME MINISTER

MEETING WITH THE CHANCELLOR

THURSDAY 6 MARCH 1980

The Chancellor would like to cover the following at the meeting tomorrow:

Flag B

(i) The indirect tax package in the budget. He told you last week that he was planning on raising about £1 billion from indirect taxes (which would put about 1% on the RPI). But he did not have any specific proposals. There will be a note from him on this later tonight. If possible, we want to minimise the RPI impact for any given revenue increase. Unfortunately those duties which push up the RPI least, such as on DERV, fall most heavily on businesses. So it may not be possible to increase the duties differentially. There is of course a good social argument for putting up the duties on the "RPI heavy" items - drink and tobacco.

(ii) The disposals programme in 1980/81. Papers on this are at Flag A. The short point is that the Chancellor is looking for £500 million, and he has identified about £400 million which is fairly firm. The other main possibilities lie with Mr. Howell's responsibilities, but he so far has been unco-operative. The best option here would be for BGC to sell off its interest in the Wytch farm oilfield - this would raise £100 million. BGC will resist because the field has been developed almost entirely through their own efforts, and because it would be hard to get an accurate evaluation - the size of the recently discovered oil reservoir below the existing reservoir has not been determined yet. You will of course want to support the Chancellor in general terms, but I wonder whether it would be right to support him on any particular scheme of disposals in the energy field without hearing Mr. Howell's case.

The Chancellor will also probably bring you up-to-date on where he has got to on the medium-term financial strategy. The paper which you saw last week has been revised to take on board some of the Governor's worries; the Chancellor is awaiting his further comments before putting it back to you.

5 March 1980

SECRET

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CH/EX. REF. NO. B(80) 19
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Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

PRIME MINISTER

DISTRIBUTIONAL EFFECTS OF INCOME TAX PACKAGE

The income tax package I propose increases the main personal allowances by the full "Rooker-Wise" increase of 17½/18 per cent but abolishes the lower rate band. The higher rate threshold and bands and the IIS threshold will be increased by about 11 per cent, which matches the net increase in the married allowance (i.e. after offsetting the effect of abolishing the lower rate band).

2. The only group who will be better off in real terms as a result of this package are those just above the present income tax threshold. Those who will lose most in real terms are at the bottom of the basic rate band (i.e. married men in the range £2,500 to £5,000 and single people with slightly lower incomes) and those in the £12,000 to £40,000 income ranges. The problem of presenting the effects of the package on the lower paid will at least be eased by its comparable effects on incomes above £12,000 (thanks to holding back to 11 per cent the increase in the higher rate threshold and bands); and more positively it can be presented as giving relatively more to skilled workers and junior managers.

3. For the same PSBR saving as my preferred package (£m900 on forecast) it would be possible to retain the lower rate band and increase allowances by something

/under

under 10 per cent. The broad effect of this would be (i) less favourable than my preferred package to married men and more to single people; (ii) less favourable to the aged; and (iii) less favourable to those at the very bottom of the income scale, so that in particular the tax threshold would drop to around the pension level.

4. The abolition of LRB as in my preferred package shifts the balance marginally in favour of the married man, because, while the LRB is worth the same to married and single, the yield from its abolition is used to give a larger allowance increase to the married man. This does something to compensate the family for our inability to index fully child benefit, and I can make a presentational virtue of this. Similarly, there will be advantage in being able to say that the elderly do better, relative to their younger counterparts, than they would have done had the LRB been retained. Perhaps the most potent presentational argument in favour of abolishing the LRB is that it will allow us to keep the tax threshold ahead of pensions. And, of course, it saves staff in the Revenue: the net saving under my package will be 1200, whereas retaining the LRB at the same revenue cost would require 450 additional staff.

(G.H.)
5 March, 1980

- 6 MAR 1980

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CH/EX. REF. NO. B(80) 18
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Treasury Chambers, Parliament Street, SWIP 3AG
01-233 3000

Prime Minister
Of the 3 packages, I would suggest the second. It is better balanced as between beer and spirits/wine/tobacco than the other two; the RPI effect (1.19.) is just about manageable. The petrol increases in all the packages could cause trouble.
T.
5/3

PRIME MINISTER

BUDGET: THE SPECIFIC DUTIES

At our meeting on 29th February I promised you a note on the specific duty options which I am at present considering.

VAT blocking

2. I should first tell you that I have after all decided against proceeding with blocking the deduction of VAT input tax by registered traders on their purchases of road fuel. The scheme is undoubtedly attractive in the sense of securing substantial additional revenue for no impact effect on the RPI and of dealing with the abuse of VAT deduction of petrol which is subsequently handed out as a "perk". However, further analysis has satisfied me that, given the pressures on company liquidity this year, the measure would bear too hardly on sensitive areas of manufacturing and distribution, particularly in the food sector. It would therefore be too high a price to pay in the short term even if the revenue could be used to help the company sector in other ways, e.g. by reducing the national insurance surcharge later in the year . Nevertheless, I think there is a good case in principle for this change and I propose, therefore, to keep this possibility clearly in mind for future Budgets.

The specific duties

3. In deciding the level of the increases I need to make in the specific duties I have been looking for additional revenue of at least £1 billion, and preferably

/somewhat

.....

somewhat more, and have been examining ways of achieving this at an RPI impact cost of about 1 per cent. I have narrowed the options to three packages (as shown in the attached tables) which are designed to produce as much additional revenue as possible for the stated RPI effect without unduly adding to business costs or resulting in serious imbalance within any of the packages. In general, they show relatively large increases, of the order of 20 per cent upwards, on petrol, VED and beer, all of which are buoyant revenue-raisers and relatively efficient in RPI terms. For petrol I have had in mind the case urged on me by David Howell for at least a 10p a gallon increase on energy conservation grounds, and have met this in the 1.1 per cent and 1.3 per cent packages. In the 0.9 per cent package the increase is held to 9p.

4. There are somewhat smaller increases in wines, spirits, tobacco, rebated oil and derv. For wines, spirits and tobacco this reflects the limited potential for raising additional revenue given in particular the high weighting of spirits and tobacco in the RPI. Because the rebated oil duty is borne mainly by industry, I do not think it would be right to increase it by more than the rate of price inflation over the past year. The scale of the duty increase on derv has been determined by the need, on energy conservation grounds, to remove the anomalous 5p a gallon duty differential (5.75p including VAT) in favour of petrol which has existed for the last three years. The case for parity has been strongly urged by Keith Joseph, David Howell and Norman Fowler and I am fully satisfied that it is the right step to take this year. Since, however, it results in a relatively small increase in the taxation of diesel-engined heavy lorries, I also

/propose

propose to accept the argument advanced by Norman Fowler on transport policy grounds for a larger increase in VED in this narrow area. The VED on heavy lorries is therefore increased by 30 per cent in each package, as compared to the 20 per cent increase for cars and vans.

5. I shall need to reach a decision on these options, together with other important facets of my Budget, before the weekend. As you will see the shape of each option is broadly similar. If there are any points you would like to discuss perhaps we could do this tomorrow morning.

Andiggins

(for (G.H.)
R 5 March, 1980
(Approved by the Chancellor & signed in his absence)

A (iii) RPI IMPACT 0·9 % . NO VAT BLOCKING

	Price Increase	Duty Increase %	Revenue 1980-81 £ million	Revenue Full year £ million	Business Costs 1980-81 £ million	RPI Impact %
Petrol	9p/gallon	21·5	405	405	145	0·3
Derv	3·25p/gallon	7·5	45	45	45	nil
VED	£10 (car)	20 (cars), 30 (rest)	240	240	95	0·1
Beer	2p/pint	23	195	215	–	0·2
Wine	6p/bottle	10	25	25	–	negligible
Spirits	36p/bottle	10	30	30	–	0·1
Tobacco	3p/20 king size	9	105	115	–	0·2
Rebated Oil	½p/gallon	17·5	50	50	50	negligible
TOTAL			1095	1125	335	0·9

Petrol						
Derv						
VED						
Beer						
Wine						
Spirits						
Tobacco						
Rebated Oil						
TOTAL						

copy of this page sent to
Sir R. Armstrong

B(vi) RPI IMPACT 1.1%. NO VAT BLOCKING

	Price Increase	Duty Increase	Revenue 1980-81	Revenue Full year	Business Costs 1980-81	RPI Impact
		%	£ million		£ million	%
VAT blocking	—	—	—	—	—	—
Petrol	10p/gallon	24	450	450	160	0.3
Derv	4.25p/gallon	10	55	55	55	nil
VED	£10 (car)	20(cars), 30(rest)	240	240	95	0.1
Beer	2p/pint	23	195	215	–	0.2
Wine	8p/bottle	14	35	35	–	negligible
Spirits	50p/bottle	14	40	40	–	0.1
Tobacco	5p/20 king size	14	175	190	–	0.3
Rebated Oil	½p/gallon	17.5	50	50	50	negligible
TOTAL			1240	1275	360	1.1*

* Sum of unrounded figures

VAT blocking						
Petrol						
Derv						
VED						
Beer						
Wine						
Spirits						
Tobacco						
Rebated Oil						
TOTAL						

D(iv) RPI IMPACT EFFECT 1.3%
NO VAT BLOCKING

	Price Increase	Duty Increase %	Revenue 1980-81 £ million	Revenue Full year £ million	Business Costs 1980-81 £ million	RPI Impact %
VAT blocking	—	—	—	—	—	—
Petrol	10p / gallon	24	450	450	160	0.3
Derv	4.25p / gallon	10	55	55	55	nil
VED	£10 (car)	20 (car), 30 (rest)	240	240	95	0.1
Beer	3p / pint	34	295	320	–	0.4
Wine	10p / bottle	17.5	45	45	–	negligible
Spirits	50p / bottle	14	40	40	–	0.1
Tobacco	5p / 20 king size	14	175	190	–	0.3
Rebated Oil	½p / gallon	17.5	50	50	50	negligible
TOTAL			1350	1390	360	1.3*

* Sum of unrounded figures

VAT blocking						
Petrol						
Derv						
VED						
Beer						
Wine						
Spirits						
Tobacco						
Rebated Oil						
TOTAL						

10 DOWNING STREET

John Hodgson (PM)

To see and

return pls.

R.

4/3

Tim (TK) R.

Returned with Sir Keith's

letter attached. Thank you.

Andrew.

10 DOWNING STREET

Tim

Thank you very much.

MR. WHITMORE

3 iii

For you to see.

TPL

① David

To see

TL 4/3

② C.F.

3 March 1980

BUDGET SECRET

Subject
copied to ~~[illegible]~~ DIDMALA
David Wright (Personal)

File HS/DS
Econ Pol 2.

10 DOWNING STREET

From the Private Secretary

3 March 1980

Dear John,

As you know, the Chancellor called on the Prime Minister on Friday afternoon to outline his approach to the budget. They had before them his minute of 29 February.

The Chancellor said that the Treasury's pre-budget forecast was suggesting a rather larger fall in output in the coming year than most outside forecasters; at the same time, the forecast for the PSBR on the assumption of unchanged tax rates was approximately £8½ billion - which was perhaps rather lower than might have been expected from the output forecast. In the forecast to be published in the FSBR, he intended to show a less depressed output path in line with outside forecasters; but he did not think it would be right to be more optimistic about the PSBR. It would be better to show a PSBR target which could be met rather than be overly optimistic and run the risk of having to introduce supplementary fiscal measures in the autumn. As between the different sectors in the economy, the forecast was showing a substantial shift of resources into the oil sector and into the personal sector, and away from the non-oil corporate sector. This was reflected in a worsening of non-oil corporate liquidity. One of the objectives of the budget must be to reverse this shift.

As far as the monetary stance was concerned, he was proposing to roll forward the target range of 7-11% per annum to April 1981, with June 1979 remaining as the base. Given the likely overshooting of the target range for this financial year, a roll forward on these lines would represent as tight a stance as could be readily contemplated; on the other hand, to go for a more relaxed target would not be credible to the markets. He believed that a PSBR of £8-9 billion would be consistent with the 7-11% roll forward. Thus, in aggregate terms he was proposing a "no change" budget.

The Chancellor went on to explain that to index all the specific income and expenditure tax points and rates would involve a reduction of income tax of some £2 billion and an increase in indirect taxes of some £1 billion. £1 billion from indirect taxes would add about 1% to the RPI. He had yet to decide what combination of specific duty increases to go for; but he did not think it would be right to do more than this in total. Consequently, he was proposing to reduce the cuts in income tax to about £1 billion; and he intended to achieve

/ this

this by abolishing the reduced rate band. In other words, there would be no going back on "Rooker-Wise", but people would enter tax at a 30% rate rather than a 25% rate. Low income earners would suffer proportionately more from this than higher income earners; and therefore to compensate for this, he intended to raise the higher tax thresholds by about 11% rather than by full indexation.

In order to provide some relief to the non-oil sector, he was hoping to raise some £½ billion by increasing PRT to 70% and possibly by advancing the oil companies' payments to some extent. He would use this money to reduce company tax liabilities arising from the recent fall in company stock levels resulting from the steel strike (the DIPS scheme), and also possibly to make some reduction in the national insurance surcharge.

In addition, he hoped to include about £50 million for the so called "enterprise package", perhaps £60 million by way of relief on capital taxes and some relief for voluntary service charities. He was also considering raising the starting point for Stamp Duty from £15,000 to £20,000 (though this would cost perhaps £80 million). To pay for these extra reliefs, he was considering raising additional revenue by disallowing the offset to the VAT liabilities that traders may currently claim as a result of the VAT they bear in their petrol and DERV purchases; and also reducing the relief on life insurance contributions from 17½% to 15%. In addition, he was considering raising taxes on fringe benefits - and in particular on business cars.

The Prime Minister gave her initial reactions to the Chancellor's proposals as follows:

i) She agreed that the monetary target should be rolled forward as proposed, and that the Chancellor should aim for a PSBR target of £8-9 billion. She also agreed that the increase in specific duties should not add more than 1% to the RPI.

ii) While she recognised that substantial savings were needed on the income tax front, she had certain doubts about abolishing the reduced rate band. She wondered whether this would be altogether consistent with the Government's announced aim of reducing the standard rate of tax to 25%; and she was worried about the distributional effects. She hoped the Chancellor would look very carefully at the latter point before reaching a final decision.

iii) As regards the proposal to reduce the national insurance surcharge, she wondered whether the business community might not prefer the alternative of a slightly lower PSBR and therefore lower interest rates.

iv) She was not altogther convinced that it would be right to give still further relief on business stocks, as seemed to be suggested by the DIPS scheme. In her view,

/the

the existing stock relief already gave companies an undesirable incentive to build up their stocks at the end of the tax year; the Chancellor's proposal would surely aggravate this.

v) She was glad to note that the Chancellor was not contemplating capital taxation reliefs on anything like the scale proposed in his minute of 12 December: for in the light of the forecast, there would clearly not be resources available in the coming year for implementing his original plans. On the other hand, she was attracted by the proposal for raising the starting point for Stamp Duty on house purchases.

vi) She was strongly against any increases in taxation of business cars. It seemed that middle managers, who benefited a great deal from the existing arrangements, had done relatively badly over the last year - taking into account the increase in mortgage rates; and to take action now would create considerable political difficulties.

The Chancellor made the following points in reply:

i) The distributional effect of abolishing the reduced rate band, provided it were accompanied by less than full indexation of the higher rate thresholds, would be more or less neutral. He would send the Prime Minister a note explaining this.

ii) He had not reached a final view on the national insurance surcharge, and he would certainly consider the point that a somewhat lower PSBR might be preferred by the business community.

iii) He had already given an indication in his speech to the Engineering Federation that he would be introducing the DIPS scheme. The scheme was intended to deal specifically with the problems caused by the steel strike, and it would operate in such a way as to benefit the manufacturing, and not the trading sector. He would send the Prime Minister a note explaining this.

iv) He hoped the Prime Minister would not completely rule out an increase in tax on fringe benefits. If nothing were done this year, their imputed value for tax purposes would fall further and further behind their real value; and this would mean increased anomalies and inequities. He would send a note setting out his proposals.

He would also send the Prime Minister a note on the specific duty options, and the note which Treasury officials had already prepared

/which

which showed the substantial shift of resources currently taking place out of manufacturing and into the oil and personal sectors.

Yours ever,

Tim Lankester.

John Wiggins, Esq.,
HM Treasury.

PERSONAL Reference

COVERING BUDGET CONFIDENTIAL

Mr Lankester, 10 Downing Street

"READY RECKONER"

We spoke about this in relation to the 2.30 pm meeting between the PM and the Chancellor.

I explained the problem about the switch to an "unchanged taxes" base and now attach the handiest short note we have to hand on the PSBR costs of various options.

M J Folger

CU
H.M. Treasury x 3942
29 February 1980

CODE 18-78

BUDGET OPTIONS 1980-81

The purpose of this note is to indicate for the Chancellor in summary form the main parameters, and related considerations, which will govern his choice of Budget options. It does not make any recommendations. It assumes:-

(i) A PSBR 'target' of at most £9 bn;

(ii) A PSBR forecast of around £8.5 bn on unchanged tax rates and allowances, thus, ceteris paribus, leaving some £0.5 bn available for allocation to companies, persons, and other miscellaneous proposals (capital taxes, heritage etc);

NON NORTH SEA COMPANY SECTOR

2. We assume that the Chancellor's main concern on the company sector will be with non North Sea companies. The main questions here seem to be:-

(i) <u>How much help does the Chancellor wish to give</u>?

On the assumption at (ii) in the first paragraph above £0.5 bn is available if all other changes had no net effect on the PSBR and the Chancellor were ready to give no net relief, even in nominal terms, to the personal sector. Anything on top of that would have to be at the further expense of the personal sector or of the North Sea sector.

(ii) <u>In what form should any help be given</u>?

The main possibilities are:-

	1980-81 £ million	
	PSBR	Revenue cost
DIPS	70-320	70-330
1% reduction in NIS (from September)	270	350
1% reduction in Corporation tax	50	50
1% reduction in small profit rate	10	14

(iii) Is there room for selective help for non North Sea companies financed by imposts on the company sector?

The main possibilities for raising revenue from companies are:-

	1980-81 £ Million	
	PSBR	Revenue Yield
VAT blocking (petrol and derv)	-420	420
or VED increase of 20% on cars and goods vehicles	-170	85*
or 17½% increase in derv	-115	115
[But all three could - not be done]		

Conclusion: If the Chancellor were to decide on any combination of 20% VED increase, VAT blocking and 17½% increase in derv it would be possible to use the revenue to offset their effects on companies by such measures as DIPS or a reduction in NIS. But because of the different timing in the items at (ii) and (iii) the effect on company liquidity would be adverse for most of this calendar year, thus increasing the demand for bank credit. To help in a way that did not adversely affect the financial position of companies would entail either raising more revenue from the North Sea, or preempting the £0.5 bn 'spare' referred to in paragraph 1 above, or hitting the personal sector even harder. There would also be no room for the other miscellaneous proposals.

NORTH SEA SECTOR

3. An increase in PRT to 70% would reduce the PSBR in 1980-81 by £330 million (revenue yield £310 m).

PERSONAL SECTOR

4. The starting point for this note is the present levels of tax rates and allowances ie before any changes are made to reflect the rise in prices since last April.

*elements that falls on companies; total revenue yield is £230 million.

Key considerations are:-

(i) Basic costings:

	1980-81 £ million	
	PSBR	Revenue cost
(a) Income tax:		
Each 1% increase in all allowances and thresholds	115	120
		Revenue yield
(b) Specific duties:		
Each 1% increase in duty on		
alcohol	10	13
tobacco	10	12
petrol and derv and rebated oil	26	29
(c) VED:		
20% increase	170	230

Conclusion: Thus, each 1% increase in the specific duties brings in just under half the cost of each 1% increase in the income tax personal allowances and thresholds. To increase both by (say) 17½% - the 1979 increase in the RPI for Rooker-Wise purposes - would involve a net addition to the PSBR of £1.1 billion.

(ii) Income tax options

In view of the cost it may not be possible, therefore, to increase income tax allowances by the full 17½% (1980-81 PSBR cost £2040 m; revenue cost £2110m) needed to meet Rooker-Wise. By way of illustration, four possible cheaper approaches might be:-

	1980-81 £ million	
	PSBR	Revenue cost
(a) Increase basic allowances and thresholds by 17½% but no increase in IIS or higher rate thresholds	1890	1950
(b) Increase all allowances and thresholds by 11%	1280	1320
(c) Increase all allowances and thresholds by 11% and buy out the lower rate band	1260	1340

	1980-81 £ million	
	PSBR	Revenue cost
(d) Increase all allowances by £125 and abolish lower rate band	about 50	about 70

NB: The approximate 1980-81 revenue cost of each 1% change in the main allowances and thresholds is as follows (the cost to the PSBR will be a little less)

	£ million
Married allowance	55
Single (and additional personal) allowance	40
Age allowances and income limit	10
Higher rate threshold and bands	9
Lower rate band	7

(iii) Indirect tax Options

Increasing the whole range of specific duties by one year's price increase (ie by 17½% throughout) would have an impact effect on the RPI of 1.0%. Together with a 20% increase in VED it would bring in £1185 million extra revenue and increase the RPI by 1.1%. To avoid even this effect on the RPI would require smaller increases in the specific duties. There is also some scope for increasing the duties differentially, though it is important to bear in mind that those duties which put up the RPI least, such as derv, fall most heavily on businesses. As a broad rule of thumb each £100m from the specific duties raises the RPI by about 0.1%. Thus a -

10% increase on drink, tobacco and oils
\+ 20% increase on VED

would raise the RPI at once by 0.7% and yield £780m in 1980-81(£650m off the PSBR).

OTHER MISCELLANEOUS PROPOSALS

4. The above makes no allowance for other proposals which Treasury Ministers have been considering for inclusion in the Budget. The main ones are:-

	1980-81 £ million Revenue cost
Capital Taxes	75 to ~~1970~~ 170
Charities	20
Stamp duty and mortgage interest	100
Enterprise package	60
Lollipops	
Gas banking ?	35

[See separate FP note for details of miscellaneous Budget proposals under current consideration].

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CH/EX. REF. NO. B(80)

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

Prime Minister

PRIME MINISTER

I thought it would be helpful to let you have my preliminary views on the prospects for the Budget before we meet tomorrow.

2. The economic and financial forecast which has been submitted to me presents me with something of a problem which I have not yet fully resolved. It predicts a larger drop in output in 1980 than any other forecasting body is expecting; but it suggests at the same time a smaller PSBR for 1980-81 than might be expected to correspond to the output path. I can see a number of reasons for supposing that output will not be as depressed as the Treasury forecast and the forecast I propose to publish on Budget Day will be more in line with what outsiders are saying. But I think it prudent to publish a PSBR which is not unduly optimistic. The figure we set as our target should be as low as we can get. But it should be regarded as a ceiling. I do not want to have to bring in supplementary fiscal measures this autumn because our estimates of the PSBR have been exceeded.

3. In approaching the Budget generally I have addressed myself to two main considerations. The first is the appropriate monetary stance for the coming year, and the PSBR that would be consistent with it. The second is the appropriate tax disposition within the given PSBR, bearing in mind in particular the need to achieve the right balance between the personal and the company sectors.

4. I shall be discussing the monetary stance further with the Governor but I think it unlikely that we shall be able to reduce the target range for £M3 over the chosen period below 7-11 per cent. I know that this will be a disappointment to you and I should explain why I do not think we should aim for a lower bracket. There is a risk that we will have significantly over-shot the range this financial year and we could not, without damage to our credibility, simply sweep this aside. I propose to affirm a commitment to bring the money supply growth back within the range by setting as the base the level of £M3 in June 1979 - as I did both at the time of the Budget last year and in the autumn when I rolled the target range forward. If I now roll forward the target range of 7-11 per cent p.a. to April 1981 with June 1979 as the base this is likely to imply a growth in the course of 1980-81 of only about 7 per cent or possibly even less. If we were to remove the corset and take into account the re-intermediation which would then occur, the permitted underlying growth would be even lower. Rates of monetary growth of these magnitudes could only be achieved, given the sort of PSBR which is feasible, at the risk of interest rates which are in my view out of the question.

5. Everything therefore argues for our going for the lowest PSBR we can reasonably secure. After the expenditure cuts we have obtained for 1980-81, unchanged tax rates would suggest a target PSBR of around £8½ billion - i.e. about the same figure as last year, but in real terms over £1 billion less. On any reasonable test a PSBR of £8-9 billion would represent a tight fiscal stance, given the downturn the economy will be experiencing, and I think that the market would so judge it. I should instinctively have liked to go for a lower figure, but I do not think I would be justified in increasing the burden of

i.e. before any revalorisation

taxation. We must bear in mind that even a Budget which keeps the burden of taxation where it now is would, given inflation, represent a net increase in the burden of tax compared with that which followed my 1979 Budget. No-one in the Treasury has been arguing for a PSBR less than £8 billion or more than £9 billion. I hope that you will agree that a figure in this range is about right.

6. My preliminary thinking as to how we should reshape the incidence of tax, within a broadly 'no change' Budget, runs on the following lines. To index all the specific income and expenditure tax points and rates would involve a reduction of income tax of some £2 billion and an increase in indirect taxes of some £1 billion - i.e. a net reduction of around £1 billion. We cannot afford this. So I propose to reduce the income tax cuts to about £1 billion and I shall achieve this mainly by abolishing the reduced rate band. (I shall in consequence have in equity to adjust the valorisation of the higher rate bands; I will explain this in detail later.) I have not yet decided how to distribute the £1 billion increase in indirect taxes, but in any case the RPI increase would be kept to about 1 per cent.

7. Within the business sector I can see a strong case for taking more off the North Sea oil companies and redistributing it to the non-oil sector. I hope to be able to do this by an increase in PRT to 70 per cent and other possibilities I am examining - which should yield some £½ billion in 1980-81 - and by using the proceeds to mitigate the effect which a fall in company stock levels would have on company tax liability next year (the so-called DIPS scheme) and possibly also to make some reduction in the national insurance surcharge. I shall also want to do something in the field of capital taxation on the lines of my minute to you of 12th December; and also to implement an enterprise package including the measures to help

small firms and to encourage wider share ownership that we have discussed in E Committee. The precise arithmetic of all these elements has still to be worked out, but I have it in mind to seek extra revenue by disallowing the offset to the VAT liabilities that traders may currently claim as a result of the VAT they bear in their petrol and derv purchases. As you know we disallow the VAT on business cars and it seems logical to do the same for motor fuel.

8. A Budget on the above lines would essentially be a consolidating Budget, with limited impact effect on the RPI. It would serve as a clear confirmation of our basic strategy - attacking inflation through tight monetary control - and would, I think, be well received by the markets.

9. As you know, however, I think the presentation will be greatly enhanced if it can be set in the context of the medium-term financial strategy we have discussed. This will offer the prospect of more substantial tax reductions when we have surmounted the next two very tight years. I understand that arrangements are being made to discuss this at Cabinet on 13th March and I shall be preparing a short paper for that purpose following further discussion with the Governor early next week.

The Chancellor is discussing this with the Governor on Monday. TL 29/2

GH.

(G.H.)

29 February 1980

29 FEB 1960

PART 2 ends:-

TL to PM 28.2.80

PART 3 begins:-

Chan. Ex. to PM 29.2.80