PREM 19/996

MT

PART 9.

SECRET

Confidential filing.

The 1983 Budget.

ECONOMIC POLICY.

Part 1: May 1979

Part 9: October 1982.

Referred to	Date	Referred to	Date	Referred to	Date	Referred to	Date
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PREM 19/996

PART 9 ends:-

Sparrow to PM (QA 06238) 31/1

PART 10 begins:-

~~MCS to~~ HMT nte 3/2

Ecm Pol

cf AW

Prime Minister (1)

You asked John Sparrow to have a look at this (for discussion at your meeting tomorrow ?).

CONFIDENTIAL

Qa 06238

To: PRIME MINISTER

From: JOHN SPARROW

31 January 1983

para 8

If you agree with X I must tell the Chancellor and John Wakeham.

Yes please

MCS 31/1

Taxation of International Business

1. We have examined the Inland Revenue's latest consultative memorandum on this subject, together with the proposals put forward at the end of 1981 about which you expressed concern.

2. The present proposals are significantly less drastic than their predecessors and would lead to action in this year's Finance Bill on tax havens only. Further work is proposed on company residence (the importation of profits and losses) and on upstream loans, with a view to legislation at a later date. Despite the concessions that have been made, problems remain.

Company residence

3. The Chancellor has now recommended against a major redefinition of company residence, but instead intends to introduce (at a later date) specific measures to prevent the importation of losses and profits. I agree that there is no need to amend the present definition of company residence - the law is clear and any change would involve upheaval and uncertainty. The problem lies in inconsistent application of existing case law by the Inland Revenue and this should be alleviated by the proposal that the Revenue should issue a Statement of Practice. However, any legislation to prevent importation of overseas profits/losses should only be drafted after careful consideration of the likely economic and commercial effects, against your own broader objectives. When losses are incurred, some measure of relief from UK tax may be crucial if the financial viability of a UK based group is not to be prejudiced. As for the importation of profits without a liability to UK tax, to prevent this would of course deplete corporate funds. And some tax would become payable if and when those profits are subsequently distributed to UK shareholders.

Upstream loans

4. Here again, the Chancellor intends to think further, bearing in mind the need to protect loans from overseas companies made to UK parent companies in the ordinary course of business. This is clearly necessary. The proportion of assets held overseas by UK based multinationals has increased, and can be expected to continue to increase. There are risks that misplaced enthusiasm might have adverse financial consequences for the companies concerned, and might even lead some of them to consider moving their head offices away from the UK. These matters also require careful study before legislation is drafted.

Tax havens

5. The Chancellor is proposing new legislation on tax havens. Although the previous proposals have again been watered down, legislation will inevitably be complex if abuses are to be dealt with effectively. It is suggested that the annual tax saving will be £100 million; this may well be overstated, but even if it is not, one has to ask if the game is worth the candle. Some of the abuses are capable of being dealt with under existing legislation. One of the problems which has been identified ('dividend trap' companies) is caused primarily by an anomaly in existing double tax relief arrangements. Another identified abuse (managed 'money box' companies) will not in fact be remedied by what is proposed.

6. The business community will not welcome these proposals. Despite the comprehensive exceptions, legislation will affect many international companies based in the UK. Apart from the additional administrative effort and cost involved, there will be genuine worries since -

(a) tax haven legislation is only part of the Revenue's plans for taxing international profits; the other proposals on upstream loans and importation of profits and losses and the Statement of Practice on company residence will not be produced until later; and

(b) no list of specified tax havens has yet been published.

7. Despite these objections, the present proposals probably provide adequate protection for genuine business transactions, and UK business should not be damaged unduly, despite the administrative inconvenience and additional cost. However, if legislation now is judged necessary, then it should only be introduced on the basis that the present deficiencies in double tax relief arrangements are dealt with at the same time. In particular 'averaging' or 'pooling' of dividends from overseas should be permitted so that there is some relief for overseas tax on dividends where one of the overseas rates exceeds the UK rate of tax.

8. That said, there seems to me to be a case for legislation to be deferred until comprehensive proposals can be brought forward to deal with all of the problems in the light of wider Government policies for the health of industry as a whole and for stimulating (or preventing) investment overseas; and after reconsideration of two fundamental questions -

(a) should the overseas earnings of UK based companies be subject to UK tax, regardless of whether they are remitted to the UK? (Germany has tax haven legislation but does not tax overseas income where a double tax treaty is in force.)

(b) should companies be subject to the same fiscal regimes as individuals, bearing in mind the fact that distributions of income by companies to individuals and capital gains made by individuals on corporate investments are already subject to personal taxation?

9. I attach a copy of a background note prepared here, which you might find helpful in considering the Inland Revenue proposals.

JB.

ECON POL : Budget '83 Pt 9

31 JAN 1983

CONFIDENTIAL

26 January 1983

Taxation of International Business

Background Note

Inland Revenue Objectives

1. In November 1981, the Inland Revenue published a consultative memorandum, referred to as the yellow paper, setting out proposals for limiting opportunities for tax avoidance by UK controlled international companies.

2. The Revenue was concerned about the increasing use of loopholes in existing legislation to minimise the incidence of UK tax. In particular companies had, in the Revenue's view, been artificially transferring the tax residence of their subsidiaries to and from the UK, to obtain relief for overseas losses and to avoid UK tax on overseas profits remitted to the UK. Loans were being made instead of dividends from overseas subsidiaries to the UK, in order to avoid tax. Tax havens were being used to shelter income from UK tax.

3. Other countries have in recent years introduced fiscal legislation to stem losses to their Exchequers. The Inland Revenue saw the proposals as catching up the others, reducing avoidance, and also preventing abuses from growing.

Consultation with industry and commerce

4. Prior to publication of the yellow paper, the Inland Revenue did not discuss the proposals with industry, commerce or their professional advisers. The draft clauses were so wide-ranging that they caused great anxiety on the part of the business community. There is little doubt that UK industry would have suffered commercially as a result of these proposals.

5. The Treasury claim to have learnt two lessons from this affair: first, it is advisable to be clearer within Whitehall as to the objectives and effects of any proposals, so that they can be considered alongside other policies for industry and commerce; second, there is a need to consult the representatives of commercial organisations informally before a consultative document is published to test likely reaction and to be clearer about likely effects.

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The present proposals

6. The present proposals were published in December 1982 under the title "Taxation of International Business". These are considered briefly below.

7. Despite reaction to the previous yellow paper, the preparatory work to the present document may be criticised in two respects:-

(a) The effects of the draft tax haven clauses on Exchequer revenues and on international companies are largely unknown. The economic considerations have not been weighed against the revenue benefits. The Institute for Fiscal Studies criticised the earlier yellow paper for not examining the impact of proposed legislation on organisations and on taxable capacity, and for relying on anecdotal evidence. Similar criticisms can be levelled against the present proposals. In addition the draft clauses have not been considered in the light of more general Government policy for the industrial and commercial sectors as a whole;

(b) prior consultation with business representatives has been of a cursory nature and limited to very general principles.

8. Although comments on the yellow paper have been taken into account in the new proposals, they will not be welcomed by business, who will see them as a further burden on international companies. If legislation is introduced, a major difficulty created by deficiencies in the present legislative arrangements for double tax relief should also be removed.

Company residence

9. The yellow paper proposed a redefinition of company residence for tax purposes on the grounds that the present situation was unclear and there was a need to determine residence by reference to the place where effective management took place.

10. The business community argued that the legal position was clear but the Inland Revenue had created uncertainty by not applying the rules in a consistent manner. They further agreed that a change at this stage would result in great upheaval, particularly to businesses who had structured their organisations based on existing legislation, and the new rules would not necessarily result in greater clarity.

11. The present consultative document states that a new definition will not be proceeded with at this stage but that the Inland Revenue will issue a Statement of Practice which will clarify the application of the present test of company residence. This should help, if only to clarify the Inland Revenue's approach to present law.

12. The document also states that the Government intends to bring forward specific measures to deal with the loss of tax, estimated at around £50 million a year, created by "importing" profits and losses.

13. The Revenue does not like the practice of "importing" losses, whereby an overseas subsidiary company which is making losses may be treated as UK resident (although its business activities are elsewhere), so that these losses can be relieved against the taxable profits of the UK group. In order to be treated as UK resident, the overseas company must be seen to have transferred its management and control to the UK. While recognising the immediate loss to the Exchequer arising out of this practice, it is nonetheless a reasonable activity to permit since:-

(a) it is typically in start-up situations where losses are incurred. In these situations the UK parent company will wish, in most instances, to control the overseas business from the UK;

(b) where overseas losses arise, UK management will typically wish to control the overseas business themselves until it is restore to health;

(c) a group is most vulnerable financially when one part is making losses. If losses incurred overseas cannot be offset for tax purposes against profits arising elsewhere, then the group's future may be prejudiced. To deny the possibility of relieving overseas losses in the UK may not enhance the commercial viability of UK based international companies;

(d) once an overseas company becomes profitable again its profits will be taxed in the UK or overseas, depending upon where it is then resident.

As a result the across-the-board banning of importation of losses will adversely affect the commercial prospects of UK companies. It should also be pointed out that the importation of losses is restricted to those arising after the company becomes tax resident in the UK. The potentiality for relief, and also for abuse, is therefore already restricted.

14. The Revenue also dislikes the practice of "importing" profits, whereby profits accumulated abroad by an overseas subsidiary can become available to a UK parent company, without payment of tax, if the overseas company becomes resident for tax purposes in the UK. This is undoubtedly a method of escaping UK tax on profits transferred to the UK; however such profits cannot be distributed to shareholders without tax becoming payable; also to tax these accumulated funds will weaken the financial position of the group and leave it with less funds in the UK for future investment.

Upstream Loans

15. In recent years UK based international companies have invested more overseas and the proportion of assets held overseas has increased. This trend has increased following the suspension of Exchange Control regulations and is understandable in view of the higher rates of return that may be earned overseas. As a result, profits have been accumulating overseas, which because of lower rates of return in the UK have been required to fund working capital and investment programmes in UK companies in the same group.

16. Despite the need for these funds, UK companies have refrained from obtaining dividends from overseas subsidiary companies, either

(a) because UK tax has become payable where overseas taxes (including withholding tax) have been less than 52%; or

(b) because of an anomaly in UK double tax relief arrangements, whereby overseas taxes (including withholding tax) in excess of 52% cannot be relieved in any way.

Thus loans have been made by overseas companies to the UK parent.

17. The Inland Revenue has identified £400 million worth of such loans, mostly in the years since 1979. Proposals have been put forward in the yellow paper to seek to tax these. However the reaction from the business community was such that the Inland Revenue has now agreed to consider the whole issue further, bearing in mind the need to distinguish clearly between loans made in the ordinary course of business and loans which are effectively disguised dividends.

18. It is likely that because of higher rates of return overseas, multinational companies will invest more overseas, and have available funds in overseas companies for investment in the group as a whole (including the UK). To seek to tax funds lent to UK companies for bona fide purposes would not assist the financial viability of UK multinationals or encourage reinvestment in the UK. Indeed to do so may encourage multinationals to move their head offices from the UK. It is probable that the loans made as disguised dividends represent a very small part of the £400 million figure. To this extent, use of this figure in the context of the Inland Revenue's current proposals is misleading.

Tax Havens

19. The use of tax havens has increased in recent years. A number of other countries, notably the US, Germany and Canada, have introduced legislation to attempt to reverse this trend. In all cases, tax haven legislation has tended to be complex in order to be effective. It has resulted in significant additional administrative effort and cost on the part of companies, including those engaged in bona fide activities; it tends to be over-general and therefore affects all.

20. It should be noted also that in countries such as the USA and Germany which have tax haven legislation the regimes are much less severe than those now proposed by the Inland Revenue. In the US "pooling" of overseas dividends is permitted (see 22(b) below). In Germany overseas earnings are not taxed even when remitted, providing there is a double taxation treaty with the overseas country.

21. In its present consultative document, the Inland Revenue has put forward proposals which represent a watering down, following representations made, of those included in the yellow paper. As a result, the figure of £100 million referred to as the annual loss of tax to the Exchequer may be a misleading figure in terms of what might be saved in the future. It is questionable whether the benefit will be greater than the costs which will be incurred by British industry, even if all the alleged benefits materialise.

22. The Inland Revenue has identified five main abuses which it is intended should be removed by tax haven legislation. These are commented upon briefly below:-

(a) "Money box" companies. These are used by UK companies to invest surplus funds overseas tax free or at low rates of tax. The Inland Revenue proposals will prevent companies from using their own money box companies to reduce tax. However they will still be able to benefit from investments in money box companies managed by some of the City institutions;

(b) "Dividend trap" companies. These are intermediate holding companies established overseas by UK holding companies to trap dividends from overseas subsidiaries so that only income distributed to the UK is taxed and the tax borne in different companies is averaged for UK DTR purposes. In practice, most dividend trap companies are established for commercial reasons to deal with the anomaly in the UK DTR arrangements referred to in paragraph 16 above. A preferred method of dealing with this problem might be to amend DTR legislation to introduce "averaging" or "pooling"; this would cure the disease rather than remove one of the present remedies;

(c) Offshore captive insurance companies. UK companies establish their own offshore captive insurance companies for two main reasons:

(i) to reduce the cost of insurance by administering the companies themselves and because investment income may bear a lower tax charge;

(ii) to circumvent UK insurance regulations which are designed to protect consumers generally.

The Inland Revenue is seeking to tax the offshore income of these captives. This would result in increased insurance costs to UK companies;

(d) Sales, distribution or service companies. The Inland Revenue would like to tax profits which are artificially transferred from UK companies to sales, distribution or service companies in tax havens. However the Revenue has such powers already under section 485 of the Taxes Act 1970;

(e) Patent holding companies. The Inland Revenue would like to tax royalty income earned by patent companies established in low tax countries where such income is derived from the UK. However in practice, it would not be possible to transfer patent rights to low tax areas other than at fair value and the Revenue has powers under the 1970 Act to deal with abuses.

23. It will be apparent from the above that either the draft clauses will not remedy the problems which have been identified, or alternatively that the problems should be dealt with (or capable of being dealt with) in some other way.

24. To introduce such proposals would have an adverse effect on the financial position of some UK companies. Unless the DTR anomaly is removed, the draft clauses would adversely affect the competitiveness of UK multinationals.

25. Instead of introducing tax haven legislation in the form suggested, consideration might be given instead to exempting overseas income from tax altogether (as in Germany), providing such income has been taxed overseas and there is a double taxation treaty in being. This will require a study of the effects of tax on international companies' investment patterns and should be considered in the light of wider Government objectives for investment overseas by UK businesses.

Licenced depositories - rents and dividends from overseas

26. There is no mention in the consultative document of licenced depositories, which are no longer required following the suspension of Exchange Control regulations. The Inland Revenue has stated that the increasing tax evasion (where income from overseas is not declared) will only be prevented by the re-introduction of licenced depositories. However no proposals have been put forward. We support this since it is Government policy that licenced depositories should not be re-introduced. We are also dubious about the extent to which licenced depositories would contribute to a reduction in tax evasion.

10 DOWNING STREET

Prime Minister

Chancellor meeting 0945

(1) Handling of Cabinet discussion on economy

(2) Married man's allowance
– Family Policy Group

? (3) Taxation of international business (note attached)

FLAG A

? (4) Nurses Review body (minute attached)

FLAG B

MCS 2/2

I think this must be the TUC Budget representations to Chancellor

Contents

Include summary items
on final page.

Figure 1.4 Getting it wrong: the Government's forecasting record

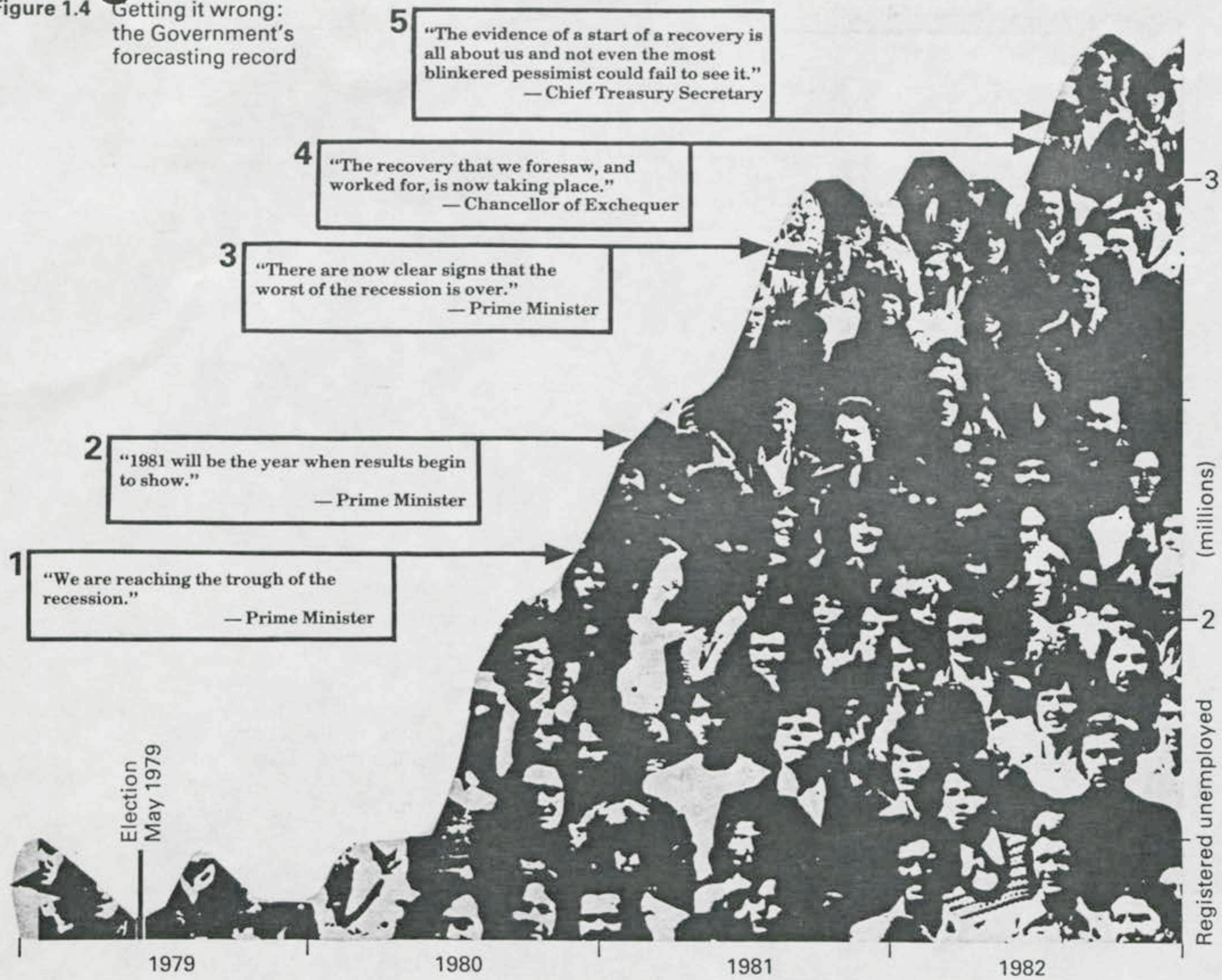


Figure 1.5 Promises come unstuck

The Government promised	The TUC predicted	What happened
To create 'more, more secure and better paid' jobs.	Government policies would lead to mass unemployment.	Unemployment rose to all-time high.
Tax cuts would provide incentives and therefore economic growth.	Tax cuts would only benefit well off; the demand for products is a more important incentive.	Increased tax burden for all but the wealthy. Record drop in output.
Cuts in public spending would benefit private industry.	Spending cuts would destroy jobs and output throughout the economy.	Jobs lost and output down in all sectors.
Modernisation of industry.	'Hands off' approach to industry would leave it falling still further behind.	Investment down by 33 per cent in manufacturing.
Growth would resume once inflation reduced.	No growth possible under present policies	Ministers announced recovery postponed — again.

with the realities of the sort of society and economy we live in.

The real costs

1.12 The results, or costs, of this philosophy have been summarised in Figures 1.1 and 1.2. But the damage is even more extensive.

- Through record plant closures and bankruptcy there has been a huge loss of capital.
- Public spending cuts have left a legacy of neglect and deterioration throughout the public services.
- Soaring youth unemployment has meant that young people have not been provided with either the skills or the experience of genuine employment which they need.
- Through long periods of unemployment, workers of all ages have been robbed of the opportunity to adapt and improve their skills and so strengthen both the performance of the economy and their own job satisfaction.
- Since the abolition of exchange controls there has been a flood of investment overseas, much of it building up industries which compete with our own.
- The rise in import penetration and destruction of industrial capacity has weakened the economy's trading prospects and international competitiveness.

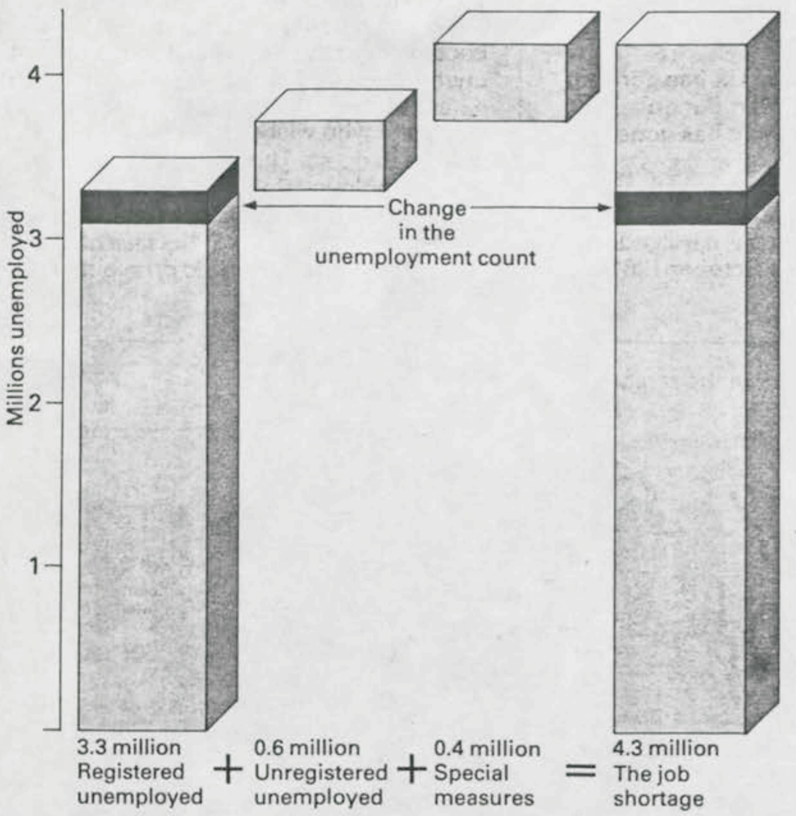
1.13 The social costs of unemployment do not always show up in official statistics, but they are none the less real for that. Unemployment, particularly when it is prolonged, reduces social contact and produces a loss of self-esteem. In place of a sense of collective purpose, it substitutes a pervasive feeling of meaninglessness. Increased unemployment is clearly linked to increasing health problems, stress, anxiety and alcoholism. Many unemployed suffer these consequences directly. Society as a whole carries the cost. The social tensions that arise from the divisive impact of unemployment can easily come to the surface, as events in 1981 demonstrated. Unemployment creates physical as well as social damage on a scale that no civilised society should tolerate.

1.14 It is not too late to repair the damage described in this chapter. But on present policies there will be no recovery. Even Government Ministers have stopped making the sort of optimistic predictions set out in Figure 1.4. This *Economic Review* shows a real alternative to their official hopelessnes. It shows how a radical and far-reaching programme can turn the economy around and attack the twin targets of mass unemployment and social inequality.

Key points

- Under this Government there has been an unprecedented economic collapse, and social inequalities have widened.
- This is quite contrary to what was promised. As unemployment has grown, recovery – according to Ministers – has always been imminent, but never quite arrives.
- The Government justifies its performance by saying that present hardship is the necessary price to pay for previous mistakes. But 1979 was the year in which decades of poor relative performance were turned into absolute decline.
- The Government's policies have been presented in a number of different guises. But the underlying philosophy has been consistent: hostility to trade unionism and to social provision, and a willingness to exploit divisions throughout society.
- Even the Government now admits that its policies are not going to produce a recovery. But the longer these are continued the more long-term damage will be done, so making the task of recovery more difficult.
- It is not too late to repair the damage, but only a radical and far-reaching programme will do the job.

Figure 2.6 The job shortage



Notes. Total for special measures includes effect of short-term working; total excludes discouraged workers.
Source: Department of Employment, 1981 General Household Survey and MSC.

2.26 The TUC estimates that the number of unregistered unemployed – not counting workers who have dropped out of the workforce – is about 625,000, while special employment measures etc keep about 450,000 out of the unemployment figures. In total, therefore, the real job shortage is over 4 million as shown in Figure 2.6.

The economic millstone

2.27 Unemployment is an economic millstone dragging down the whole economy. The Government has had to pay out over £5 billion in 1982-83 in benefits to the unemployed, but in addition it also loses the taxes the unemployed would have paid had they been in work. The House of Lords Select Committee on Unemployment, reporting in May 1982, estimated that on this basis, each unemployed person costs £5,000. This means that a registered unemployment total of 3 million costs the Government £15 billion.

Key points

- The Government's new financial strategy has meant that output has stagnated, investment fallen, and bankruptcies increased.
- Manufacturing trade is in deficit for the first time for a century.
- The manufacturing and construction industries have been the worst hit.
- Unemployment is expected to go on rising, to 3.5 million (old count basis) this year.
- Long-term unemployment is a major feature of the unemployment crisis; over 1 million workers have been out of work for more than a year.
- Unemployment has hit hardest at older workers, young people, women and ethnic minorities.
- In the worst hit regions, there are over 40 workers for every vacancy.
- The real job shortage is over 4 million.
- A registered unemployment total of 3 million costs the Government £15 billion a year.

Chapter 3
THE TRUTH ABOUT UNEMPLOYMENT

This chapter looks at some of the myths surrounding the increase in unemployment since 1979. Some of these myths have been created by the Government, others have achieved a degree of popular acceptance. The purpose of this chapter is to show that they have no basis in fact, and instead to set out the truth about unemployment. Other myths, about the world recession and the size of the public sector, are dealt with in Chapters 6 and 8.

This chapter will set out the truth about the myths that:

- lower wages mean more jobs.
- unemployment is the price of change.
- new technology has caused unemployment to go up.
- immigration is to blame.
- women going out to work keeps unemployment high.
- the unemployed are better off than those in work.

Myth 1: lower wages mean more jobs

3.1 The Government has repeatedly said that unemployment will not come down unless workers accept lower wage increases, or even have their wages cut. It is said that this would make labour cheaper, and so give firms the incentive to take on more workers. But a wage cut would also reduce the ability of workers to buy goods and services. This means that firms would have no incentive to employ more people to produce more goods which will end up stored, unsold, in warehouses.

3.2 It is also sometimes argued, however, that if workers accept wage cuts then the goods and services they produce will be cheaper. This will mean that customers will buy more, and the extra demand created will mean that firms can employ more people. But this argument also falls down on the fact that the wage cut will also cut purchasing power. So although goods and services might be cheaper, consumers will have less money in their pockets to buy them. No extra demand will have been created, so firms will have no incentive to produce more by taking on extra workers.

3.3 It is also said that if workers took lower wages, this would mean cheaper exports, and consequently jobs would be created through an increase in overseas sales. This has been a favourite theme of most CBI and Government policy statements in recent months – that excessive wage rises have been the major cause of the lack of competitiveness and unemployment. This is an odd argument to come from a Government which has pursued a high exchange rate policy, as Chapter 2 demonstrated. In terms of the long-run problems of poor competitiveness, Figure 3.1 reveals that these cannot be explained by the level of UK total labour costs. This shows that for 1981, out of the largest industrial producers in the western world, the UK ranks amongst the lowest in terms of labour costs. Only Spain, Ireland and Greece have lower labour costs.

3.4 Whilst Britain remains a low wage country, it also has a poor productivity record. Measured by the amount produced by each worker, Britain compares unfavourably with most of its major competitors. This is partly because of the depressed state of the economy, but also longer-term factors which affect productivity such as investment, training and research and development. Changes in productivity over the last few years are looked at in more detail below. But in looking at productivity it is important to remember that the demand for British goods abroad does not depend exclusively on price, but also design, quality, reliability and technical performance. This means that even if British goods were cheaper, it does not necessarily mean that many more would be bought.

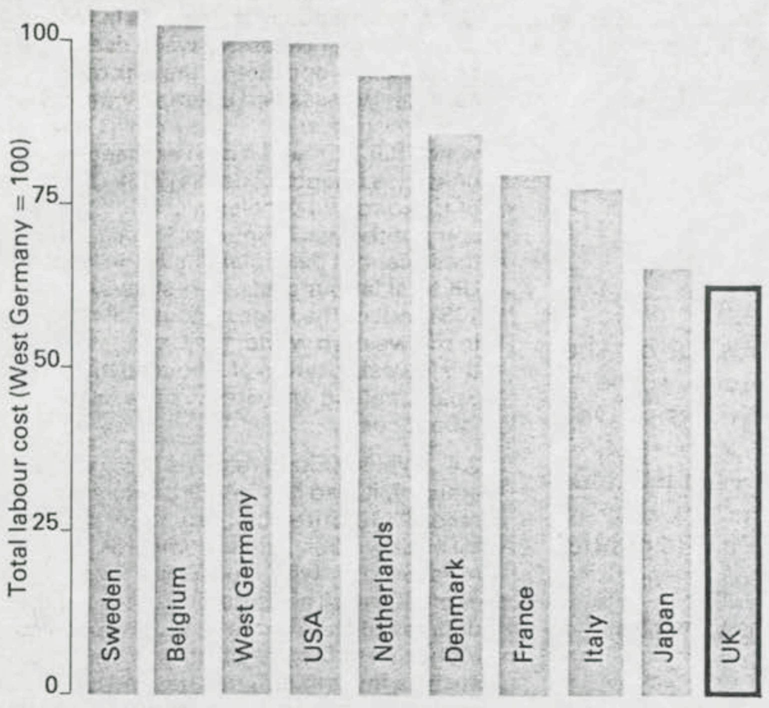
3.5 If it were true that, as the Government claims, we were 'paying ourselves too much', then the share of the national income taken by wages and salaries should have been growing. Figure 3.2 shows income from employment – wages, salaries, employers national insurance contributions etc – as a share of total domestic income – which includes pre-tax profits and income from rent and from self-employment. The share 'we pay ourselves' has not changed significantly over the past 15 years. In fact this share has barely changed since 1955, and has actually fallen slightly since the 1960s – from 68 per cent between 1962 and 1971 to 66 per cent between 1972 to 1981.

3.6 Finally, many workers who have accepted wage cuts have in the long run lost their jobs anyway. Moreover, as the 1982 *Economic Review* reported, research by the Department of Employment reveals that there is no relationship between the level of youth wages and unemployment amongst young people.

Myth 2: unemployment is the price of change

3.7 The Government and others have seen unemployment as a necessary price to pay for transforming the British economy, and laying the foundations for future growth. Chapters 1 and 2 have shown the true nature of the 'transformation', which after five years has destroyed a considerable portion of

Figure 3.1 Labour costs in other countries



Source: West German Employers' Institute (WI).

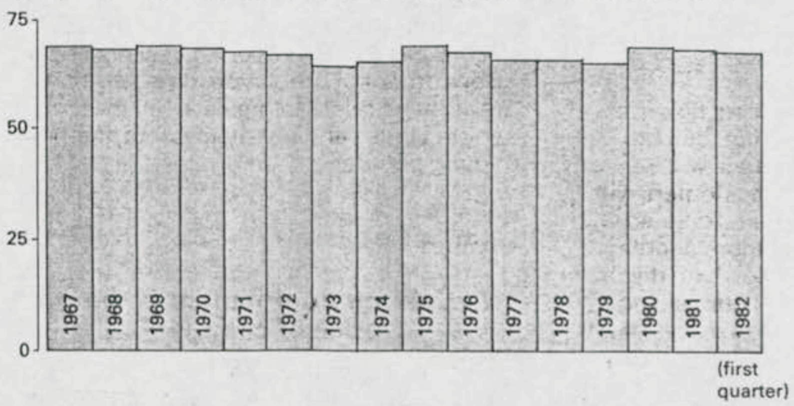
manufacturing industry. Above all, however, the Government has pointed to the so-called 'productivity miracle'. This was the increase in the amount produced by each worker during 1980 and 1981, particularly in the manufacturing sector.

3.8 The Government has claimed that firms have become more productive as a result of demanning and changes in working practice. The claim, however, represents a fundamental confusion in the Government's mind between a one-off increase in productivity and an improvement in the long-run trend.

3.9 In fact, the so-called productivity miracle has only been accompanied by a massive fall in output and employment. This is shown in Figure 3.3. From 1975 to 1979 productivity in manufacturing was steadily increasing, accompanied by rising output and relatively stable employment. Had this trend continued, then productivity would be just as high now but without the enormous loss of output and jobs. All the Government has achieved is to continue the existing long-run trend in productivity.

3.10 The real picture is that short-run or one-off increases in productivity may possibly be occurring, but only at a tremendous cost in terms of higher unemployment and lost output. The long-run productivity prospects have certainly not been improved, and if the present cutbacks in investment and training continue, productivity growth may be even lower than in the 1970s. Moreover, the productivity of the unemployed is zero, and if this were taken account of, then the increase in productivity since 1979 would be even less impressive. The prospects for employment will be very poor, as a large number of jobs would have been destroyed without providing any new sources of employment. The only effective means of increasing the long-run productivity trend is to combine a controlled growth of demand with measures to encourage investment and training. These are set out in more detail in Chapter 7.

Figure 3.2 How much of the national income we pay ourselves



Note: Percentages based on income from employment divided by total domestic income. Income from employment includes wages and salaries, pay to HM Forces and employers' national insurance contributions.
Source: CSO.

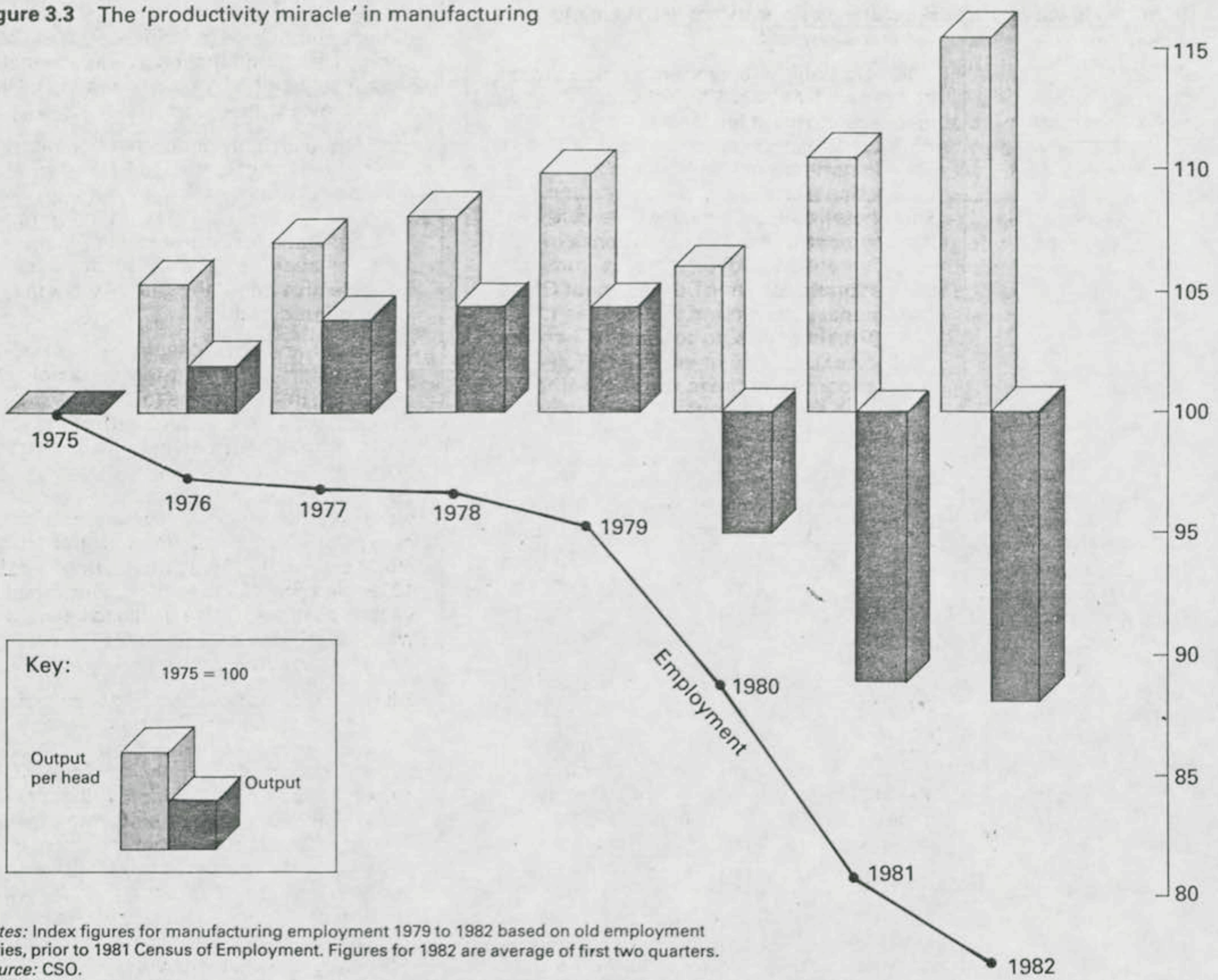
Myth 3: new technology is to blame

3.11 New technology has a great potential to add to the efficiency of UK industries, to allow it to produce more, and to improve its competitiveness. Many people have expressed fears that this has created 'technological unemployment', because of a gap between the higher rate of productivity the new technology will allow and the overall growth of the economy. This concern has been heightened because new technology will affect the service industries, which have been a major source of new employment in the past. If this happened, new technology will put more people out of work than expansion elsewhere in the economy could cope with.

3.12 The rate at which new technology is introduced will depend, like most investment decisions, on whether or not firms believe they can sell the extra output produced. In a depressed economy, with bleak prospects and unchanged policies, the overall rate of investment and investment in new technology will be correspondingly lower. As the economy picks up, however, and market prospects get better, then more firms will invest, particularly in new technology. The impact of new technology on unemployment will then critically depend on how much productivity gains outstrip overall growth in the economy, and how much new technology is imported rather than being made in the UK.

3.13 There is very little new investment taking place in the economy, as Chapter 2 showed, whether in new technology or in other forms of capital. Nonetheless, there are many individual examples where the limited and piecemeal introduction of new technology which has taken place so far has led to workers losing their jobs. This is because the investment has taken place against a background of mass

Figure 3.3 The 'productivity miracle' in manufacturing



Notes: Index figures for manufacturing employment 1979 to 1982 based on old employment series, prior to 1981 Census of Employment. Figures for 1982 are average of first two quarters.
Source: CSO.

unemployment. The TUC believes that new technology can be introduced harmoniously, without job loss and with increased benefits in the form of shorter working time and better working conditions. But this can only take place within a growing economy. Without that growth, new technology will be seen as a source of job loss at a time of high unemployment, and as such its introduction will be difficult and slow.

Myth 4: immigration is to blame

3.14 A particularly vicious myth put around by racialists is that in some ways immigration, particularly by ethnic minorities, is to blame for high unemployment. Despite the publicity given to immigration, the population of the UK has not increased. This is because for almost every one of the last 20 years, more people have emigrated than have come to the UK. Only ten years ago, the UK had an economy which could support 24 million workers. The recession has reduced employment opportunities for all races.

3.15 Within the UK, workers from the ethnic minorities made up just over 4 per cent of the unemployed in August 1982. But in three of the regions – North, Scotland and Wales – with some of the highest unemployment (much of it going back for many years), workers from ethnic minorities account for less than 0.5 per cent of the unemployed, whilst in the South East, with the lowest unemployment rate, they account for 7.6 per cent of the unemployed. This shows that in regions with the highest unemployment there tend to be relatively few immigrants.

3.16 The TUC has already published a *Charter for Equality of Opportunity for Black Workers,* which called for a wide range of initiatives in the workplace to help promote equal opportunities for black workers, including the need for trade unions to ensure that the myths and propaganda of racialists are countered, and the positive contribution ethnic minorities have given to industry and services is publicised.

Myth 5: women going out to work are to blame

3.17 Another myth about unemployment which is still encountered is that women going out to work help keep unemployment high. It must be said right from the start that not only should every person, male or female, black or white, have the right to a job, but that steps should be taken to ensure equal opportunities in the labour market. Policies on this issue are set out in more detail in Chapter 9.

3.18 Up until 1979, women's employment had grown by about 120,000 a year whilst male employment fell by much less, by 20,000. Many of these new jobs for women were in non-manual, service sector occupations, and many were part-time. This shows that the increase in female employment was not at the expense of male employment. Moreover, a recent study by the National Economic Development Office on regional policy found that between 1966 and 1978, there was no connection between the level of unemployment in a region and the number of women in work or women registered as unemployed. This shows that any attempt to discourage women from working will not decrease unemployment or increase job opportunities for men. Moreover, the number of people in work and those who want to work but are unable to do so would be exactly the same – the 'job shortage' described in Chapter 2 would be just as large.

Myth 6: the unemployed are better off out of work

3.19 It is often said that many of the unemployed are better off out of work instead of working. The Supplementary Benefits Commission concluded in its *1979 Annual Report* that the numbers who got more in benefits than they would have got in work are tiny. Those few who did were mainly men who had only been recently made unemployed, or had had very low wages and a large family. A survey by the Policy Studies Institute (PSI) in March 1979 confirmed this, and found that only 3 per cent of the unemployed got more in benefits. The survey also found that on average, benefits were less than half previous earnings. One of the survey's conclusions was that:

> 'There is no evidence that benefits reduce the incentive to find work; on the contrary, those receiving higher than average benefits make greater efforts to find work than those receiving lower than average benefits, and they are less selective about the kind of work they are prepared to do . . .'

3.20 A study by the Manpower Services Commission of the long-term unemployed, published in 1980, came to similar conclusions, and also found that people in areas of high unemployment were twice as likely to consider anything at all than were people in areas of low unemployment, and were also correspondingly less likely to insist on a particular type of job. A further MSC study on hard to fill vacancies, published in 1979, also concluded that problems in filling vacancies did not arise because benefits were too high, but because the wages offered were far too low.

3.21 This evidence can be backed up by more recent research findings. A report by the Institute of Fiscal Studies, published in early 1982, found that only 4 per cent of those currently becoming unemployed got as much as 90 per cent of their former earnings. Nor do the unemployed benefit much from large redundancy payments. A survey by the Institute for Manpower Studies in May 1981 found that 35 per cent of those who were made redundant got nothing, and another 15 per cent got less than £500.

Key points

This chapter has shown that:

- lower wages will not mean more jobs because workers' purchasing power will also be cut.
- many of the unemployed had low pay in their last job.
- Britain's total labour costs are lower than most other countries.
- the share of the national income taken by income from employment has not grown.
- new technology has not caused the present recession.
- immigration and women going out to work have nothing to do with the level of unemployment.
- the unemployed are not better off being out of work.

Chapter 4
TUC POLICIES FOR 1983: ACTION NOW

Previous chapters have shown that Government policies offer higher unemployment and stagnant output for 1983. This chapter shows that the TUC's Budget proposals offer a clear alternative. Urgent action could be taken by the Government which would achieve a major reduction in unemployment and a significant boost to output. This chapter shows that:

- increased public spending is essential for economic recovery.
- the TUC's £10 billion expansionary package would create investment-led growth.
- registered unemployment would fall by over 570,000 in one year.
- the package can be financed without leading to runaway inflation or higher interest rates.

The TUC's Budget strategy

4.1 The TUC's Budget strategy is based on the need for the Government to accept responsibility for the level of real output and employment in the economy. Its two key objectives are:

- a return to full employment; and
- a reduction in the gross inequalities which still exist in society.

4.2 The economic crisis is now so severe and the loss of output has been so great over the last three and a half years that these objectives cannot be achieved in a single year or by the sole reliance on the traditional policies adopted by governments in the past. This is why the next chapter sets out a medium-term growth and employment strategy which would reduce unemployment below 1 million over five years. However, this chapter shows that action could be taken immediately which would reverse the upward trend in unemployment, get the economy moving and help to reverse the growth in inequality.

4.3 The TUC's 1983 Budget proposals are designed to improve both the demand and supply sides of the economy. In other words the policies are designed to ensure that extra purchasing power is spent on British-made goods and services – for example by ensuring that British firms do not run into bottlenecks caused by skill shortages or lack of up to date machinery. The Government has ignored these aspects: for example the abolition of hire purchase controls has led to an increase in purchases of imports rather than British goods.

4.4 *Expansion of demand* through increased Government expenditure is vital if the economy is to be pulled out of the recession. All industrial surveys show that the key factor holding back production is a lack of orders now and uncertainty about demand in the future. The Government should therefore increase its level of spending in order to compensate for the depressed level of demand and investment in other sectors of the economy.

4.5 An expansion of demand by itself could, however, lead to a serious rise in imports unless it is accompanied by urgent measures to increase competitiveness and control imports. The UK's trading competitiveness has been seriously damaged over the last four years because the Government's tight money policies led to an overvaluation of sterling. This was partially reversed by the rapid depreciation of the pound in the last months of 1982 and early 1983. Even this, however, failed to restore the lost competitiveness which Government policies had produced. Moreover, the Government's reaction to the depreciation demonstrated the self-defeating nature of its approach. By forcing up interest rates in response, it imposed additional costs on the economy and offset some of the gains which depreciation could have achieved. At the same time the outward flow of investment, which originated in the Government's abolition of exchange controls, has accelerated.

4.6 The TUC advocates a re-imposition of exchange controls and an exchange rate which is maintained at a lower level from its overvaluation in 1982. Such a *devaluation* would give an immediate boost to competitiveness if accompanied by an accommodating monetary policy that did not force up interest rates. This would not be a substitute for the supply-side policies set out in the following chapters but it does recognise that these will take some time to act. The TUC recognises that the system of floating exchange rates makes it difficult for any Government to pursue an exchange rate policy in isolation. Nevertheless, the active use of interest rate policy, intervention by the Bank of England in the foreign exchange markets and the use of exchange controls could give the Government some influence. This does, of course, run counter to the Government's free market approach, in particular its view that control of the domestic money supply should take precedence over all other policies. But this merely confirms how damaging that approach has been. ?

4.7 However, the devaluation of sterling would in itself not be enough and there is a limit to how far this should go in view of its effect on inflation. The use of *selective import controls* to prevent a sharp rise in import penetration levels will therefore be vital. The key sectors would include motors, machine tools, steel, textiles, tyres and furniture. The aim of these is to contain existing proportions of imports, but in a growing market. Such selective action is preferable to the competitive deflationary policies pursued by many Western governments.

The 1983 TUC Budget package

4.8 The 1983 TUC Budget package therefore includes measures which, as the first stage of the five-year plan set out in Chapter 5, will produce a coordinated expansion of the economy and at the same time help to reduce inequality. Last year the TUC called for an expansion of £8.3 billion, approximately 4 per cent of GDP. The TUC judges that a similar budgetary boost in proportionate terms is needed this year. This is because the amount of spare capacity in the economy is about the same.

4.9 The TUC has drawn up a package of measures which, on the basis of the low growth which the TUC expects from present policies in 1983, would achieve a 4 per cent growth rate. The key elements of the package are set out in the following paragraphs. The package is designed to achieve sustained growth, without running into inflationary or other constraints. It is a mix of policies designed to achieve a mix of objectives. These proposals are in addition to present Government policies. They also take as their starting point TUC policy that income tax allowances, excise duties and pensions and benefits are fully increased at least in line with inflation. A failure to carry out the indexation of personal tax allowances would cut real demand still further and so worsen the prospects for the year ahead. In the same way, an increase in personal allowances in line with inflation will not constitute a 'give-away' Budget.

4.10 This is how the TUC's £10 billion Budget package is made up:

TUC BUDGET PACKAGE

Programme	*Cost for 1983-84*
'Reconstruction of Britain' public investment	£3,200 million
TUC manpower, education and training strategy	£1,800 million
Regional/industrial strategy	£850 million
Local authority services	£250 million
State pensions	£700 million
Social benefits	£750 million
NHS current expenditure	£175 million
Reduction in VAT from 15 to 12.5 per cent	£2,300 million
Total Budget expansion	**£10 billion**

Public investment

4.11 A key element in the TUC's package is public investment. Chapter 5 sets out a five year 'Reconstruction of Britain' programme of major public sector investment projects. There should be an immediate start on that programme in 1983/84 in order to lay the foundation for further action in order to implement the £30 billion programme in full. A priority area in 1983 would be house building and repair. The housing programme has been slashed by over 40 per cent by the Government which has created a housing crisis and severely depressed the construction industry. This expenditure could be undertaken quickly and have an immediate impact on the economy. The construction industry would also be given a major boost by large expansions in road building and repair, and hospital building (where there is a back-log of neglect to be urgently remedied), two areas which have also been severely hit by public expenditure cuts. The package also doubles the amount spent on the Urban Programme which is designed to help regenerate our inner cities. This money can be spent quickly if it is channelled through Partnership and Programme area local authorities.

House construction and renovation	£1,390 million
Education repair and renovation	£145 million
Hospital repair and renovation	£425 million
Energy conservation	£115 million
Roads	£360 million
Urban programme	£445 million
Water and sewers	£75 million
Telecommunications	£230 million
Total extra cost of investment programme:	*£3.2 billion*

Regional industrial strategy

4.12 The TUC has called for a major expansion in the level of regional support for jobs and investment as will be outlined in Chapter 7.

- Regional Employment Subsidy of £25 for every additional worker taken on in the worst hit regions. This would create over 125,000 jobs and cost *£650 million.*
- Regional Investment Grants to be increased by *£200 million* to make up for the large cuts over the last three and a half years.
- Total Extra Cost of Regional Industrial Strategy: *£850 million.*

Manpower and training

4.13 The TUC proposes an emergency programme of additional expenditure in this area. The aim is:

- to give immediate help to unemployed people, and promote employment;
- to begin to reverse the short-sighted and damaging Government cuts already imposed on mainstream training and employment services and provisions; and
- to ensure that essential training and education provision is available to underpin national economic recovery.

Figure 4.1 Manpower and training

Young people

The TUC wishes to see a full range of training opportunities for all young people entering the world of work. The Manpower Services Commission's *Youth Training Scheme,* which replaces the present Youth Opportunities Programme, is an important step forward. It will be vital for the MSC to ensure that the desired quality of the scheme is sustained and monitored. The TUC will be making its full contribution to that work.

But the provision that the MSC has for helping young people needs to be improved by:

increasing the allowance paid to unemployed trainees to at least £30 a week

Cost £120 million

a further 20,000 apprentices places to stop the devastating fall in apprentice intakes, assist redundant apprentices and sustain vital skills training, especially in the key engineering sector.

Cost: £20 million

sustaining the *Community Industry Scheme* for disadvantaged young people, especially 17-18 year olds, and bringing payment back into line with decent wage rates.

Cost: £5 million

Educational maintainance allowances

Parallel to the provision of real training for young people must be the development of alternative opportunities for full-time education. Young people must have a choice to remain in full-time study after the age of 16. This choice can only be realised if a scheme of grant aid is introduced so that young people can be encouraged to continue their studies without incurring financial penalties. The TUC accepts that such a scheme would need to be means-tested on parental income and proposes that the scheme should provide young people with £15.80 per week, the current level of supplementary benefit available for 16 and 17 year olds.

Cost: £200 million

Training for adults

The increasing pace of industrial change and the growing impact of new technologies means that adult workers, both unemployed and employed, require greater training at all levels to meet the skill demands of jobs in the late 1980s and 1990s.

The way forward is through increased state investment complementing the efforts of industry. Instead the Government have cut back the capacity of the training system – the very reverse of the positive role which the state must play in this crucial area. It was in this context last year that the TUC argued for the development of an employment and training subsidy scheme with the twin aims of creating new jobs and of placing unemployed workers into systematic job training. Employers would be able to get a £60 a week subsidy for 12 months for every extra unemployed worker whom they recruited and trained over and above their normal establishment. We now wish to see this scheme extended with the additional option of employers obtaining the subsidy for retraining adults in employment both to upgrade skills and to train in new technologies. This could create an additional 80,000 jobs and training opportunities at a cost of £250 million.

Cost: £250 million

Training Opportunities Scheme

The MSC's *Training Opportunities Scheme* (TOPS) offers training in Skill Centres or in colleges to adults who are unemployed or who are re-entering the labour market. But the scheme has been cut back from a planned level of 100,000 places to less than 60,000 places in the last three years. More places and a wider range of skills training and work preparation courses are now needed to ensure capacity, particularly in Skill Centres, is geared up for economic recovery. It will also be essential to provide direct training opportunities for adults including courses for married women returning to work. Provision should be made to increase TOPS places by 40,000 (including 10,000 on work preparation for those out of work for long periods) in 1983-84 at an additional cost of £75 million.

Cost: £75 million

Paying for Industrial Training Boards

In 1982 the Government abolished 16 ITBs and stopped covering the operating costs of the remaining 7 ITBs covering vital sectors of the economy. Direct state funding of operating costs should not be cut off at a time when industry is in deep recession and hard pressed. The Government should change its decision and make available £30 million to cover ITB operating costs in 1983-84.

Cost: £30 million

Long-term unemployed: New Employment Programme

Over a million people have been out of work for more than a year. They have immense needs for jobs and training. A *New Employment Programme* should be created for those long-term unemployed people by overcoming the weaknesses of the current Community Programme. This will involve:

abolishing the £60 average wage cost restriction to bring it into line with the average wage cost of the old Community Enterprise Programme;

maximising the number of full-time places, building on the present 45,000 places to give at least an additional 85,000 full-time places paying the rate for the job.

developing a proper training element and budget to promote adequate training opportunities for long-term unemployed people who are in the programme.

Cost: £150 million

Job Release Scheme

The *Job Release Scheme* offers opportunities for older workers to retire early and release jobs for younger unemployed people. The scheme should be widened to include men aged over 60 and women aged over 55. This would provide 20,000 full-time jobs for younger unemployed people at an additional cost of £110m in 1983-84.

Cost: £110 million

Employment services

Since 1979 rising unemployment and cuts in public expenditure have increased the pressure on public employment services and undermined certain key functions. On top of that the 'Rayner Scrutiny' has imposed further cuts in cash and staffing, thereby threatening to undermine the job centres network.

The modernised employment service through its job centres has shown it is an essential aid to the economy in quickly helping job seekers to find jobs and employers to find suitable recruits. The cuts made and in prospect put the service at risk at a time when its functions in helping the unemployed and aiding national economic recovery will be vital.

There should be a reversal of the cash and staffing cuts imposed on the public employment service and a start should be made in 1983-84 by increasing staffing complements in job centres. In addition, a new special needs scheme for long-term unemployed people to cover their advisory counselling and placing needs should be developed.

Cost: £50 million

Higher education

4.14 The development of higher education is now at a critical stage, both in the public sector and in the universities. The TUC believes that additional funding must be made available to both sectors in 1983-84 to safeguard opportunities for young people and to enable the institutions to respond rapidly to new needs. It is essential that opportunities are expanded in key scientific and technological subjects, not only for initial training but for updating skills and knowledge required to help regenerate Britain's industries and services. The TUC is again calling for an end to financial discrimination against overseas students, and a rise in student grants in line with inflation.

Cost: £110 million

Local Education Authorities

4.15 In *Programme for Recovery: TUC Economic Review 1982* the TUC argued that faced with the difficult task of rebuilding much of the nation's essential educational framework, the local education authorities needed substantial additional resources to offset the damage inflicted by successive rounds of cuts. These needs have become even more urgent. The TUC believes that the Government should add £730 million to the Rate Support Grant for 1983-84 for spending on these educational priorities:

- developing under-fives provision, with coordination of education and day care services particularly in the inner cities;
- reintroducing financial support for school meals and milk;
- a special inner city programme to help young black people;
- restocking school and college libraries and employing essential ancillary staff in schools;
- encouraging curriculum reforms in secondary schools — particularly preparation for working life and for living in a multi-racial society, and equal access of boys and girls to all subjects with special encouragement for girls to study maths and sciences;
- development of vocational preparation for 16 and 17 year olds within the certificate of prevocational education; and
- rebuilding services for adults, with special provision for unemployed adults and the black communities.

The £730m to be spent on these services would be additional to the £200m for education grants and employment-related training and to the MSC programmes.

Cost: £730 million

Social expenditure

4.16 Higher expenditure on health services, pensions and other social benefits will be essential if the growing inequalities created by the Government's economic policies are to be reversed.

- *£175 million extra* is needed for NHS current expenditure (in addition to the resources contained in the *Reconstruction of Britain* package) to meet the TUC's target of 3 per cent annual real growth.
- *£700 million extra* is called for to help increase retirement pensions. This extra expenditure between November 1983 and April 1984, in addition to the Government's estimated 5 per cent inflation proofing for 1983, would enable pensions to rise to £39.50 for a single person and to £63.50 for a couple from November. This assumes that the Government does not clawback any of the increase in pensions over and above the inflation rate in 1982.
- *£750 million extra* is called for to help addition to full inflation proofing, for other benefits to give special help to the long-term unemployed and families. It would enable child benefit to be increased to £8.75 per week and the special child benefit for one-parent families to be increased by £2 a week. Long-term supplementary benefit rates would be extended to the unemployed and steps be taken towards an adequate unemployment benefit system as set out in the *TUC Benefit Charter for the Unemployed.*

Local authorities

4.17 Local authorities services have suffered considerable damage as a result of the continued cuts in Rate Support Grant.

- *£250 million extra* expenditure is needed to provide immediate relief for the inner-city local authorities which have been worst hit by the penalties imposed by the block grant system.

VAT reduction

4.18 The TUC is again calling for a reduction in the rate of VAT from 15 to 12.5 per cent for two reasons:

- it would have an immediate impact on demand, output and thus employment; and
- it would be anti-inflationary as it directly reduced prices.

4.19 A cut in VAT is preferable to spending the same on reducing the Employers' National Insurance Surcharge (NIS) for two reasons: cuts in the NIS would have less impact on the rate of inflation than a cut in VAT and there is also little evidence to show that a cut in the NIS would have any measurable impact on employment. Employers have simply used the cut in the NIS in the 1982 Budget as an opportunity to increase their profits without creating any new jobs and a similar response to a further cut in the NIS can be expected.

- A cut in VAT from 15 to 12.5 per cent, costing approximately *£2.3 billion*, will reduce prices and help to hold down inflation.

Results of TUC's Budget proposals

4.20 The TUC has again used the Treasury economic model to illustrate the effect of expansion on jobs, growth, prices and the balance of payments. In doing so, the TUC has used the publicly available version of the model widely used by leading independent forecasting groups and by the House of Commons Library. This version differs in several important respects from versions used by the Treasury in the past year. In addition, the Treasury indicate in their published simulations using the latest model, that they apply judgements which can significantly alter the results. These judgements explain why differences can arise when testing the effects of policy measures on the model. For the purposes of carrying out the forecast it is necessary to assume that either the money supply or interest rates are held constant. To some extent this technical decision depends on whether a monetarist or non-monetarist approach is taken – while the Government would hold the money supply constant, the TUC believes that the money supply should be increased to accommodate the increase in output. The model is not capable of simulating the type of selective and temporary import controls advocated by the TUC. The effects of these would therefore be in addition to the results shown below. The simulations include a devaluation of sterling of 10 per cent from its effective rate in the Autumn of 1982, and show the resulting differences from the forecast made for the economy at that time. Although the pound has moved since then, the results are still valuable in showing the benefits of devaluation if combined with economic expansion.

4.21 Figure 4.2 shows the effect on output, employment, unemployment, prices, the balance of payments and real personal disposable income of the TUC's Budget package. Each table shows the change to these key economic variables after one, two, three and four years. It should be emphasised that the results for the first two years are more reliable than those for the third and fourth. Nevertheless, the shape of economic developments over the medium-term period cannot be ignored. The TUC would expect that the National Economic Assessment, described in Chapter 5, would analyse the sort of relationships revealed by simulating the effects of policies in this way together with the issues discussed in the following paragraphs.

4.22 These results confirm the value of the TUC's proposals in boosting output and employment. In particular, they show that an expansionary Budget can make a major first step towards the TUC's job target. In addition, there are a number of other favourable effects – manufacturing investment is 4.5 per cent higher at the end of the first year and 5 per cent higher at the end of the fourth year. Competitiveness (*ie* relative unit wage costs) improves by 9 per cent after one year. Company profitability is consistently higher than on present policies, though the increase tails off towards the end of the forecast period.

Figure 4.2

RESULTS OF TUC BUDGET PROPOSALS

	Unemployment	*Employment*
Year 1	−574,000	+755,000
2	−673,000	+891,000
3	−739,200	+978,000
4	−712,000	+943,800

	GDP	*Inflation*
Year 1	+3.3%	+0.9%
2	+4.3%	+1.8%
3	+4.7%	+2.7%
4	+4.2%	+3.3%

	Balance of payments	*Real personal disposable income*
Year 1	−£2411m	+3.2%
2	−£798m	+1.0%
3	−£22m	+2.0%
4	−£730m	+0.8%

Note: All figures represent changes from what is forecast to happen over this period if present policies are continued.

4.23 However, some major economic problems remain – the TUC has never argued that a one-year Budget package can solve all of Britain's problems. Although exports are higher than on present policies – 1 per cent after one year – imports are even higher at 1.7 per cent. There is a slight deterioration in competitiveness by the end of four years and a deterioration in the balance of payments of £2.4 billion after one year. This is largely inevitable because of the time lag between firms importing raw materials and components and exporting the finished products. The full benefits to the balance of payments from devaluation therefore take 12 to 18 months to be felt. However, it is clear that expansion must be accompanied by direct measures on imports. They would avoid the need to cut short economic expansion in the face of temporary balance of payments difficulties, as has happened too often in the past. Moreover, it should be stressed that the continuation of present policies will not avoid balance of payments difficulties – indeed deterioration is already forecast.

4.24 The results from the Treasury show an increase in the Public Sector Borrowing Requirement – though after one year this increase of £6.4 billion is two-thirds that of the original budget stimulus, reflecting the extra tax revenue generated by employment growth and the reduction in the cost of unemployment. The PSBR as a percentage of gross domestic product rises from 2.8 per cent to 4.7 per cent, reflecting the expansionary fiscal policies which the TUC advocates. This increase is no cause for alarm – such an increase is indeed necessary if expansion is to be promoted.

4.25 There remains the worry about the effect of this PSBR increase on interest rates and the money supply. The TUC believes that a more accommodating monetary policy would allow this extra PSBR to be financed without any damaging increase in interest rates. Even if interest rates did rise, the impact on industry would be more than outweighed by the benefits firms would receive from higher levels of demand. The CBI's industrial surveys confirm that the cost of finance is a far less important determinant of the level of investment than is the level of demand. Far from crowding out the private sector the TUC package would improve profitability, investment, employment and output in the private sector.

4.26 The final worry expressed by critics of expansionary policies is the possible effect of the increase in the money supply on inflation. As earlier chapters have demonstrated, there is no close relationship between changes in the money supply and changes in the rate of inflation. If the crude monetarist theories first pronounced by the Government were to hold, inflation in Britain today would be well into double figures on the basis of past increases in the money supply. The results from the Treasury model show that the increases in the money supply do not feed through quickly or automatically into increases in inflation. In addition, the results suggest that a well-balanced package can effect a large decrease in the level of unemployment at a relatively small cost in extra inflation. This must be contrasted with the Government's policies which have secured a small reduction in the rate of inflation at the expense of a huge increase in the numbers of jobless. The trade-off between inflation and unemployment is not immutable, indeed it has been substantially worsened by this Government's policies. The aim of the TUC's policies is to secure the maximum increase in living standards and employment at the minimum cost to inflation.

4.27 One effect of the TUC's policies detailed above is to lead to an increase in real personal disposable income, and in the initial years this reflects the priority given by the TUC to quick-acting measures to improve the living standards of those in receipt of state benefits – *ie,* the unemployed, the old and those with large families.

4.28 Looking further ahead, to the development of policies for the medium-term, the TUC will be giving close attention to the development of the standards of living both of those in work and out of work, and also the balance in the use of the nation's resources between investment and consumption. Many of the medium-term policies to boost investment, explained in later chapters, will not take full effect until the mid-1980s and the simulations above (although presented in a medium-term timescale) do not represent the TUC's medium-term programme. This is set out in the next chapter.

Conclusion

4.29 The TUC's immediate expansionary policies would therefore succeed in producing higher employment. However, in order to achieve the target of reducing unemployment below a million within five years, the first-year package must be followed up with the policies set out in the following chapters of this *Economic Review.*

Key points

- The Government's deflationary Budget strategy has been responsible for the severe drop in output and employment over the last three years, and the continuation of that strategy will mean another year of worsening prospects.
- The TUC's alternative Budget strategy includes increased government expenditure, a lower exchange rate, reduced VAT and managed trade.
- The Budget package will lead to economic expansion of 4 per cent and give a major boost to employment.
- Coordinated expansion would not lead to runaway inflation.
- But to tackle the underlying weaknesses of the economy, the first-year Budget needs to be followed up by a medium-term growth strategy in order to reduce unemployment below one million.

Chapter 5
A FIVE-YEAR PLAN FOR BRITAIN

This chapter shows how a five-year plan for Britain, on a similar scale to post-war reconstruction, can defeat mass unemployment and lay the foundations for lasting growth. It shows:

- how a five-year plan can bring unemployment down below 1 million.
- that planning will only succeed if it is based on real advances in industrial democracy.
- the rates of economic growth that will be needed.
- the implications for public expenditure and investment.

5.1 Chapter 3 has exposed some of the myths about unemployment. But the biggest myth of all is that the only option open to Government is to sit back and do nothing. Unemployment can be reduced by Government policy. Not only can it be, it must be.

5.2 This was the lesson which was finally learned after the tragic experience of the 1930s slump, and the world war which followed it. In 1944 a consensus which had built up across the political spectrum was expressed by a Government White Paper:

> 'The Government accept as one of their primary aims and responsibilities the maintenance of a high and stable level of employment after the war . . .
>
> The Government are prepared to accept in future the responsibility for taking action at the earliest possible stage to arrest a threatened slump'.

5.3 In the same year, the TUC approved a statement on Post-War Reconstruction. The concluding note of that statement was that:

> 'The implementation of many of the proposals for reconstruction greatly depends upon the state of full employment being maintained in the post-war world . . .
>
> The task of the trade union Movement is at one and the same time to inspire the Government to pursue a proper employment policy, and to protect workpeople against unnecessary encroachment upon their freedom of action'.

The task before us now is on the scale of post-war reconstruction. It is important to recall that the determination and political will that underlay the post-war reconstruction helped produce a long period of high employment, growth and more equality.

The principles behind the plan

5.4 This chapter spells out the principles on which the TUC's five-year plan for reconstructing the British economy is based. It also shows how this plan is directly relevant to many of the detailed problems which will be faced. Chapter 4 sets out the action needed in the first year of a five-year plan. Subsequent chapters deal in greater depth with particular components of the plan. Chapter 7, for example, details the policies for industry and trade that will be required including the negotiation of agreed development plans with leading companies; while Chapter 8 looks at the international context. However, these chapters do not represent a complete blueprint. Successful planning does not work that way. Our approach distinguishes three crucial steps:

- taking action to get the economy moving again;
- making changes which allow priorities to be debated and agreed and the broad framework of policy to be implemented; and
- stimulating the maximum involvement of working people in economic decisions so that the details of the plan are built up from the experience and expertise of those working within industries and services.

5.5 There are no short-cuts to this third step, in many ways the most crucial one. Last year's Congress and the Labour Party Conference adopted a report from the TUC-Labour Party Liaison Committee on *Economic Planning and Industrial Democracy*, the proposals of which form the framework for achieving full employment. The vital principle of that report is that industrial democracy will be the source from which planning will derive its authority, its knowledge and its power.

5.6 Any other approach would be futile. The last few years have demonstrated the damaging consequences of relying on unrestrained market forces. Yet there is no way in which the state could pretend to assume responsibility for the millions of decisions which make up the economy. The key task is therefore to extend the control of workers over these decisions.

5.7 This is not to deny that the state has a crucial role to play in reforming our economy. The Liaison Committee set out a series of practical steps which would make planning possible:

- a new, powerful Department of Economic and Industrial Planning to shift the focus of government thinking away from ad-hoc crisis management towards the medium-term allocation of resources to meet agreed goals;

- an opening up of the planning system for public expenditure so that decisions are informed by those who produce and use the goods and services which public expenditure provides;
- a strengthened tripartite system building on the National Economic Development Council, through a National Planning Council, which will connect directly with the activities of trade unionists in their workplaces. This will be able to build on the work currently being undertaken by the TUC to establish or strengthen joint union/management bodies at company and plant level and so strengthen tripartite bodies at sector level; and
- agreed development plans with leading companies, with trade unionists playing a central part.

In addition, the TUC is proposing that the Government should present an annual 'Employment Budget' as well as a Financial Budget. This would help shift the focus of budgetary policy towards meeting targets for employment and output. It would signify a commitment to judging between policy options on the basis of their impact on unemployment.

Planning: democracy in action

5.8 But to rely too much on action by the state would be wrong. It would miss the crucial point that Britain's economic decline has gone hand in hand with a growing loss of accountability in economic decision-making, as control has been concentrated in fewer and fewer hands. 100 companies now account for 40 per cent of industrial output and trade in the UK and 40 per cent of the nation's resources are allocated through the highly secretive system of public expenditure planning. As decision making has become more unaccountable, so it has become increasingly unimaginative. Maintaining Treasury dominance over public spending is seen as more important than encouraging new ideas from new sources. 'Balancing the books' has been seen as more worthy than investing in the future.

5.9 The only way to redress this imbalance is by making decision making more democratic. The trade union Movement, with its network of representatives and its ability to tap the expertise of workers, is the appropriate counterweight to centralised and unaccountable power. To return to full employment we must plan the path to recovery. That means bringing all our resources together in the drive for reconstruction. But one of the major resources which, at the moment, is systematically frozen out of the economy is the knowledge and commitment of working people, conveyed through their unions.

5.10 So planning must be seen as a process which directly stimulates the maximum degree of involvement of workers in decisions affecting them. That is why new rights on information, consultation and representation are central to this approach.

Getting the economy moving

5.11 But for democratic planning to be developed successfully, however, a climate of economic growth and reconstruction will be vital. Only within such an environment can the difficult choices that planning poses be faced up to with confidence that the pay-off will be a positive gain, rather than a redistribution of misery. Also it is only in such a climate that local initiatives can be integrated with, inform, and on many occasions amend, national strategic priorities.

5.12 The starting point for the five-year plan must therefore be agreement on the overall targets for growth in output and employment. In this first instance, the priority goal must be to:

- reduce unemployment to below 1 million.

5.13 The target of reducing unemployment below 1 million from the present registered level of 3.3 million would mean creating 500,000 jobs a year. However, as Chapter 2 explained there are nearly 1 million workers who have not registered as unemployed but are seeking work or who are on special employment schemes. In addition, an extra 300,000 people may join the workforce over the next five years as a result of the 1960s 'baby boom'. Therefore, to reduce the real level of unemployment below one million over the next five years it is necessary to create around 3.6 million jobs – just over 700,000 jobs a year. This is equivalent to increasing the employed workforce by 3 per cent annually.

5.14 If the economy returned to an average productivity growth rate of around 2 per cent this would mean that output would have to grow by about 5 per cent a year – offsetting this extra productivity – in order to meet the jobs target. On the other hand, the TUC has argued in the *Campaign for Reduced Working Time* that reduction in working time should be used to maximise the employment effect of expanding the economy. If some of the benefits of increased productivity were taken in increased leisure as opposed to extra incomes for those in work, then each increase in output would create proportionately more employment. More workers can clearly be employed if they are working 35 hours per week, with no overtime, as opposed to 40 hours plus substantial overtime as happens too often at present. The TUC's objective is therefore to reduce working time by 10 per cent over the five years, or by an average of 2 per cent per year. This would achieve the TUC's target of a 35-hour basic week. The TUC estimates that given changes in working practices and increased production, one-half of this reduction in working time would go towards increasing employment. This means that the final output growth required to reach the jobs target is 4 per cent per year – 1 per cent less than if no cut in working time occurred.

Figure 5.1 Unemployment target: 1 million

3.3 m	Registered unemployment
+ 1.0 m	Unregistered unemployment and special employment schemes
+ 0.3 m	Increased workforce
4.6 m	
− 1.0 m	TUC target

= 3.6 million jobs need to be created 3% + 2% = 5% = 4% per year

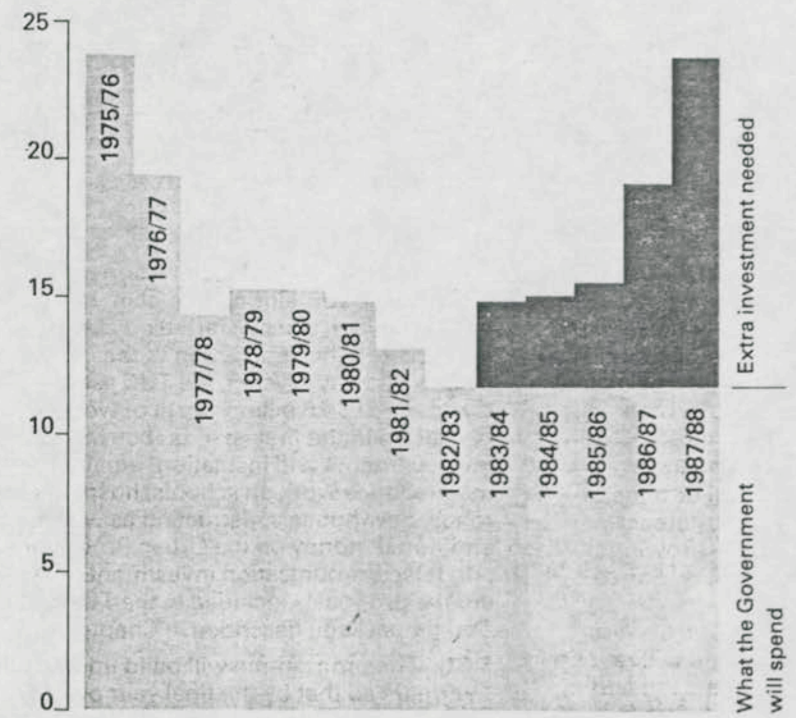
3%	+ 2%	= 5%	But, with reduction in working time	= 4% per year
employment growth	productivity growth	output growth		final output target

Investment and jobs

5.15 Reduced working time will thus play a key role in distributing the benefits of new technology. Nevertheless there remain fears about the effects on jobs of the introduction of new technology, both in the manufacturing and service sectors. It has been argued that the jobs lost in manufacturing have been lost for good and that the introduction of new technology in the service sector removes its employment creation potential.

5.16 The TUC does not accept that view. The TUC's 1983 Budget proposals, shown in Chapter 4, will directly increase employment in manufacturing by 200,000. As growth continues, of course, there will be increasing investment in new technology, especially in view of the sharp reduction in manufacturing capacity during the recession.

Figure 5.2 Restoring the cuts in public investment



Note: All figures in 1982 cash.
Sources: The Government's Expenditure Plans 1981-82 to 1983-84, and The Government's Expenditure Plans 1982-83 to 1984-85.

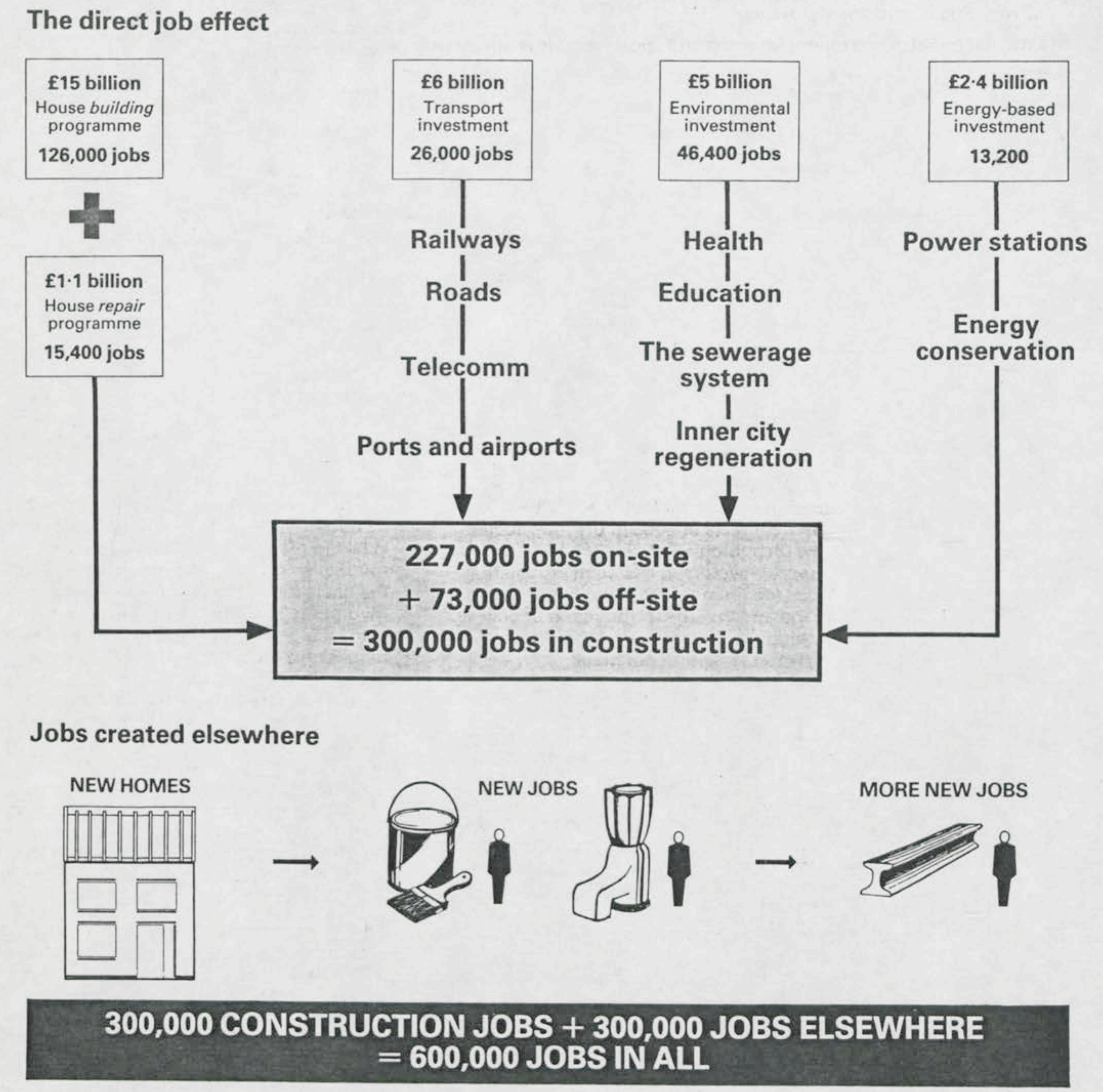
5.17 This new technology will be less labour intensive and so the extra employment created initially will be correspondingly low. This is by no means the whole story, however, since technological change and economic growth are dynamic processes. Investment – if it is of the right sort – can create jobs. At the moment we are seeing the worst possible development in industry. Such investment as is taking place is being introduced to rationalise or cut back production, not to lay the basis for expansion. No technological revolution is taking place. Instead we are witnessing something altogether more familiar – a muddled and uncoordinated piecemeal application of new techniques in an atmosphere of fear. The evidence from the past is that a major wave of investment and innovation does improve employment. By helping to make goods cheaper it increases living standards and so creates extra demand, more output and more jobs. Employment may not necessarily grow in the sectors in which the investment takes place but it is the indirect stimulus to activity in linked sectors that improves job prospects.

5.18 It may well be true that the introduction of technology in the private service sector will slow down and possibly reverse the employment growth seen in that sector in recent years. However, the analysis is incomplete without a consideration of the role of employment in the public services. Many of the short-term proposals set out in Chapter 4 and the medium-term proposals set out in later chapters will involve a growth in public service employment. The pattern of employment growth must be a regular item for discussion in the National Economic Assessment. However, it is already evident that a major source of employment growth in the coming years must be the construction industry and those industries which supply it.

The reconstruction of Britain

5.19 The TUC's five-year programme for public investment will gear expenditure on construction and other public projects towards renovating the structure of the economy and creating jobs. The programme would reverse the collapse of capital investment which has occurred over the last three years, as shown in Figure 5.2.

Figure 5.3 The five year public investment programme



Sources: Reconstruction of Britain (TUC, August 1981) and TUC.

The full *Reconstruction of Britain* package would cost £29.5 billion over five years and create nearly 600,000 jobs. Half of these jobs would be created directly in the construction industry while the rest are created as a result of the subsequent orders placed in other sectors. Figure 5.3 shows the projects to which resources would be allocated. It shows that house building will be a major priority, which reflects the sharp cutbacks over the last three years and the growing housing crisis. Other priority areas include the rebuilding of the economy's infrastructure. Roads, railways and sewers have all been badly neglected and will reduce the efficiency of public and private industry unless urgent work is carried out. Similarly, all sectors of industry will be helped by the energy programme which will produce more energy more efficiently.

5.20 The first year of the investment programme contains construction based projects which can be started quickly. Taking into account the contraction of the industry over the past two years, the TUC estimates that nearly £3.25 billion worth of work could be started in the first year, on house improvements and insulation, repair and maintenance work on schools, hospitals and roads, new house construction as well as additional money on the Urban Programme and telecommunication investment. These are the proposals included in the TUC's 1983 Budget package described in Chapter 4.

5.21 The programme will build up over the five years so that by the final year over £9 billion of extra public investment will take place. This reflects the long lead times before some of the major energy and infrastructural investment can take place.

Developing the plan

5.22 The previous sections have set out the broad outlines of the TUC's view of how the economy should develop over the next five years. But neither this chapter nor the short-run Budget package outlined in Chapter 4, with its medium-term implications, represent what a five-year plan will look like in practice. The detailed plan will need to be built up on the basis of extensive discussions at all levels of the economy. For example, as the PESC system is opened up it will be possible to take a fresh look at the sort of jobs our public services ought to be doing and start directing new resources to meet those goals.

5.23 In the same way trade unionists within companies will be able to use new rights, and the opportunities opened up by an active industrial strategy, to change the direction of corporate planning and tackle urgent, practical, problems. On trade, for example, information about a particular company's prospects for exporting or import substitution can be fed through the strengthened tripartite mechanism of the National Planning Council. In this way decisions on trade measures will be informed not only by the problems faced by particular sectors but also by the opportunities that lie within them for developing new products and markets and achieving sustained growth. Similarly, investment plans – including the introduction of new technology – could be openly discussed on the basis of a better flow of information through joint union machinery and tripartite bodies. In this way decisions would be taken on the basis of asking the question 'what more could we be doing with these resources?' rather than 'how do we best cut back?'

5.24 These same principles of democratic involvement, forward planning and seeking to make the most effective use of the nation's resources must be applied to the economy as a whole, as well as its separate components. That is why the TUC attaches so much importance to the idea of a National Economic Assessment. This would be the annual stage at which examination would be made of the way the economy was developing and alternative courses of action openly discussed. The implications of a particular growth rate for expenditure on the public services, and the implications of this in turn for both the development of the social wage and the order books of private sector companies would need to be thrashed out. For example, within the National Economic Assessment there would have to be considerable scope for short-term budgetary action to bring unused resources into use by increasing real personal disposable income, as well as an appreciation of the possible limits to expansion posed by skill and capacity bottlenecks. But the assessment would not be solely concerned with the planning of demand and supply within the economy. Alongside this, there would have to be careful analysis of the collective bargaining implications both of economic policies and of social policies on the distribution of income and wealth, such as action on low incomes.

5.25 The National Economic Assessment will work because feeding into it will be a whole range of new initiatives sparked off by advances in democratic planning. These will be channelled through the National Planning Council so that at the heart of decision-making about the national economy will be the priorities and expertise of workers expressed through their unions. In this way the National Economic Assessment will mark a genuine extension of collective bargaining – and the responsibilities that go with it – at all levels.

Key points

- The starting point for a five-year plan must be the commitment to full employment and social progress shown in the period of post-war reconstruction.
- Planning must involve new institutions, designed to tackle structural weaknesses in the British economy. But it will only work if there is maximum involvement of trade unionists at all levels of decision-making.
- The priority goal is to reduce unemployment to below 1 million over five years. This means economic growth of 4 per cent sustained over that period.
- A major public investment programme is at the heart of the TUC's five-year plan. But investment is needed throughout the economy.
- Investing for reconstruction on this scale will create jobs in all sectors.

The size of the public sector

6.27 Despite the importance of its contribution, the public sector is condemned by the Government as too large, inefficient and unproductive. It therefore cuts it back and hands over what it can to private firms. In reality the public sector is not too large but too small. Both in relation to the tasks which it needs to perform and in comparison to the public sector in other countries, there are not enough resources at the command of public authorities. Figure 6.3 shows that the UK public sector is about average in size compared to that of the other Western trading nations. Furthermore, out of the 41.7 per cent of GNP claimed by general government expenditure in the UK in 1979, 11.7 per cent was taken up by payments such as pensions, which are transfers (or redistribution) of income rather than a direct claim on productive resources.

6.28 The TUC does not believe in public spending for its own sake but because it is essential to meet welfare needs and to provide a national network of services and industries. We are concerned that the best use is made of the resources in the economy, and that the way these are allocated reflects the priority attaching to the needs of society.

Key points

- Only public spending can meet the basic needs of the worst off.
- Only public spending can provide a national network such as transport or telecommunications.
- The planning system must be reformed and opened to public debate. It must concentrate on allocating real resources to meet real needs.
- Public spending helps the rest of the economy by supplying a better infrastructure and a better labour force, and buying goods and services from it. The public sector can be used to restore economic growth.
- The public sector is not too big, but too small.

Figure 7.7 Imports take larger share

	Percentage				
	1978	*1979*	*1980*	*1981*	*1982 (first half)*
Vehicles	31.6	38.0	46.9	55.7	62.1
Metal manufactures	19.2	20.1	23.5	21.3	24.1
Paper and board	29.2	31.4	31.4	35.0	38.1
Mechanical engineering	23.8	27.3	27.3	27.8	34.6
Electrical engineering	33.5	40.9	39.4	48.1	56.1
Instrument engineering	52.2	54.6	59.7	52.9	62.7
Chemicals	30.9	34.2	33.1	35.7	40.3
Drink and tobacco	13.4	17.0	17.5	18.9	20.9
Other manufactures	18.4	20.7	23.5	25.0	26.6
Textiles	26.2	28.1	29.7	32.7	34.1
Clothing and footwear	21.8	24.6	25.6	25.8	23.7
Total manufacturing industry	**24.3**	**27.4**	**28.2**	**29.7**	**32.5**

Note: The figures indicate the share of the UK market taken by imports expressed in volume terms.
Note: Figures are available only for three of the 1981 quarters.
Source: CSO, Production Accounts.

the negotiation of agreed development plans with companies. Some indications can be gathered from EDC and SWP work, such as the call from the Electronic Consumer Goods SWP for import controls on colour TVs. But in the short and medium term, the TUC is calling for import controls on sectors and products which will play a key role in economic reconstruction or which will be subject to serious problems of adjustment to new market conditions. Coverage is likely to include sectors such as machine tools, information technology, biotechnology, petrochemicals, motor vehicles, coal, textiles and clothing, shipbuilding and steel. The key to this strategy will be to build up a strong industrial base for supplying the domestic market, as a precondition for export success in the long run. The Government's industrial policy needs to be constructed along those lines, including a lower sterling exchange rate to allow exports to prosper. It also has to reach agreement with multinational companies, whose internal transfers increasingly dominate international trade, to ensure that Britain gets its share of productive activity and is not used simply as a market for their products.

7.40 As already noted, membership of the EEC might pose problems for this trade strategy – though other countries pursue a vigorous trade policy within the EEC, such as the French Government's decision to impose non-tariff barriers to inhibit imports of video-recorders. In many industries, Britain's position is so serious that restraint on imports must be an overriding priority.

Key points

- Deindustrialisation – a long-run development – has accelerated rapidly in the past three years.
- An efficient and competitive industrial sector is crucial if the return to full employment is to be sustained.
- A planned approach to industry, involving those affected by the decisions, is the key to industrial success.
- A new investment strategy, based on the National Investment Bank and NEB, and harnessing the pension funds, is a top priority.
- Industrial policy must be flexible enough to have a strong input from regional and local interests.
- Public corporations can be used to create real jobs in the public and private sectors, and clear mechanisms are needed to manage the movement away from excessive defence expenditure.
- Powerful research, training and education strategies are needed to underpin industrial recovery.
- Given the high levels of imports, there is a clear case for the planning of trade, based on a managed exchange rate and import controls.

8.28 The Brandt Report called for both an expansion of the world economy and a transfer of resources to the poor countries of the South as the first steps in improving the lot of the population in both parts of the world. Sadly, the Governments of the world have paid only lip service to Brandt and have failed to institute the policies advocated. Even the much vaunted summit meeting of world leaders at Cancun (Mexico) in 1981 produced little positive action, despite assertions to the contrary from those such as the British Prime Minister. What is now required is a political initiative, aimed at making a reality of the Brandt proposals, on the same scale as the political movement that established the Marshall Plan in the post-war years. Until the political will is found there can be little hope of international economic reconstruction.

8.29 In conclusion, it must be acknowledged that the approach set out here is not free of problems. The reconciliation of industrial development in the Third World with employment security in the North is one such problem. The adjustment to new trade patterns and the establishment of a new international division of labour will pose great challenges, not least to trade unions, in all parts of the world. Nevertheless, the only alternative to facing up to these problems is to continue the present downward cycle. The approach set out in this chapter offers a route away from the despair such a course would create. It is also founded on the strong trade union principles of solving problems by negotiation, and without shifting the burden onto someone else's shoulders.

Key points

- The world economy is in crisis and the problems are getting worse.
- The policies of the UK and USA Governments are a major cause of the problems.
- Expansion in one country can run into difficulties if the rest of the world stays in recession; but coordinated expansion would help the world economy as a whole, and each country would gain proportionately more than through isolated action.
- Positive policies are needed to secure development in the Third World.

An important element is the provision of paid time off for union training for women trade unionists. The TUC Education Service has been expanding its provision of special bridging courses for women trade unionists, and is producing a new book in its education series, *Women Workers Education Book.*

9.24 Involving women more in trade unions is of central importance to the TUC's *economic* strategy because, as Chapter 5 makes clear, the TUC's proposals for a return to full employment are based on trade unionists taking part in decision making at all levels of the economy. The planning and industrial democracy framework proposed by the TUC will be responsible for decisions of great significance to women, and it is therefore essential that women play their full part. For example, decisions on public expenditure are to become much more open and subject to discussion, and it is crucial that unions press for significant real increases in resources going to childcare, health provision, child benefits, pensions, and training and educational programmes geared to women's needs. The agreed development plans – described in Chapter 5 – which are to be negotiated between companies, trade unions and Government could also become a vehicle for the introduction of positive action programmes.

9.25 Many of these special programmes and initiatives depend on trade unions for their negotiated introduction, development and monitoring. Others, such as positive action programmes, could also be encouraged by means of public sector contracts. But it is equally true that many of them need to be underpinned by legislation. Just as collective bargaining has done little to alter the relative distribution of income and wealth in this country, so too it has done little to end the inequalities suffered by women. Strengthening the Equal Pay and Sex Discrimination Acts and the Wages Council machinery, restoring schedule 11 of the Employment Protection Act, clarifying the status of homeworkers, improving maternity and paternity rights, ending discrimination in the tax and social security systems – these are dependent on or will be immeasurably helped by legislation. The TUC is also consulting unions on their views about a legislative approach to low pay and shorter working time. In the last analysis, ending the discrimination suffered by women will require political will as well as collective bargaining initiatives by trade unions.

Key points

- Women remain largely segregated in low paid jobs and sectors, and constitute the overwhelming majority of the low paid.
- The Government's economic policies have damaged women's interests by reducing job opportunities, cutting public services and driving down living standards.
- The TUC's economic programme will help women by providing more jobs, increasing expenditure on public services, providing comprehensive childcare facilities, attacking low pay and cutting working time.
- Positive action programmes in employment, education and training are major priorities.
- The TUC has launched collective bargaining initiatives and campaigns to help improve women's position – for example, in relation to part-time workers, homeworkers and maternity/paternity provisions.
- The TUC is monitoring unions' progress in improving representation of their women members.
- Men must take more responsibility for childcare and work in the home.
- Many of the policies described in this chapter would be helped by legislative backing.

Key points

- Inequality is a long-standing problem, but the massive rise in unemployment under the present Government has played a direct role in making inequality worse.
- Government cutbacks have resulted in a significant and sustained reduction in living standards for a major part of the working population.
- In contrast to the unemployed and low paid, the rich have been getting richer. Disparities in income are reinforced by the extreme inequalities in the ownership of personal wealth.
- The TUC's five-year programme for the economy is matched by a comprehensive package of measures to promote equality in terms of job creation, pay, the quality of working life and reductions in working time.
- Priority must also be given to people who are unable to support themselves out of employment income, and this requires a renewed emphasis on improving the social wage.

UNEMPLOYMENT: THE MYTHS THE ALTERNATIVE

This 4 page report summarises the key points from the TUC's *Economic Review 1983*. It is about unemployment – the causes and the cures. It is also about how we pull the British economy out of slump and towards growth.

Britain's slump and mass unemployment are a disgrace and an indictment of the Government. But mass unemployment is not inevitable and never has been. Alternative policies started now could cut the dole queues by 570,000 in a year, and get unemployment below 1 million within five years – *without* the side effects the Government predicts.

Below we provide answers to some of the most important questions and myths about the slump.

1 'Things are not that bad'

Since the Government took office in 1979 Britain has suffered an economic collapse.

Unemployment has reached the highest level in Britain's history: by the beginning of 1983 it was 2 million higher than May 1979. In other words unemployment has risen by over 1,500 for every day the Government has been in office.

National output – the total amount produced in the economy – has actually dropped, by 6.2 per cent. Prices have risen by 52 per cent and there are 1.5 million *more* people living below the 'poverty line'.

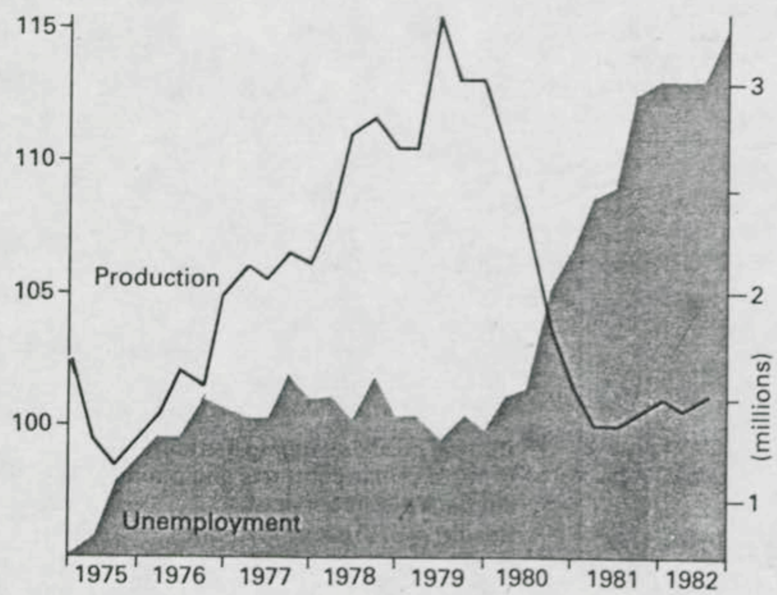
Bankruptcies have reached record levels (5,151 in 1981 alone) and, for the first time in peacetime in over 100 years, we started importing more manufactured goods than we export.

Figure 1 shows what has happened to:

- unemployment; and
- production.

The picture could hardly be clearer. In both cases, 1979 was the turning point – with unemployment rising out of control and production starting to nosedive.

Figure 1 The record of decline



Note: Unemployment is total registered unemployment (including school leavers) UK.
Note: Production is index of industrial production (all industries), 1975 = 100.
Source: CSO.

2 'Other countries have the same problems'

Nobody is denying there is a recession in the world economy. What the Government has to explain is why Britain is doing so much *worse* than its main competitors.

Since 1979, no other major economy has suffered such a drop in industrial production and jobs. Of the seven biggest economies in the second half of 1982, Britain had the worst unemployment rate along with Canada.

Of the ten EEC states, only Belgium had a higher unemployment rate than Britain. Our industrial production has slumped seven times faster than the OECD average since mid-1979. Over the same period Britain had by far the worst record on overall output of *all* the 24 OECD member states. While output actually fell here and in the USA, it rose in every other country.

3 'At least we're beating inflation'

The Government is obsessed with the need to slow the price-rise (inflation) rate, apparently at whatever cost to the economy.

On the *plus* side, the inflation rate by December 1982 was 5 points lower than when the Government took office.

Now look at the *minus* side:

- Prices went up 52 per cent in the Government's first 45 months in office.
- For 34 out of those 45 months, the inflation rate was higher than the one they inherited in 1979.
- Each 1 per cent drop in the Retail Prices Index has cost us 400,000 more people unemployed (on that basis, zero inflation could mean 5 million plus unemployed).

No one has ever denied that inflation will come down if the economy is savagely deflated as Britain's has been. But the squeeze the Government have used to choke off price rises has all but crippled the economy.

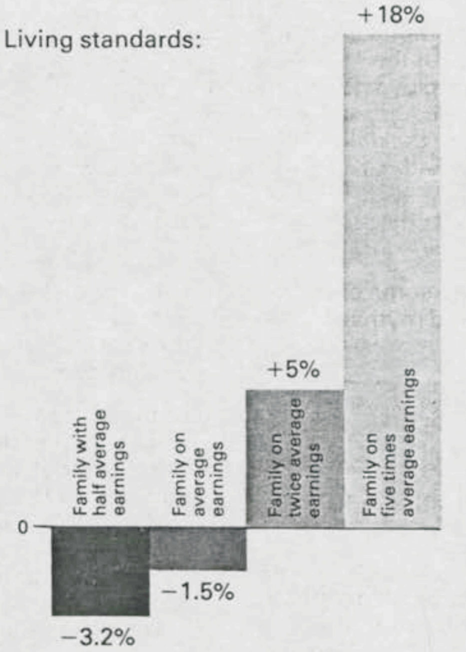
4 'At least we're paying less tax'

The Government's election promise was to cut the amount we pay in tax. Exactly the opposite has happened. The Government has actually *increased* taxation – the amount it takes from earnings through income tax, VAT, national insurance and so on.

Not that the effect has been spread evenly. When it comes to living standards, the facts show that the less you earn, the worse you've done since 1979. This is because the Government have seen to it that tax changes favour the better off. Figure 2 gives some examples:

Figure 2 Inequality: the record

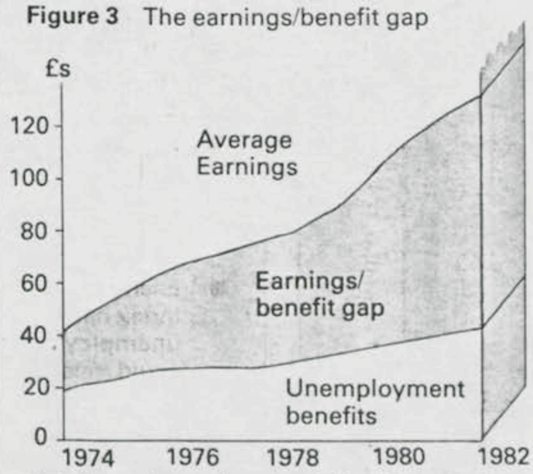
Poverty: 1.5 million more people below the poverty line than in 1979



Note: Change in real weekly net income for a married couple with two children.
Source: Hansard.

The unemployed are getting poorer. Figure 3 shows how the gap between unemployment benefit and average pay has widened since 1979.

Figure 3 The earnings/benefit gap



Note: Unemployment benefit calculated for married couple with two children and includes child benefit.
Source: Social Security Statistics/DE *Gazette*.

5 'A recovery is on the way'

The Government's forecasting record is the best possible proof of their incompetence. Figure 4 shows why. It contrasts Government's predictions of recovery with the steadily rising unemployment graph.

There is no reason to think the latest batch of 'recovery' predictions are right either. For example:

- company failures were up by 39 per cent in 1982.
- another 625,000 jobs were lost in the last 12 months.
- employment in the key construction sector last year dropped to a million for the first time since 1929.
- even the Treasury expects that in 1983 our balance of payments surplus will disappear – and that's including all the income from North Sea oil.

6 'Unemployment is not the Government's fault'

The Government are directly to blame for the level of unemployment in Britain. Mass unemployment is *not* the fault of:

World Recession Our earlier figures show that Britain's jobs record is far worse than our competitors.

High wages Of the 17 largest producers in the western world, Britain ranks fourteenth in terms of labour costs. Only Spain, Ireland and Greece are lower.

New technology The slump has meant Britain is innovating more slowly than its competitors.

Immigration Virtually every year, more people emigrate than come to live here. Only ten years ago our economy could support 24 million workers – recession hits job opportunities for everyone.

Women going out to work Research shows that virtually none of the rise in female employment has been at the expense of men's jobs. Over half a million women's jobs have disappeared since 1979 and over 1.25 million women cannot now get a job.

What *has* pushed up unemployment is the Government's monetarist policies. *Key measures the Government have taken to curb the 'money supply' and (supposedly) inflation are directly to blame for Britain's slump and mass unemployment:*

Cutting public spending has starved countless firms of public contracts and purchases, and cut back public services.
Result: more unemployment.

Higher interest rates have forced firms to cut back on investment and production; pushed the value of the £ too high; restricted pay settlements and cut purchasing power.
Result: more unemployment.

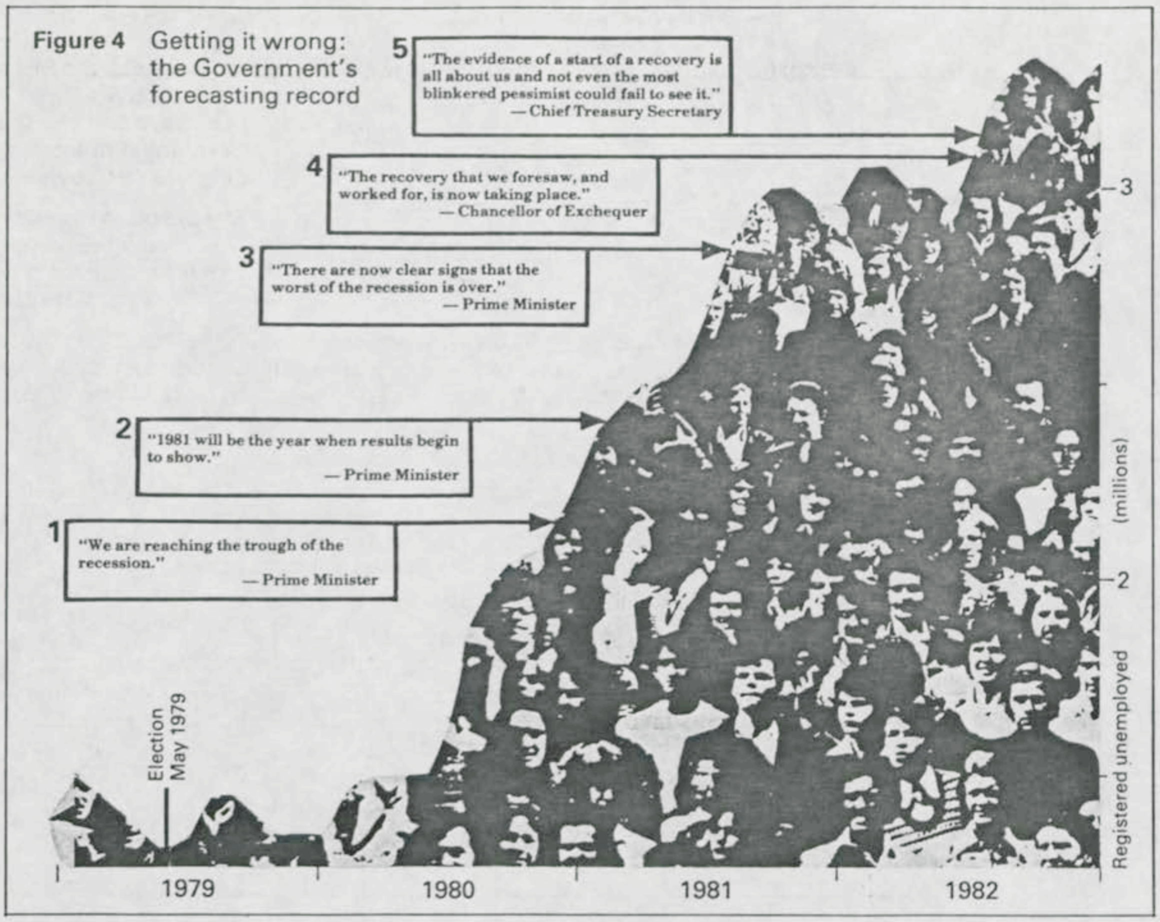


Figure 4 Getting it wrong: the Government's forecasting record

High Exchange Rate has made exports more expensive so fewer sales and less production for exporters. Meanwhile, cheaper imports take bigger share of home markets.

Result: more unemployment.

Abolition of exchange controls allows flood of funds out of UK into foreign shares and businesses, less funds for UK industries.

Result: more unemployment.

THE TUC ALTERNATIVE

The Government have now had four years to make their economic theories work. All that has happened is that Britain's economic decline has turned into a collapse.

The TUC alternative would:

- cut unemployment by over half a million after a year.
- get unemployment down below 1 million after a five-year expansion programme.
- bring in a new democratic framework for planning the way industry develops.
- improve the public and social services the community relies on.
- tackle gross inequalities in our society.
- lay the basis for long-term economic growth.

The first step is to expand, or 'reflate', the economy.

How to expand the economy

If the Government have proved one thing over the last four years, it is that attacking inflation at the expense of everything else does not produce economic growth. It produces mass unemployment.

The alternative is for Government to use the community's wealth as a motor – to get the economy moving again.

In *Action Now* the chart below shows how and where the boost should come and how it must be followed up by a *Five-Year Expansion Plan*.

The immediate boost would come from:

- jobs directly covered by the package (in *eg* building, engineering, public services).
- spin-off jobs in related and supplying industries.
- more people with jobs and a decent income – so more demand for the goods and services industry provides.
- lower prices after the cut in VAT – so more trade in goods and services.

Even the Government agree that a public spending push like this would create jobs. The Government's argument is that we can't afford it. As with nearly all their other economic judgments, the Government are wrong.

ECON POL

10 DOWNING STREET

27 January, 1983.

I refer to your circular dated 26 January concerning Budget Publications and Supply Estimates for 1983. Our requirements are as follows:-

2 copies of F.S.B.R.

A Logan
Duty Clerk

Mrs. H. Tyre,
Library,
HM Treasury.

10

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

PRIME MINISTER

THE 1983 BUDGET

We spoke on 20 January about the 3 February Cabinet, and I now enclose the paper which I plan to circulate. It is very similar to the one I circulated last year - C(82)1 - which produced a rather successful discussion on 28 January.

2. I am sure that we should again resist any pressure for changes in the monetary and fiscal framework which we have established. Sustaining present policy is right, both economically and politically.

3. My present thinking therefore is that:-

a. for the monetary aggregates we should, as envisaged in last year's Red Book, reduce the target range from this year's 8-12 per cent to 7-11 per cent for 1983-84. Our policy in respect of the exchange rate should remain unchanged (though in periods of weakness due to political factors, we should not allow interest rates to rise.)

b. the 1983-84 PSBR should certainly not be much higher than the estimated 1982-83 outturn, now put at £8 billion: indeed we have spoken of the case for showing a lower figure next year. We published a figure of £8 billion (2¾ per cent of GDP) for 1983-84 in the Autumn Statement. Our latest forecast (before any changes beyond revalorisation) is some £6 billion.

4. This would give us room for tax cuts of some £1.5 to £2 billion, depending on whether we in the end go for a PSBR of £7.5 or £8 billion. It is far too soon to settle this; indeed it is important to stress that we are still at an early stage: the picture, and the figures, may change a lot before 15 March. In order to retain freedom of manoeuvre, my Cabinet paper does not mention the £6 billion and £2 billion figures.

5. I should prefer that colleagues concentrate their advice on how best we should target our fiscal measures. As the draft Cabinet paper says, the fall in the exchange rate has to some extent changed the balance of claims for relief as between persons and companies. Given the fall in interest rates over the last year, and the reductions in NIS which we announced in the autumn, it could be argued that the bulk of tax reductions in March should go to raising income tax thresholds. Within a total fiscal adjustment of £2 billion, there may be scope for raising them some 8 percentage points over the Rooker-Wise revalorisation, giving around 13½ percentage points in all. This would restore allowances to roughly the same percentage of average earnings as in 1978-79.

6. But there are also strong pressures for further help for companies; and it is of course true that substantial problems of profitability and competitiveness remain. And we do want to encourage output, as well as demand. Moreover, a Budget that contained major tax reductions, but none for companies, would be out of line with what we have tried to do in recent years, and could be misconstrued as electorally-motivated.

7. I am at present inclined to helping both individuals and companies. Action on industrial rates is ruled out for the present largely on grounds of practicality. A further reduction in NIS, or indeed its abolition, is widely sought; and if there is room some small move - say a further half per cent reduction -

would certainly be desirable. Conceivably there may be a stronger case for a reduction in the Corporation Tax rate, from 52 per cent to, say, 50 per cent.

8. The indirect taxes ought I believe to be revalorised in line with inflation in most cases. However I shall want to look carefully at the individual components; and, as you have asked, will look in particular at the petrol and derv duties. But the real price of petrol at the pumps has in fact dropped since the last Budget, and a failure to revalorise these duties would cost some £0.25 billion.

9. I am also working on a range of possible measures to promote enterprise and small firms, to encourage wider share ownership, and to stimulate technology and innovation. I envisage further concessions on oil taxation as an encouragement to North Sea development. And I am looking again at the ceiling on mortgage interest relief.

10. The questions posed in my Cabinet paper are designed to give colleagues an opportunity to express their views on the broad strategic issues, and on the right blend of fiscal change. What we must of course avoid on 3 February is any attempt to reach precise quantified decisions: the whole picture could change sharply as a result of major oil price, or exchange rate, movements. I shall wish to keep you in the picture throughout; but I would not want to have to go back to Cabinet to seek the reversal of decisions reached too soon, too precisely, and too collectively.

11. We might perhaps discuss this, and the draft paper, at our meeting on 27 January.

GH

(G.H.)

26 January 1983

Budget - SECRET

9

PRIME MINISTER

1983 BUDGET: CHANCELLOR'S MEMORANDUM OF 26 JANUARY

The Chancellor's proposals are very similar to those which I have discussed with Peter Middleton. On the whole I think they are on the right lines. I have one or two reservations, mostly of a minor kind.

1. I would prefer the lower PSBR £7-7½bn for reasons I have sketched before.

2. I think this is an opportunity to get rid of the investment income surcharge, especially when we are at the same time proposing to do a super Rooker-Wise. It is doubtful whether we shall have such a good opportunity again for a year or so.

3. I think there is a much more powerful case for reducing Corporation Tax from 52 per cent to 50 per cent, than for yet again decreasing the NIS. A decrease in Corporation Tax will go to profitable companies, whereas a fall in NIS will go to all corporations, profitable or loss-making. We believe in the profit motive.

4. On the monetary aggregates, I think the Chancellor is about right. I would be inclined to put them at 6-10%, but I would not regard it as a critical argument to win.

In the Cabinet paper I do very much welcome the point the Chancellor makes in para 13, where he says that there is very little difference between, for example, reducing the national insurance charge paid by employees and that paid by employers. In the medium term there is really no difference at all.

AW

26 January 1983

ALAN WALTERS

SECRET

DUTY CLERK
10 DOWNING ST

BUDGET PUBLICATIONS AND SUPPLY ESTIMATES 1983

Last year the Library supplied you with the following publications:

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Finance Bill	-
Finance Bill Votes and Proceedings	-
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Finance Act	-
FSBR	~~1~~ 2

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Would you please let us know by Friday 4 February whether you need the same number of copies as last year or whether you are able to make some economies.

J H WORMALD
Librarian
26 January 1983

Replies should be addressed to Mrs H Tyre, Library, 50A/4, x7117.

20

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU
Telephone 01-379 7400
Telex 21332

Director-General
Sir Terence Beckett CBE

Secretary
Denis Jackson

CBI CONFEDERATION OF BRITISH INDUSTRY

26 January 1983

F E R Butler Esq
Prime Minister's Office
10 Downing Street
London SW1

Dear Robin,

I enclose a copy of the CBI's Budget Representations to the Chancellor which have been approved by CBI Council.

Yours ever,

John

J T Caff
Economic Director

Econ Pol

Confederation of British Industry
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103 New Oxford Street
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CBI CONFEDERATION OF BRITISH INDUSTRY

26 January 1983

Michael Scholar Esq
Prime Minister's Office
10 Downing Street
London SW1

Dear Michael,

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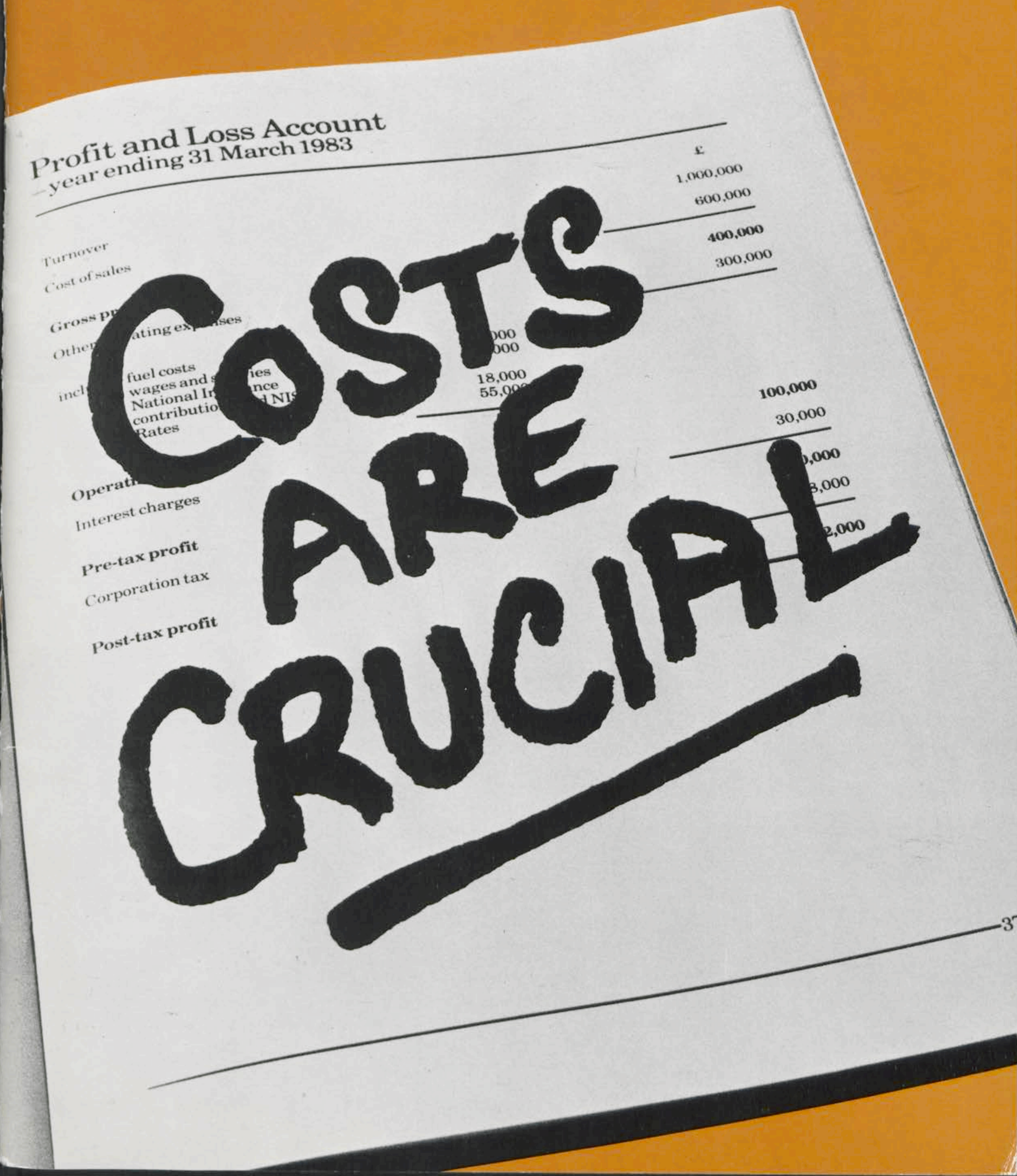
Yours ever,
Jon

J T Caff
Economic Director

Budget Representations to the Chancellor January 1983

CBI



BUDGET REPRESENTATIONS
TO THE CHANCELLOR
JANUARY 1983

CBI

Confederation of British Industry
Centre Point
103 New Oxford Street
London WC1A 1DU

January 1983

£3.00

CONTENTS

I MAIN REPRESENTATIONS

This year's Budget must make Britain more competitive. The emphasis therefore must be on reducing business costs to ensure that a larger share of demand is satisfied from home output.

The world outlook is uncertain and no more than a modest recovery seems likely. We are still some 20% less competitive than in 1975, despite the helpful measures announced in the 1982 Budget and Autumn Statement. In depressed world markets, Britain faces intense pressure from overseas competitors.

Profitability is essential for investment. With competitiveness it holds the key to our ability to satisfy future demand and create jobs. Industry's profitability has fallen sharply in the last decade, and to stay in business firms have been forced to cut investment, stocks and manpower. The CBI proposals are aimed at reversing this process as quickly as possible.

I.1 The Proposed Budget

Our main recommendations for the 1983 Budget are:

* **ABOLITION OF THE NATIONAL INSURANCE SURCHARGE (Section III.2).**

* **LOWER BUSINESS RATES (Section V): a 15% derating of business premises, the abolition of empty property rating, and 'mothball' relief for rates on parts of properties temporarily unused, financed initially by central government grant. In addition, a ceiling should be imposed on business rate increases.**

* **ADDITIONAL CAPITAL EXPENDITURE: increased provision for investment and reduced underspending on capital projects in the public sector (Section IV.2); and, for the private sector, the reintroduction of the Small Engineering Firms Investment Scheme (SEFIS) (Section IV.3), improvements in Corporation Tax (Section III.7) and measures to encourage research and development (Section IV.3).**

* **MORE COMPETITIVE FUEL AND ENERGY COSTS FOR BUSINESS (Section IV.4).**

* **INDEXATION OF PERSONAL TAX ALLOWANCES AND BANDS (Section III.3).**

Other important recommendations but with relatively lower costs include: tax changes to encourage equity investment in smaller firms, for example through Small Firms Investment Companies (SFICs) (Section III.12); measures to reduce the disincentive effects of capital taxation (Section III.5); and certain special measures to reduce unemployment (Section IV.5).

I.2 Financing the Recommendations

The costs of our proposals and ways of financing them are set out in Table I.1.

* **We reject the option of financing our proposals by raising taxation elsewhere as inconsistent with our objectives of raising output, improving incentives and reducing inflation.**

TABLE I.1

EXCHEQUER COST OF THE RECOMMENDATIONS

	£ billion 1983/84 prices 1983/84	1984/85
Abolition of National Insurance Surcharge	1.3	1.5
Lower Business Rates	1.0	1.2
Public Sector Capital Expenditure	0.5	1.5
Other Measures to raise Investment[1]	0.2	0.6
Reductions in Fuel and Energy Costs	0.2	0.2
Indexation of Personal Tax Allowances and Bands[2]	0.9	1.2
Special Employment Measures[3]	0.1	0.2
Other Tax Changes[4]	0.1	0.3
Government Expenditure Economies[5]	-0.6	-1.6
Feedback Effects[6]	-0.8	-2.4
Effect on Public Sector Borrowing Requirement[7]	2.9	2.7
Effect on Public Sector Borrowing Requirement on Treasury Definition[8]	2.6	2.2

1 Changes in Corporation Tax, Reintroduction of the Small Engineering Firms Investment Scheme, R & D measures.

2 Costing assumes indexation by 6% to compensate for 1982 inflation. The additional cost of indexation to restore real value of allowances in 1983/84 to 1978/79 levels would be £0.5 billion in 1983/84 and £0.7 billion in 1984/85.

3 The costings allow for direct savings from reduced benefit payments. Effects on PSBR from higher activity, for example through increased tax receipts, are included in the feedback effect.

4 Mainly Small Firms Investment Companies, Capital Transfer Tax and Capital Gains Tax changes.

5 See Table IV.1: manpower cost economies and reduced contingency reserve.

6 Feedback effects reflect the estimated impact of these recommendations on activity levels. Their impact is mainly to reduce the PSBR as higher activity generates more tax revenue and reduces the number receiving unemployment benefit in comparison with what otherwise would have happened.

7 In comparison with a definition of unchanged policies that assumes no indexation of tax allowances etc.

8 In comparison with a definition of unchanged policies that assumes indexation of tax allowances etc and revalorisation of excise duties.

* **We see scope for reducing government current expenditure and recommend that our proposals be financed partly from this source (Section IV).**

We anticipate a substantial undershoot in the Public Sector Borrowing Requirement (PSBR) for 1982/83. Even on unchanged policies, after taking account of the measures announced in the Autumn Statement, an undershoot in 1983/84 seems likely. We therefore believe that the scope for fiscal adjustment will be greater than the £1 billion tentatively assumed in the Autumn Statement.

The CBI welcomed the Chancellor's statement on the operation of monetary policy: "Flexibility is essential. But flexibility has to be achieved without a drift into laxity"[1]. We estimate that our recommendations would lead to a PSBR of about £9 billion, 3% of GDP. We believe that this would be consistent with monetary restraint and, provided that external circumstances permit, with further falls in interest rates (Section II) while encouraging a recovery in activity.

In our income tax recommendations we have assumed indexation to compensate for the erosion of allowances and bands through inflation during 1982. Should scope remain after the implementation of the other recommendations, we would support a further modest increase in these allowances to compensate for falls in their real value through inflation in earlier years.

I.3 The Effects of the Recommendations

Our measures are designed to improve competitiveness, profitability and to raise investment. They would:[2]

* **Assist exports and hold back imports;**
* **Help achieve lower inflation;**
* **Boost activity; and thus**
* **Generate more jobs.**

---

1 Speech by the Chancellor of the Exchequer at the Lord Mayor's Banquet for the Bankers and Merchants of the City of London, October 1982.

2 Annex 2 shows these effects in more detail.

II THE ECONOMIC BACKGROUND

This section shows the need for action by Government to support the progress made by business in improving competitiveness and looks at the financial scope for doing so. The reasoning draws on the analysis of the economic situation and prospects in Annex 2.

The rate of inflation has fallen significantly in the past year. But output and employment remain depressed, with profitability, a key to future growth, at historically low levels. This points to the need for measures to raise activity without risking the resurgence of inflation.

II.1 The World Economy

Our proposals need to be set in the context of a sluggish world economy. Both world trade and, probably, output in the industrialised countries fell in 1982. We forecast only a slow recovery in 1983 but this is still at risk.[1] The weakness of the international economy in 1982 has contributed to two further problems; the growth of protectionism and the debt problems of certain developing countries.

* **As a major trading economy the UK has a direct interest in international action to deal with these problems as well as agreement by the governments of the major industrial nations on co-ordinated policies for economic recovery without exacerbating inflation.**

II.2 Competitiveness

Given the international prospects, UK producers face intense competition. Our recommendations are therefore designed to increase demand in areas where it is likely to be met from domestic production and to improve UK producers' shares of domestic and overseas markets.

* **We believe that the best way of raising domestic activity while minimising the risk of a resurgence of inflation is to improve competitiveness by reducing business costs.**

This is highlighted by the experience of British business in domestic and overseas markets.

Imports of manufactures have risen from roughly 17% of the home market for manufactures in 1970 to 25% in 1980 and over 28% in the first half of 1982; while British manufacturers selling abroad have seen their share of the exports of the main industrial nations fall from over 10% in 1970 and in 1980 to 8-8½% in the first three quarters of 1982. These developments have resulted in a serious loss of business and jobs.

Other indicators of competitiveness show a similar picture. UK relative unit labour costs arestill around 20% higher than in 1975, a typical post-war year for competitiveness. Again, in 1982, the CBI Industrial Trends Surveys showed on average nearly 70% of manufacturing exporters citing price

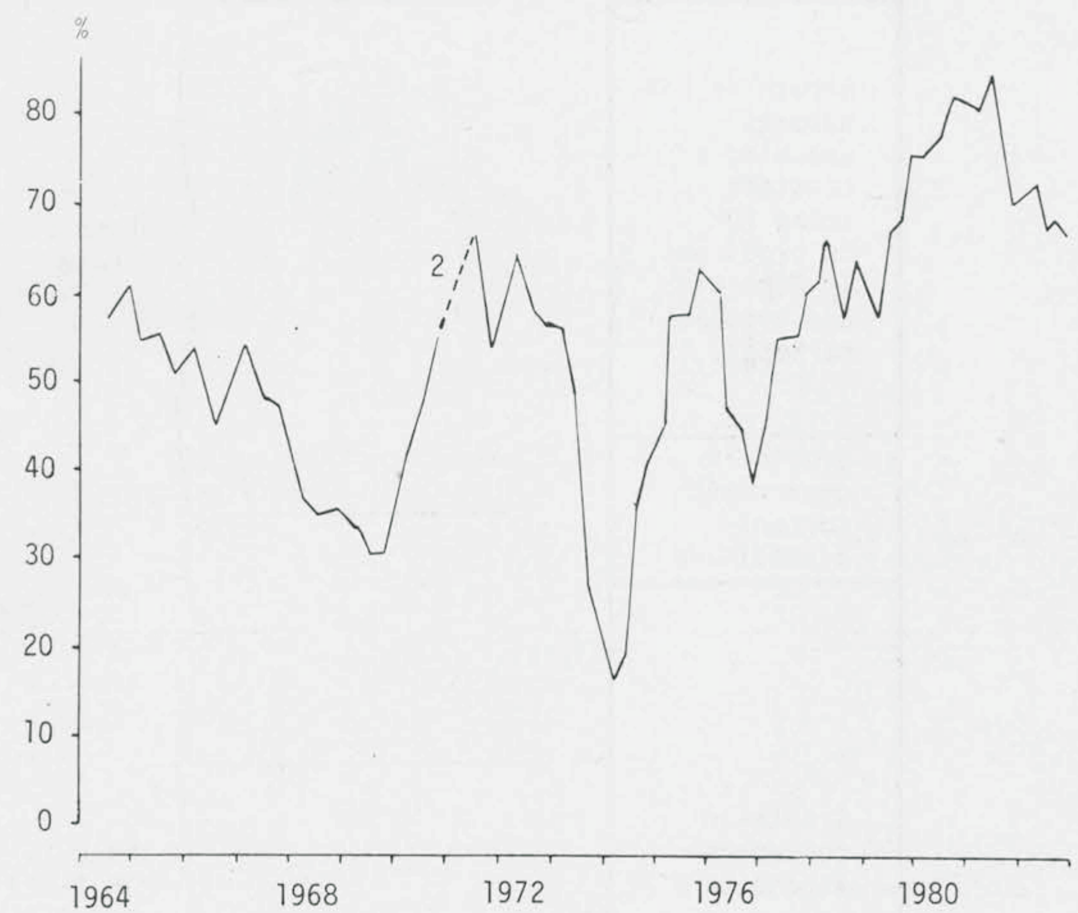
---

1 For a detailed discussion, see CBI Economic Situation Report, November 1982, pp 36-42.

competition as an important factor restricting their exports. Chart II.1 shows how high this proportion is in comparison with previous years.

CHART II.1

MANUFACTURERS' PRICE COMPETITIVENESS[1]



1. Percentage of respondents to CBI Industrial Trends Survey who consider that their export prices (compared with those of overseas competitors) limit their ability to obtain export orders over the next four months.

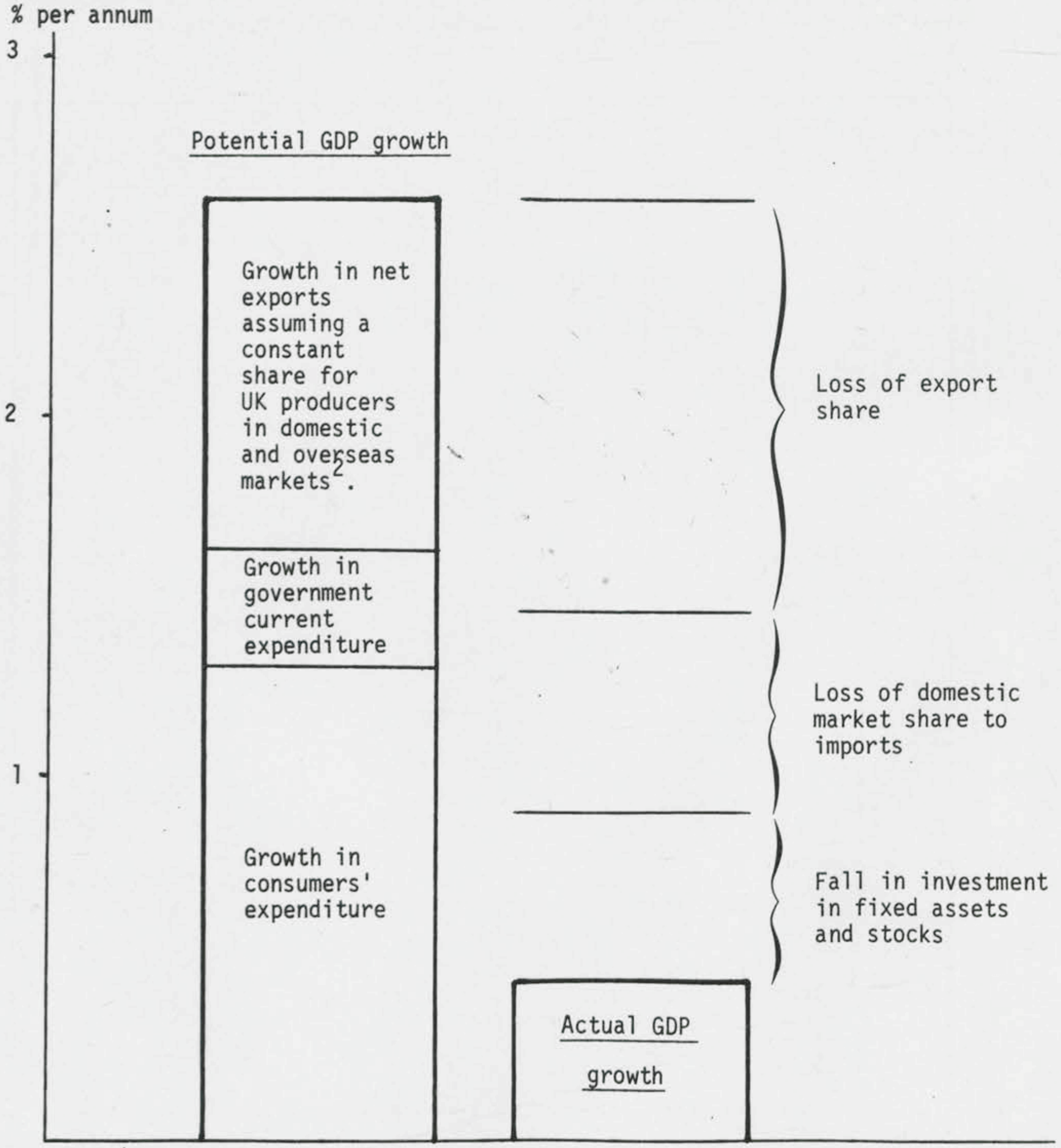
2 Survey 40 (February 1971) abandoned because of the postal strike.

Source: CBI Industrial Trends Survey

Chart II.2 shows, in a different way, the need for improved competitiveness to raise activity levels. The left hand column shows that between 1977 and 1982, the sum of the rises in UK consumers' demand, government current expenditure and demand in our export markets provided a stimulus to GDP growth worth 2½% per annum. However, because of our loss of share of both export and domestic markets, both directly related to declining competitiveness, and to a lesser extent, because of cuts in investment in

CHART II.2

POTENTIAL AND ACTUAL GDP GROWTH 1977-82[1]



1. Potential growth is annual percentage rise in GDP at 1975 prices that would have occurred had the UK held its share of domestic and overseas markets and maintained its levels of investment over the period 1977-82. Actual growth is measured on the expenditure basis at market prices for statistical consistency. GDP growth over this period measured on an output basis and at factor cost was about 0.1% per annum.
2. For constant export share, UK exports of goods and services are assumed to grow in line with OECD exports. For constant import share, imports of goods and services are assumed to grow in line with UK final expenditure.

Sources: OECD exports: OECD Economic Outlook, December 1982
Other figures: CSO, CBI estimates

both fixed assets and stocks, the actual growth in GDP over the period was only ½% per annum (and excluding North Sea Oil, GDP fell by nearly ½% per annum). This is shown in the right hand column.

To succeed in holding and, where possible, regaining market shares, it is particularly important that UK firms are competitive in their products, marketing and costs. Much of this must be the responsibility of businesses themselves but the government can help or hinder. Our proposals for the Budget show the best way of backing the efforts of businesses to become more competitive, by reducing those costs which are beyond their control. At the same time, action is also necessary to improve the prospects for pay and productivity.

Pay and Productivity

An encouraging feature of the last two years of pay bargaining has been the much more realistic level of settlements. In the 1980/81 and 1981/82 pay rounds the underlying rates of increase of earnings were 11% and 9% respectively, after running at 20% in 1979/80. There have been a number of factors responsible for this fall. One has been the growing realisation that a continuation of the excessive settlement levels that characterised pay bargaining in 1979/80 would be catastrophic.

However, in the current pay bargaining context, there is no cause for complacency. In most of our major competitor countries the average level of settlements has been falling too. With income from employment representing four-fifths of UK domestic incomes, failure to moderate settlements would lead to uncompetitive price increases or a renewed collapse of profit margins or both.

* **It is therefore essential that in the public sector wage costs are held down. Private sector pay negotiators for their part must scale down their earnings expectations to ensure improved competitiveness, bearing in mind the lower underlying rate of inflation.**

Real incomes of those in work have held up well in the present recession. Thus the costs of recession have been borne almost entirely by business, in reduced profitability and bankruptcies, and by those becoming unemployed. A greater measure of restraint in the pay demands of those in work would make it correspondingly easier to 'price back into jobs' those out of work.

The gains in productivity of 1981 and 1982 have been impressive although two qualifications are needed. First, a considerable part of the rise has been merely a recovery from the previous sharp fall in 1979 and 1980. Second, distinguishing cyclical movements of productivity from changes in long run trend rates is especially difficult with the economy still in deep recession. It seems that some of the spectacular gains in productivity recorded in 1981 and 1982 reflect only the shutting down of the least productive plants and processes rather than improved efficiency in the remaining operations. Given the special factors that have applied in the past two years it is essential that industry renews its drive for higher efficiency if the rate of productivity growth is to be maintained. It is worth noting, however, that many industrialists believe that they could achieve considerably better levels of productivity if activity levels were higher, permitting fuller use of capacity.[1]

II.3 Monetary Policy, Public Borrowing and Interest Rates

The previous section has shown the need for measures to improve competitiveness. This section looks at the financial scope for Government action.

The Chancellor has indicated recently that monetary policy will continue on the lines set out in the Medium Term Financial Strategy.[1] At the same time he pointed out that the targets covered more than one monetary variable and that firmness was not inconsistent with a flexible interpretation of the individual targets, using other relevant information, such as movements in asset prices and exchange rates, to assess the position.

We have indicated that our proposals would lead to a modest increase in public borrowing in comparison with what would otherwise have occurred. In assessing the interest rate consequences of this additional borrowing in the context of the monetary targets we note:

Firstly, the overall level of activity in the economy, both actual and forecast, needs to be taken into account. Although the Medium Term Financial Strategy set out in the 1982 Budget Statement shows the PSBR falling as a percentage of money GDP by ¾% each year the text points out that 'decisions about the appropriate size of the PSBR in any particular year will be taken in the normal way at Budget time'.[2] In previous Budgets, consistent with the Medium Term Financial Strategy, PSBR targets have been raised, when necessary, to take account of greater than expected falls in output. Demand, real profitability and employment can now be seen to be substantially worse than expected at the time of the 1982 Budget. Conversely the inflation performance has been substantially better. As a result, the growth of money GDP has been significantly lower than was expected at the time of last year's Budget. This relatively slower growth is expected to continue into 1983 and should leave room within the overall thrust of firm monetary policy for measures to boost activity.

Moreover much of the Government's present need to borrow reflects the impact of the continuing recession on tax revenues and benefits payments. The 'high employment' PSBR, adjusted to exclude this impact, would on any such estimate of its size for 1982/83 be very greatly reduced.

These factors would be enough on their own for a PSBR outturn for 1983/84 that was somewhat higher than that envisaged at the time of the 1982 Budget yet remaining consistent with the overall aims of the Government's anti-inflation strategy.

Secondly, the proposed level of public sector borrowing as a percentage of GDP would still remain low in comparison both with the recent past in the UK and with other industrialised countries.

---

1 Survey evidence supporting the anecdotal information received by the CBI is contained in National Institute Economic Review, August 1982.

2 Speech at the Lord Mayor's Banquet, October 1982.

Chart II.3 shows how public sector borrowing as a proportion of GDP has fallen sharply from the excessive levels of the mid-1970s. For 1983/84 the PSBR of about £9 billion or 3% of GDP implied by our proposals would remain far below these levels. In addition 1981/82 was characterised by undershooting, with the actual PSBR being £2 billion below projected levels. It is likely that this may again be the case in 1982/83 with the PSBR outturn being perhaps as much as £2 billion below the £9½ billion projected in the March 1982 Budget.

CHART II.3

PSBR AS PERCENTAGE OF GDP[1]

1. PSBR as percentage of GDP at market prices.

Sources: 1973/74 to 1981/82, Financial Statistics and CSO; 1982/83 CBI estimate, assuming PSBR as announced in 1982 Budget; 1983/84 CBI forecasts, assuming implementation of CBI proposals.

Meanwhile, the OECD figures in Chart II.4 show public borrowing in the UK lower in 1982 than in any other major industrialised country[1].

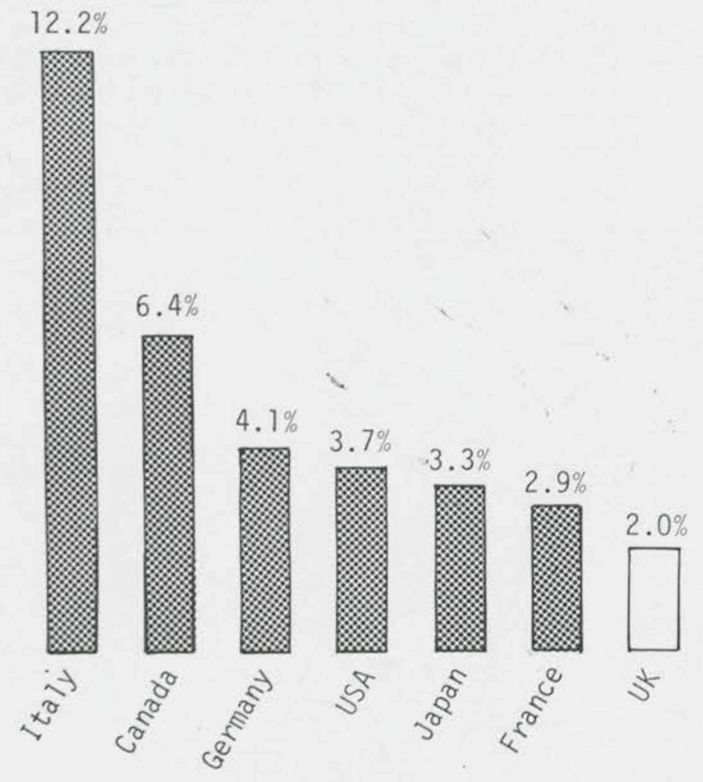
Thirdly, in assessing the financial consequences of a given level of government borrowing not only the absolute size but also its composition is relevant.

---

1 The figures refer to a somewhat narrower concept of public borrowing than our PSBR, but are on a comparable basis; and indeed they are more meaningful than would be a comparison of PSBRs, partly because of the differing degree of nationalisation in the various countries.

CHART II.4

INTERNATIONAL COMPARISON OF GOVERNMENT BORROWING[1]



1. General Government Deficit as percentage of GDP/GNP at market prices, 1982.

Source: OECD Economic Outlook, December 1982

The effect of a change in the level of public borrowing on interest rates and/or the money supply will depend on the effects on 'real' and 'financial' variables with which it is associated and on whether or not it is combined with economic policies encouraging financial confidence. For example a rise in public borrowing which reduces the need for companies to borrow from the banks might have little net effect on interest rates or on the money supply. Equally, a given PSBR resulting from measures to improve competitiveness might, through the effect on financial confidence of a potentially better balance of payments, be expected to permit lower interest rates than a PSBR of the same size generated through measures boosting consumers' expenditure and hence imports.

The proposals which we have put forward would, if implemented, improve the quality of the PSBR through their beneficial effects on competitivness and hence the balance of payments, their effect in reducing inflationary expectations, and their effect in reducing, at least in the short term, company borrowing from the banks. In turn they would reinforce the confidence of the financial markets in the Government's determination to deal with the fundamental problem of competitiveness.

Fourthly, we believe that our PSBR proposals are not inconsistent with further reductions in interest rates, as explained below.

The balance of risks

Deciding on the appropriate target to be aimed at for public borrowing involves a judgement about the relative risks from PSBR levels that are too high or too low. Too restrictive a PSBR would involve undue risks, given the weak state of the domestic economy and the depressed outlook for international trade, of further cuts in capacity and increases in unemployment. Too high a level of borrowing might lead to an inflationary relaxation of monetary control or higher interest rates. A level of borrowing that was so high as to lead to a loss of financial confidence in the Government's fiscal stance could lead to particularly adverse consequences for interest rates.

We judge that the level of borrowing implied by our proposals, especially when account is taken of the nature of these proposals, would involve little risk of generating a loss of financial confidence, while a lower PSBR would be too restrictive.

Interest Rates

Bank base rates fell from 14½% at the beginning of 1982 to a low point of 9% in early November. Around the turn of the year, some of this fall was reversed in response to pressure on the exchange rate, leaving base rates at 11% in mid-January. Each 1% point fall in UK interest rates is worth £270 million a year to industrial and commercial companies.

* **It is therefore important that we see a return to falling interest rates as soon as possible.**

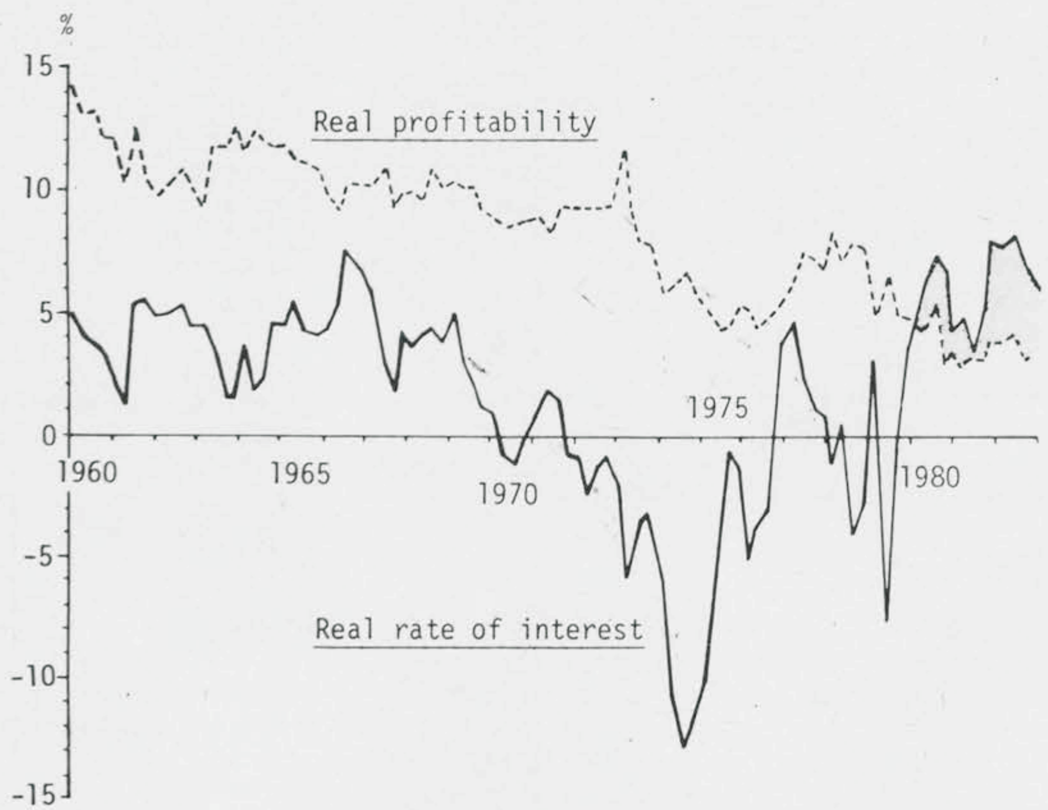
In real terms and in relation to profitability these rates are still very high (see chart II.5) imposing a heavy burden on business.

In the first 10 months covered by the 1982/83 monetary targets, monetary growth was within the 8 to 12% annual growth range set as a target in the Medium Term Financial Strategy. The effects of rapid growth in bank lending have been compensated for by 'overfunding' the PSBR. On a seasonally adjusted basis, public sector debt sales exceeded the public sector borrowing requirement by £2.7 billion in the first 10 months of the monetary target period.

In 1983/84 bank lending to the private sector is likely to fall as banks cut their mortgage lending and in response to the falls in inflation that have taken place. The CBI proposals would, in addition, reduce company borrowing from banks both as a direct result of higher profitability and through the effects of higher profitability on share issues. The level of public borrowing implied by our proposals should, therefore, be compatible with continued monetary restraint and falling interest rates. However, the prospects for interest rates will depend not only on domestic monetary influences but also on international factors, particularly US interest rates.

CHART II.5

REAL RATE OF INTEREST[1] & REAL RATE OF PROFITABILITY[2]



1. Base rate + 2% less inflation rate (RPI) over subsequent 12 months.
2. Gross trading profits plus rent minus stock appreciation and capital consumption for industrial and commercial companies excluding North Sea activities as a percentage of capital employed.

Source: CBI estimates based on Bank of England and CSO figures.

III TAXATION

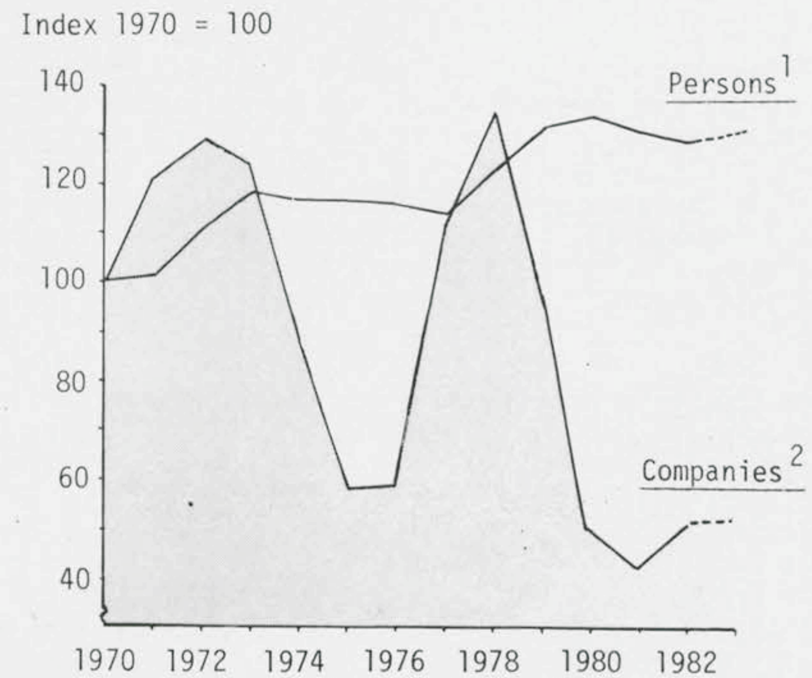
This section sets out our overall taxation objectives and specific recommendations for the 1983 Budget.

It is important to shift towards a balance between business and personal taxation which will increase our competitiveness in world markets and reduce import penetration.

Chart III.1 shows how post-tax real incomes of businesses have fallen dramatically and are likely to remain low in 1983, while total real income of persons has held up remarkably well, despite the recession and rise in unemployment, and is forecast to remain buoyant this year.

CHART III.1

PERSONS' AND COMPANIES' REAL INCOME



1. Real personal disposable income.
2. Undistributed income plus dividends on ordinary shares after providing for depreciation, stock appreciation and additions to tax reserves. Deflated by Total Final Expenditure Deflator.

Sources: CSO and CBI estimates.

III.1 Personal and Business Taxation

Our forecast on unchanged policies shows consumers' expenditure continuing the strong growth started in the second half of 1982. But increased import penetration and sluggish world demand for UK exports result in a continued depressed forecast for business activity as a whole (see Annex 2).

The forthcoming Budget can best help activity by improving competitiveness. Excessive reductions in personal taxation, resulting in increased consumer purchasing power, would draw in further large amounts of imports so long as British industry remains so highly uncompetitive, whereas cuts in business costs would help to keep imports out, as well as encouraging production for export by British firms.

An improvement in business profitability from the present extremely low level (see chart A.3) is also essential, along with improved competitiveness, for recovery and prosperity in the future.

- Higher profits are needed to increase investment - particularly if we are to keep pace with technological advances in Germany, Japan and elsewhere. If we do not, still more jobs will be lost to foreign competitors.

- If the economy is to recover significantly, higher profits will be needed to help finance higher stocks and work in progress, particularly after the drastic de-stocking of the past three years.

- Higher profits are also needed to fund research, development and investment in marketing at home and abroad, and indeed provision for the future generally, on which so many firms have had to cut back during the past couple of years or so simply to ensure their financial survival.

It has been argued that cuts in business costs would be used to finance higher pay settlements and that reductions in personal income tax would be reflected in lower pay settlements. Evidence from periods of income tax and National Insurance Surcharge changes does not in any way support either contention. In present circumstances, and at present levels of demand, it is most unlikely that UK companies would use reductions in costs to raise pay settlements. They are more likely to use them to stay in markets at home and abroad where they have been barely covering prime costs, to raise their market shares where possible, to increase investment and other provision for the future in the ways just described, and to hold down prices.

The CBI nevertheless recognises the importance of incentives for the personal sector and the need to prevent these from being eroded by inflation, but doubts whether much, if anything, can be done in the forthcoming Budget to reduce the burden of personal taxation in real terms given the relatively limited scope for reducing the PSBR, and above all the over-riding need to improve competitiveness and business profitability.

In addition to the abolition of the National Insurance Surcharge (discussed below), our other main recommendations for reducing business costs are discussed in other chapters: business rates (Chapter V); energy costs (IV.4); need to keep interest rates as low as possible (II.5).

III.2 National Insurance Surcharge

Cuts in the National Insurance Surcharge (NIS) were announced by the Chancellor in his 1982 Budget and in the Autumn Statement.

The clear cut advantages of reducing or abolishing NIS were set out in our previous representations. Abolition would improve competitiveness, reduce costs, boost profitability and encourage employment. To maintain a special tax on jobs, hindering exports and boosting imports, with unemployment at its present high level, is perverse.

This year, with growing real personal disposable incomes expected to boost consumer demand and depressed world trade likely to hold down exports, the case for giving priority to reducing UK labour costs through abolishing the Surcharge is especially strong.

The National Insurance Contribution rates which employers will be paying from April will be 0.25 percentage points higher in respect of employees contracted into the State Pension Scheme and 0.65 percentage points higher in respect of those contracted out.

* **It is therefore crucial that the 'Jobs Tax' should be abolished from April. This would have a direct cost of £1.3 billion in 1983/84 and £1.5 billion in 1984/85.**

The Chancellor has shown in his imaginative move announced in the Autumn Statement that the administrative problems surrounding the early implementation of changes in the tax can be surmounted and we have therefore assumed the abolition of the Surcharge from the beginning of the financial year. We have also assumed that the savings from the abolition of the tax will be recovered from the Government sector. For Nationalised Industries we have assumed that the benefit from abolition will be reflected in increased investment and/or lower prices (in addition to the proposals set out in Sections IV.2 and IV.4).

III.3 Income Tax

Our long-term objective remains a reduction in income tax rates so that the basic rate of income tax does not exceed 25% and the top rate 50%.

In the CBI's view we need to differentiate between action on thresholds and personal allowances on the one hand and rates of tax on the other. We believe there is a difference between the need for incentives to work at all which particularly involves the thresholds, and the incentive to work harder. We look forward to further consideration of the issues involved, when the Sub-Committee of the Treasury and Civil Service Committee reports on its enquiry into the Structure of Personal Income Taxation and Income Support. Of particular concern is the high effective marginal rate of tax resulting from income tax and national insurance contributions combined with benefit withdrawal.

Given the economic prospects, our emphasis on cutting business costs and the need to hold down import penetration, we believe changes in income tax this year should be concentrated on indexation. Increases in line with inflation in the personal tax allowances, basic rate limit, higher rate bands and investment income surcharge threshold are required in order simply to stand still in terms of the income tax burden on individuals. Failure to index these for 1982 inflation would mean an extra £0.9 billion tax revenue in 1983/84 and an extra £1.2 billion in a full year. We recommend that:

* **Indexation to allow for inflation over the last year should be the main income tax priority for this year. If resources permit after our other proposals are implemented, we would recommend further modest increases in these allowances, bands and thresholds to compensate for the erosion of their real value in earlier years.**

III.4 Indirect Taxes

We are not asking for a change in the rate of VAT this year. However we propose some adjustments to the VAT system.

* **We urge that the threshold for VAT registration should continue to move upwards. Not only will this help some smaller firms but also it should reduce the administrative burden. At the same time the facility of voluntary VAT registration should remain freely available in appropriate cases.**

Our Budget calculations are based on the assumption that there will be no increase in excise duties. Increases in these duties have a disproportionate effect on the Retail Price Index compared with their extra yield and the level of indirect taxation on the items subject to excise duties is high relative to that on other goods and services. Taxes on alcohol, tobacco products and oil products need to be considered in this light.

Our latest calculations on fuel costs show that the UK tax on DERV, the bulk of which is bought by business, is considerably higher on average than in other EEC countries. As part of the campaign to reduce business costs this differential should be phased out over a period of time. Although some reduction might be made this year, in our view the timing of later moves should take account of the motor industry's ability to meet shifts in demand.

An important constraint on this industry is the special car tax. This discriminates against a major industry and there is a strong case for planning to eliminate it.

III.5 Capital Taxes

Given the wide belief that smaller firms will play an important role over the next few years in providing new jobs and developing new technology, consideration of the tax problems that confront them and their proprietors is important.

We wholeheartedly agree with the statement by the Chancellor in the 1982 Budget that: "there is no case whatever for maintaining a system of capital taxes which, by holding back business success and penalising personal endeavour, does serious economic and social damage".[1]

1 Budget Statement, Hansard, 9 March 1982, Col 754.

We set out our position on these taxes in full in our submission to him in 1979,[1] and we have welcomed the steps which have been taken in line with our recommendations to reduce their burden.

However, there remain areas where there is a need to continue to improve the capital tax system, some of which are shown below. Costings of changes to capital taxes are difficult to produce but we estimate that the overall revenue cost of our recommendations would be unlikely to exceed £100 million in 1983/84 and £300 million in 1984/85.

Capital Gains Tax

Particularly gratifying, in view of our repeated representations on the topic, was the introduction last year of relief designed to alleviate the taxation of the inflation element in capital gains. For future gains this will ultimately do much to reduce the damage caused by this tax.

We note the reasons why the Government felt unable to give relief for inflation occurring within the first year of ownership of assets or on losses. However the length of the Finance Bill debates on these subjects is indicative of the complexities in the new rules caused by the accommodation of these two restrictions.

* **We urge that the treatment of losses and assets not held for twelve months should be kept under constant review.**

We also believe that fair treatment of those who have continued to hold assets over the longer term, which covers an era of high inflation, requires that they too should obtain relief for the inflationary element in the value of their assets. One rough and ready but administratively simple solution to the problem of past inflation which also encompasses our view that gains on assets held over the longer term ought not to be taxable is that:

* **Assets held at April 1982 which have been in continuous ownership for seven years should fall out of the capital gains tax net.**

There remain a number of other points which we raised in our 1979 submission where the Government has not yet met our requests but which we believe merit action. These include:

* **Rationalisation of the retirement relief provisions.**

* **Action to relieve the double charge on capital gains where assets are held through a company.**

Capital Transfer Tax

As with capital gains tax we welcomed the introduction last year of an element of indexation relief into capital transfer tax. However with the latter as well as the former, a number of points we registered in 1979 remain outstanding.

1 Capital Taxation: CBI Submission to the Chancellor of the Exchequer, 1979.

Especially important is the need to avoid the damaging effects of this tax on small and family businesses. This point is recognised in most other EEC countries where gifts within a family are taxed at reduced rates.

Whilst not repeating all of the outstanding points from our previous submission to the Chancellor[1] we do wish to emphasise certain points where early action would be particularly beneficial:

* **The relief for business assets should be improved by amalgamating all the existing classes of qualifying assets and giving them relief at 75%.**

* **Consanguinity relief for lineal descendants and analogous relief for full time employees of a business owned by the transferor should be introduced to reduce the burden of CTT by not less than half that otherwise payable.**

* **Lifetime rates of CTT should be half those on death throughout the scale.**

* **Consideration should be given to the possibility of holding over CTT liability arising on death in relation to business assets.**

* **The period of payment by instalments of CTT and CGT should be extended from eight to twelve years.**

* **The £250,000 limit on interest free payments for CGT should be abolished and henceforth the provisions for instalment payments and interest should be the same for CGT and CTT.**

III.6 Share Options and Incentives

Ten years have elapsed since the Conservative Government of 1972 encouraged companies to stimulate management enterprise and participation by the use of share option and incentive schemes.

Since that time there has been a host of changes in the relevant law which have led to considerable complication. We suggest that Government should now review the whole area with a view to rationalisation and simplification. We urge that schemes such as those set up in response to the 1972 initiative should be encouraged by removing the charge to income tax.

III.7 Corporation Tax

We have recently submitted our initial response to the Government's Green Paper on Corporation Tax[2] and it is not necessary for us to repeat here all the points made in that context.

In our paper we emphasised the need for stability but we coupled this with suggestions for improvements to the operation of Corporation Tax. We do not

1 Capital Taxation: CBI Submission to the Chancellor of the Exchequer, 1979

2 CBI Submission on the Green Paper on Corporation Tax, October 1982.

believe that the open ended debate on the Green Paper which may follow from the submission of the various representations should be used as an excuse for not taking early action to correct specific anomalies. We shall continue therefore to mention in our annual Budget and Technical Budget Representations those items to which we give current priority within our overall economic policy.

One theme of our suggestions for evolutionary improvements to the present Corporation Tax is the need for modernisation to make the tax more closely reflect current commercial realities.

The main items which we wish to emphasise for inclusion in this year's Finance Bill are set out below. In total we estimate that their Exchequer cost would be £90 million in 1983/84, £500 million in 1984/85 and £650 million after 4 years.

Capital Allowances

One aspect of business taxation about which we have repeatedly regretted the lack of action by Government is in the field of capital allowances for commercial buildings. At present, relief is only for buildings in the hotel and catering industry, although the initial allowance is even there only 20% in comparison with 75% for industrial buildings.

In our Green Paper response referred to above we have pointed out that all our major international competitors have allowances for commercial buildings. The Green Paper itself accepts the argument for giving capital allowances for all capital that is consumed in earning income. We therefore once again urge the Chancellor to recognise the principle. As well as correcting an existing anomaly this would give a boost to the construction industry and so to employment and provide a welcome recognition of the role of commercial business in the vitality of the economy.

* **We recommend that straight line writing down allowances should be introduced for new commercial buildings at 2% per annum.**

The cost of our proposals is negligible in the first year and small for a good many years thereafter as shown below[1].

In our 1980 Budget Representations we drew attention to the case for modernisation and improvement of mining capital allowances. We regret that no action on this front has yet been taken.

Advance Corporation Tax

Many companies are faced with regular bills for Advance Corporation Tax (ACT) despite the fact that they have insufficient profits to be liable to mainstream corporation tax and cannot fully utilise corporation tax reliefs and allowances to which they have earned an entitlement.

1 Assuming companies have sufficient profits fully to absorb the allowances estimated costs are: first year - negligible; second year £20 million; third year £45 million; fourth year £70 million; fifth year £100 million; sixth year £130 million - eventually £1500 million a year.

In our representations in previous years and in our response to the Corporation Tax Green Paper we have drawn attention to various difficulties concerning the treatment of ACT. Given that ACT is advance corporation tax we feel that early action should be taken on at least some of these problems. This could go some way to reducing the build up of unrelieved allowances to which reference is made in the Green Paper.

Ever since the 1971 debates on the imputation system we have drawn attention to the particular problems faced by companies with a large proportion of their income derived from overseas. The problem of their inability fully to utilise double taxation relief can be acute.

* **We recommend, therefore, that double taxation relief should be available for offset against ACT.**

Companies which have taken steps to incur expenditure in ways which capital allowances are designed to encourage should be able to get timely relief.

* **The offset of capital allowances against ACT should be permitted.**

Other amendments to ACT to which we are giving priority this year are:

* **The setting of ACT payments against companies' next mainstream corporation tax liability.**

* **Removal of the restriction of ACT set off to 30% of income.**

Corporate Financing

A fresh approach is needed to the taxation aspects of corporate financing. This should recognise the role of flexibility in funding for example in the use of new forms of financing as they emerge in the market to obtain capital at the lowest available rates. Two topics to which we have drawn specific attention in our Technical Budget Representations are:

* **Acceptance credits**

* **Convertible loan stock.**

Recently the authorities have indicated a desire to see a revival in the corporate bond market to secure a spread of debt maturities and to reduce the present level of bank borrowing. We believe that such a revival will be held back without more favourable tax treatment.

We regret that the consultative document of 12 January on the tax treatment of deep discounted stock suggests that the Government is not yet convinced of the case for asymmetrical treatment of lenders and borrowers. However, we shall continue to press for this question to be examined further and urge that the debate should not be foreclosed before relevant issues of practice, as well as principle have been fully aired.

Losses on Foreign Currency Transactions

Tied in with the review of corporate financing is the question of transactions involving conversions between sterling and foreign currencies.

* **We propose that action should be initiated by providing tax relief for all losses on foreign currency borrowings.**

This should improve competitiveness by bringing the UK more into line with other countries and by reducing the cost of such borrowings.

Reduced Rate of Corporation Tax

Although we are concentrating our business tax representations on cost cutting measures rather than reductions in the rate of corporation tax itself, we propose relatively cheap measures in relation to the lower rate:

* **The lower rate of corporation tax should apply to the first tranche of all companies' profits.**

* **The thresholds for the lower rate should continue to be moved upwards at least in line with inflation.**

III.8 Development Land Tax

This tax raises very little revenue, estimated to be £40 million in 1982/83, but does affect commercial decisions for example by discouraging businesses from disposing of assets they no longer require. This is of particular concern at present when a large amount of business property is out of use.

* **We therefore urge the abolition of development land tax or, failing which, suspension of its operation for at least two years to provide an incentive to proceed with relevant development projects as soon as possible.**

III.9 International Taxation

Last year we urged the Chancellor not to take precipitate action on certain international taxation proposals which had been the subject of consultative papers. We are grateful that he decided that these matters needed more time for further consideration.

We shall be responding separately and in detail on the further consultative document issued on 20 December 1982. Its length (125 pages) and the nature of the complex issues involved leave us still concerned as to whether the time available for consultation is adequate to ensure full consideration of all relevant matters before attempting legislation in this year's Finance Bill.

We echo the Chancellor's sentiment that in contemplating action in this field "we must be very careful not to prejudice legitimate business particularly because of the importance of London as a financial centre"[1]. We therefore strongly recommend that:

* **Legislation should not be introduced on international taxation which could prejudice legitimate business.**

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1 Hansard, 9 March 1982, Col. 748.

III.10 Technical Budget Representations

We have already submitted the full text of our Technical Budget Representations to the Government[2].

Last year we referred to the desirability of a Technical Taxation Bill to begin to tidy up the numerous technical anomalies that have crept into the taxation system. Changes are necessary to the legislative process if there is to be early progress on correcting these anomalies and beginning the evolutionary programme of improvements to which we refer in our response to the Corporation Tax Green Paper. We suggest that:

* **Urgent consideration should be given to methods whereby early and effective Parliamentary action on taxation reforms can be taken.**

III.11 Purchase of Own Shares

We welcome the taxation relief provided last year for companies repurchasing their own shares. However we are keeping the operation of the legislation under review particularly in relation to the requirement that the repurchase must be for the benefit of the trade of the company.

* **We recommend in addition that relief be extended to unquoted shares of quoted companies.**

III.12 Smaller Firms

The CBI recognises the vital role that smaller firms must play in generating new jobs and new wealth in the future. It has therefore welcomed the measures taken by the present Government to encourage the development of new firms and the expansion of existing smaller firms.

However, this sector will be able to fulfil its true potential only when overall economic conditions improve. The priorities for smaller firms in the next Budget are therefore identical to the priorities for business as a whole - reduction in business costs, improved competitiveness and restored profitability. The CBI's main economic policy and tax recommendations cover these concerns.

Within this section we deal with two specific recommendations which are of exclusive concern to smaller firms. Other matters, which are of particular concern to smaller firms are dealt with within the main tax recommendations, or in the case of the Small Engineering Firms Investment Scheme (SEFIS) in Section IV.3.

Small Firms Investment Companies (SFICs)

One of the CBI's current objectives is to increase the amount of equity investment in the smaller company sector. The Government has already introduced several helpful measures in this respect notably the Business Start Up Scheme (1981 Finance Act), the Venture Capital Scheme (1980 Finance Act) and the new rules relating to unquoted trading companies repurchasing their own shares (1982 Finance Act). We believe that the Government now has

2 Copies are available from the Taxation Department, CBI Economic Directorate.

an opportunity to build on these foundations and stimulate a radically improved climate for investment in smaller firms.

The CBI has already sent proposals to the Government suggesting a framework through which the investment by individuals in private companies could be stimulated. It has, however, been made clear in submitting these proposals to Government that it is the objectives rather than the vehicle with which the CBI is primarily concerned.

These objectives are:

i Extension of existing incentives for investment in start up companies to established smaller companies in order to stimulate investment in the smaller company sector as a whole.

ii The encouragement of individuals and large financial institutions - such as banks and pension funds - to invest in smaller companies by giving them a spread of risk through a single investment.

iii Improvement of the marketability of investment in smaller companies by making it easier for individuals and institutions to realise their investment at an appropriate time. Investing in smaller companies would therefore be a more attractive proposition than it is at present.

iv The identification of willing investors and the matching of them to smaller companies in need of finance. This would make it easier for both individuals and institutions to invest in smaller companies and encourage a wider cross section of society to participate in the ownership of business.

The proposals for SFICs put forward by the CBI would enable funds to be attracted from both individuals and institutional investors and for this money to be invested in defined smaller companies. Rules would govern the nature, size and spread of the investment, but these should be sufficiently flexible to enable financial packages to be specifically geared to the needs of smaller companies. It should also be possible for the investment to be supported by the contribution of managerial and other technical assistance.

The objective of encouraging equity investment in smaller companies could be secured, in part, through the extension of the Business Start-Up Scheme but some other changes will be necessary if the objectives the CBI has identified are to be achieved. How best this might be done we would be pleased to discuss with Government but in order that these discussions may take place from a constructive base, we have developed our SFICs proposals, the main points of which are:

i Individuals subscribing for shares in a SFIC, or directly in a qualifying company, should receive the same tax advantage as is currently available under the Business Start Up Scheme.

ii Financial institutions, and other corporate bodies, should be permitted to buy shares in a SFIC.

iii Qualifying companies should, in general terms, be defined as smaller unquoted trading companies. There should be no requirements for a qualifying company to be "new" or to be carrying on a "new" trade.

iv SFICs would be permitted to lend to their portfolio companies but only as part of a financial package which involved a substantial equity investment. The possibility of a SFIC borrowing money on terms which would allow it to on-lend to its portfolio companies at market rates should be investigated.

v A SFIC should comply with strict rules concerning the nature, size and spread of its investments. However, these rules would allow it sufficient flexibility to derive some income to use for management fees, or to repurchase its own shares. Approval would be required from the Inland Revenue before a SFIC could operate.

vi SFICs themselves would have a tax status similar to some existing investment institutions. They would, therefore, be exempt from capital gains tax on most transactions.

Disincorporation

For some businesses the price of incorporation with all that it involves in terms of compliance with various company law requirements is proving excessive.

It is important to facilitate the continuation of previously incorporated businesses as partnerships or sole proprietorships. We therefore recommend that:

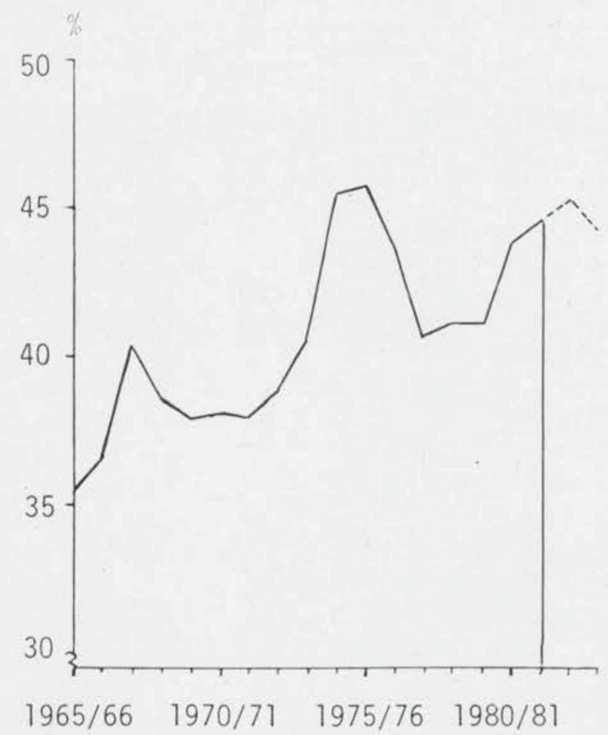
* **Government should examine the various tax and other measures which apply on disincorporation with a view to simplification and amelioration of any tax burdens where the transactions are carried out for genuine business purposes.**

IV GOVERNMENT EXPENDITURE

CBI policy on government expenditure has been described in a number of documents including the Report of the CBI Working Party on Government Expenditure[1], and most recently in a detailed paper submitted to the Chief Secretary to the Treasury[2]. We have argued that there is a need to restrain total levels of public expenditure, to facilitate a reduction in the cost burden on business within a given fiscal stance. The CBI has also argued that within a reduced expenditure total, there should be a shift in favour of capital expenditure in order to redress the imbalance which has arisen in recent years. Both measures would assist in restoring the cost competitiveness of British industry.

CHART IV.1

SHARE OF GOVERNMENT EXPENDITURE IN GDP



Definition: Planning total of government expenditure as percentage of expenditure estimate of GDP at market prices.

Source: The Government Expenditure Plans 1982-83 to 1984-85 (Cmnd 8494 Table 1.1); CSO; CBI forecasts for 1982-83 and 1983-84.

1 'Report of the CBI Working Party on Government Expenditure', September 1981.

2 'Government Current and Capital Expenditure', paper submitted to the Chief Secretary to the Treasury, July 1982.

This section updates CBI policy in the light of more recent information.[1]

IV.1 Planned Levels of Spending

The latest Government announcement shows that total expenditure in 1983/84 is planned to be £120.06 billion (excluding debt interest) which is some £600 million lower than the planning total of £120.7 billion[2] for 1983/84 announced in the 1982 Budget. Whilst the CBI welcomes the Government's achievement in avoiding an increase in planned expenditure for 1983/84, this represents only a marginal reduction in total public expenditure in both cost terms, and as a percentage of GDP, over the likely outcome in 1982/83. It is clear that in certain areas, particularly the current expenditure of local authorities, there are persistent problems in controlling expenditure levels. Moreover, the revised planning total for 1983/84 was only held within previously announced totals after taking account of:

i A reduction in cash limits equivalent to the savings from reductions in NIS.

TABLE IV.1

MAIN CBI RECOMMENDATIONS ON GOVERNMENT EXPENDITURE[1]

	£ million, 1983/84 prices	
	1983/84	1984/85
Extra capital expenditure	500	1500
SEFIS and industrial support	85	100
Extra expenditure on reducing energy costs	200	200
Special employment measures	100	200
Offset by:		
Savings from manpower cost economies[2]	-350	-700
Savings from a reduced contingency reserve	-200	-900
Savings from lower unemployment levels and other demand effects of CBI package[3]	-350	-800
TOTAL EFFECT ON GOVERNMENT EXPENDITURE	-15	-400

1 In comparison with totals announced on 8 November 1982 for 1983/84, and in comparison with totals given in the March 1982 White Paper for 1984/85 (adjusted for subsequent policy changes).

2 Excluding savings which would arise from the abolition of NIS, which are already taken into account in the costing of this proposal.

3 See footnote 6 to Table I.1.

3 In particular the Chancellor's statement on 8 November 1982 in respect of government expenditure for 1983/84.

2 Planning total in Cmnd 8494 adjusted for Budget changes. Figures expressed in cash terms.

ii A forecast increase in public sector costs which is lower than that foreseen in March 1982.

iii A substantial reallocation from the contingency reserve to spending programmes (see Section IV.6).

Table IV.1 summarises our main recommendations in respect of government expenditure. We urge the Government to announce changes in favour of enhanced efficiency in the provision of public services as soon as possible, although we recognise that the full savings from these measures may not accrue until 1984/85.

IV.2 Extra Capital Expenditure

The need to redress the imbalance in government expenditure in favour of greater public investment has been a consistent feature of CBI policy in recent years. Attempts to curtail the total level of government expenditure and its share of national output have been largely unsuccessful because of difficulty in containing current costs. Public sector capital expenditure, part of our investment in the future, with direct implications for industrial competitiveness, has shown a consistent decline in real terms since the mid 1970s and in 1981/82 was some 25% lower than in 1976/77[1].

* **We believe there should be a revival in public sector investment, in part to correct the substantial underspending of recent years, but also to improve both the standard of our national infrastructure and the efficiency of publicly owned industry.**

Such a revival would benefit the construction industry in particular, where output is now running at 16% below its 1975 level. The low import content of construction activity, and its high labour intensity, imply that any increase in construction output would have direct benefits for UK employment. A fuller discussion of these issues is contained in the First Report of the CBI Steering Group on Unemployment, November 1982, which also considers the case for more emphasis on tourism.

* **We recommend that the Government directs its attention to three particular categories of public sector investment:**

i **Infrastructure**

Investment in motorways, by-passes, link roads to the East and South coast ports, and roads designed to assist inner city regeneration, would yield attractive economic and social returns and contribute, via lower transport costs, to a more competitive economy. We also urge the Government to speed up infrastructural improvement in other areas including the water and sewerage system which is, in many places, in need of urgent repair. Whilst we recognise that some infrastructure investment schemes do not lend themselves well to private sector financing, we would urge the Government to consider seriously such

1 See 'Government Current and Capital Expenditure', CBI submission to the Chief Secretary to the Treasury, July 1982. Figure adjusted for effect of council house sales.

proposals as have been put forward, for example the financing of roads by royalty payments.

ii Nationalised Industries

Certain of the nationalised industries feel that their ability to invest in projects which would enhance efficiency, and thus reduce costs, are hampered by a lack of finance. Some of these schemes also fall into the infrastructure category, for example rail electrification. Wherever possible, the Government should consider the introduction of private finance into profitable schemes, as suggested in the Ryrie Report.

iii Local Authority Underspending

We applaud the recent attempts by Government to correct the underspending of capital cash limits which has been evident in local authorities for a number of years. However, underspending of £1.5 billion in one year is difficult to rectify in the last few months of a financial year. It has been argued that short run changes in capital expenditure policy have contributed to this underspending, together with the fear that investment projects incur future current costs. It is misleading to believe that capital expenditure in general incurs the latter in that some projects may, for example, save on energy or labour costs. In addition, road maintenance is now a capital item. It is clear however, that problems may be caused by debt financing. We would therefore urge the Government to consider how debt charges could be treated in calculations of the Rate Support Grant in order to overcome this problem.

Our recommended increase in capital expenditure of £500 million in 1983/84 and £1500 million in 1984/85 will assist in eliminating the cumulative underspending of recent years. We also propose:

* **That Government assists in the long-term planning of local authority investment in essential local road construction, housebuilding and urban renewal schemes. A welcome step away from one year planning is the recent announcement that at least 80% of the 1983/84 housebuilding budget will be available in 1984/85.**

* **That the Government extend the practice of allowing a limited carry over of capital allocation from one financial year to the next.**

* **In addition we recommend that those activities which can be contracted out or privatised be transferred to the private sector, where investment can take place with fewer arbitrary constraints.**

IV.3 Industrial Investment

We believe that two particular industrial support programmes should receive additional resources in 1983/84 and 1984/85.

a Small Engineering Firms Investment Scheme (SEFIS)

* **We propose that SEFIS, first introduced in March 1982, be reintroduced with a ceiling of £50 million allocated to it in 1983/84.**

This would allow for some relaxation of the original rules which restricted eligibility to firms covered by Standard Industrial Classification 3 and to metal-working machinery. We believe that SEFIS has, and would continue to encourage productive investment, and increase competitiveness in a sector of the economy which has been badly hit by recession.

b Innovation Support

In view of the importance to the economy of the development of new products and processes, we recommend that the Government does more to help industry to maintain or increase its investment in this area. We estimate that it would be reasonable to allow for additional expenditure of £30-40 million in 1983/84 to finance these changes, increasing to £50 million in 1984/85.

This money could usefully be spent in the following ways:

* **Continuation of the maximum rate of grant payable on new projects of 33 1/3% throughout 1983/84.**

* **Grants for the later stages of innovation should be more widely available than at present.**

* **Relaxation of the 'additionality' criterion in order to facilitate the take up of funds.**

In addition we recommend that while the support for computer and associated industries proposed in the 'Alvey Report' is welcome, this should be additional to existing support programmes.

IV.4 Energy Costs

The CBI and individual sectoral organisations have made consistent representations over the last two years about the level of UK energy prices and the threat they pose to international competitiveness. In certain respects there has been some relief and we welcome the £250 million assistance given to industry in the 1981 and 1982 Budgets. We also welcome the gas price freeze and the standstill of average electricity prices envisaged for 1983.

However, problem areas remain, particularly for the electricity intensive industries.

* **We seek further relief from the severe burden borne by these industries and also continue to drive for competitive UK energy prices.**

* **In line with our overall statement on energy policy we would like to see greater financial assistance by the Government to encourage investment in energy efficient plant, equipment and processes.**

In the present economic climate industry is unable to take advantage of apparently attractive energy saving investment because of lack of funds. Further assistance, possibly through low interest loans with deferred repayments until the projects start to show a financial return, would accelerate the realisation of potential energy savings. Additional funding should also be made available to encourage replication in the Energy Conservation Demonstration Project Scheme.

Gas

British Gas announced in November 1982 that the freeze on industrial contract prices would be maintained until October 1983. We welcomed this move. With exchange rate movements and price increases on the Continent it is likely that during 1983 UK prices will be within the range of those applying elsewhere, although the situation will need to be monitored closely to ensure significant disparities do not reappear.

Heavy fuel oil

The duty on heavy fuel oil is largely responsible for the disparities between UK product prices and those in competitor EEC countries. We acknowledge the difficulties involved in lowering this duty but urge that it be kept continually under review. The existence of this duty adds strength to the case for taking alternative actions to reduce industry's energy costs.

Coal

We are requesting the extension of the Department of Industry Coal Firing Scheme for another year.

Electricity

We welcomed the limited help for electricity intensive industries in the last two Budgets but pointed out that considerable price disparities remained in comparison with certain European countries. Although we welcome the electricity price standstill in 1983, the review of the Bulk Supply Tariff by the Department of Energy which made such a standstill possible does nothing for the particular group of industries on whose behalf we have been campaigning.

* **We therefore strongly urge the Government to take further action to reduce the costs for these consumers to bring them closer to those of their continental competitors. We estimate that this would involve a cost of approximately £200 million.**

It is worth noting that while the Government argues that it cannot reduce electricity prices further because of the high costs of production, it does not apply the corresponding argument to gas where we have relatively low costs of production.

IV.5 Special Employment Measures

* **Moderate additional resources should be made available to develop special employment measures.**

The first of the measures described below, the continuation in an adapted form of the Temporary Short Time Working Compensatory Scheme (TSTWCS), has been agreed as CBI policy, and is being discussed with the Secretary of State for Employment. Consultations are continuing on the remaining three proposals. For 1983/84 a sum of £100 million has been included for these measures (the cost for 1984/85 is estimated at £200 million). These figures are in addition to the funds already allocated by government to the Youth Training Scheme. This will be implemented in September 1983 and the CBI is formally committed to its support.

The TSTWCS is due to end in March 1984. This scheme has kept a significant number off the unemployment register by allowing employers to maintain their workforces during difficult periods. The CBI now believes that a permanent scheme for short time working compensation should be introduced.

The Job Release Scheme (JRS) encourages early retirement and the CBI believes that the scheme could be extended by reducing the age at which people become eligible to join.

The CBI fully supports the Government's announced job-splitting scheme (to take effect from January 1983) and believes that it could be developed by incorporating a system for encouraging phased retirement. This is estimated to involve no net additional cost to the Exchequer once the scheme is fully operational. Such a scheme would keep the Government grant to an employer for splitting a job but would, in addition, encourage those nearing retirement to split their job by giving them part of the payment made under the JRS.

Finally, the Community Programme Scheme which provides temporary work for the long-term unemployed could be given additional funds so as to improve the quality of projects undertaken through the scheme. This improvement in quality is a necessary first step towards increasing the number of places provided by it.

IV.6 Controlling Government Expenditure

General Efficiency

The CBI welcomes a number of steps which have been taken in the course of 1982, designed to improve the efficiency of both central and local government. We welcome in particular the establishment of an Audit Commission for local authorities - a measure we have pressed for strongly in recent years. We urge that this Commission undertakes value for money and comparable performance studies. This would improve efficiency, and also the accountability of local authorities to their electorates. In similar vein we also welcome the positive response by Government to the recommendations of the Treasury and Civil Service Select Committee in favour of improved financial management in the Civil Service[1].

The CBI has argued strongly that comparative studies of the cost of Regional and District Health Authorities would be of great benefit in enhancing the efficiency of what is in effect a loose federal structure. We support the recommendation of the House of Commons Public Accounts Committee that the Department of Health and Social Security should take much stricter financial control of the NHS.

We urge the Government to consider how management expertise can be harnessed to improve the efficiency with which public services are provided. In this respect we welcome the announcement by the Secretary of State for Health and Social Security of private sector involvement in an efficiency scrutiny of the National Health Service.

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1 Efficiency and Effectiveness in the Civil Service - Government Observations on the Third Report of the Treasury and Civil Service Select Committee. Cmnd 8616.

Use of Contingency Reserve

We pointed out in July 1982 that the very large contingency reserves built into the 1982 White Paper for expenditure in 1983/84 and 1984/85 (£4 and £6 billion respectively) were likely to encourage a slackness in expenditure control. Whilst we welcome the fact that Government has been able to contain the planning total for 1983/84 within the level previously planned, it is clear that substantial increases in, for example, local authority current expenditure were contained within a marginally reduced total only by drawing on the contingency reserve.

* **The £6 billion figure contained in the existing 1984/85 plans should be substantially reduced, particularly in view of the more favourable prospects for cost inflation. This would also improve financial control in next year's public expenditure review.**

TABLE IV.2

GENERAL GOVERNMENT MANPOWER (GB): THOUSANDS, FULL TIME EQUIVALENT

	1980/81	1982/83	% change 80/81-82/83	Government target for* 1983/84	% change 80/81-83/84
Armed Forces	334	323	-3.3	334	no change
Civil Service	697	655(1)	-6.0	639	-8.3
Local Authorities					
Teaching	620	2242(2)	-3.2	561	-6.7
Education Support	442			369	
Protective & Social	480			496	
Other	775			736	
NHS					
front line	582	625	+7.4	606	+4.1
support staff	369	369(3)	-	379	+2.7
TOTAL	4299	4214	-2.0	4120	-4.2

Sources: (1) Treasury Press Release, July 1982

(2) Joint Manpower Watch, England, September 1982
Joint Manpower Watch for Scotland, Scottish Office, September 1982
Joint Manpower Watch for Wales, September 1982

(3) Question asked by Mr Ralph Howell of the Chancellor of the Exchequer, Hansard Col 290, 12 November 1982

* See Table IV.8, CBI Working Party report on Government Expenditure.

IV.7 Manpower Reductions

The CBI's report on Government Expenditure identified significant scope for cuts in public service manpower which are consistent with maintaining the existing level of services. Overall, allowing for all employment associated costs, we identified savings of at least £2 billion at 1981/82 prices by 1984/85. We argued that these savings should obtain in 'non front line' areas, particularly in the local authorities and NHS. Our evidence of significant regional disparities in manning levels for both local authorities and the NHS has been supported by other bodies.[1]

Table IV.2 outlines where reductions in public sector manpower have been achieved. These figures illustrate that there is still substantial scope for rationalisation in levels of public service manpower. We note that the Government has been more successful in controlling levels of manpower in the Civil Service (saving £124 million in 1981/82)[2] than have the local or health authorities. We welcome the establishment of manpower targets for each regional health authority as a preliminary step towards achieving reductions in overall NHS manning. We would urge the Government to consider how it might exert pressure on local authorities to act likewise (for instance, through the use of a cash limit for wages and salaries). We believe that the tightening of financial management throughout the public services, and the introduction of a MINIS-type system wherever possible will aid these objectives.

* **We recommend manpower cost savings of £350 million in 1983/84 and £700 million in 1984/85.**

IV.8 Public Sector Pay

The CBI Working Party Report showed that public sector pay relative to private sector pay had improved for all categories of public sector workers during the 1970s.

Chart IV.2 gives the most recent figures, indicating that there was some reversal in the post-Clegg public sector advantage in 1981/82. Relative pay does however remain high by historical standards for manual workers in the public services.

* **We urge the Government to adhere firmly to its 3½% guideline for public sector pay increases in 1982/83.**

IV.9 Pensions

* **In evidence to the Scott Committee of Inquiry in 1981 into the value of Pensions we recommended that fully inflation-proofed pensions in the public service sector be discontinued.**

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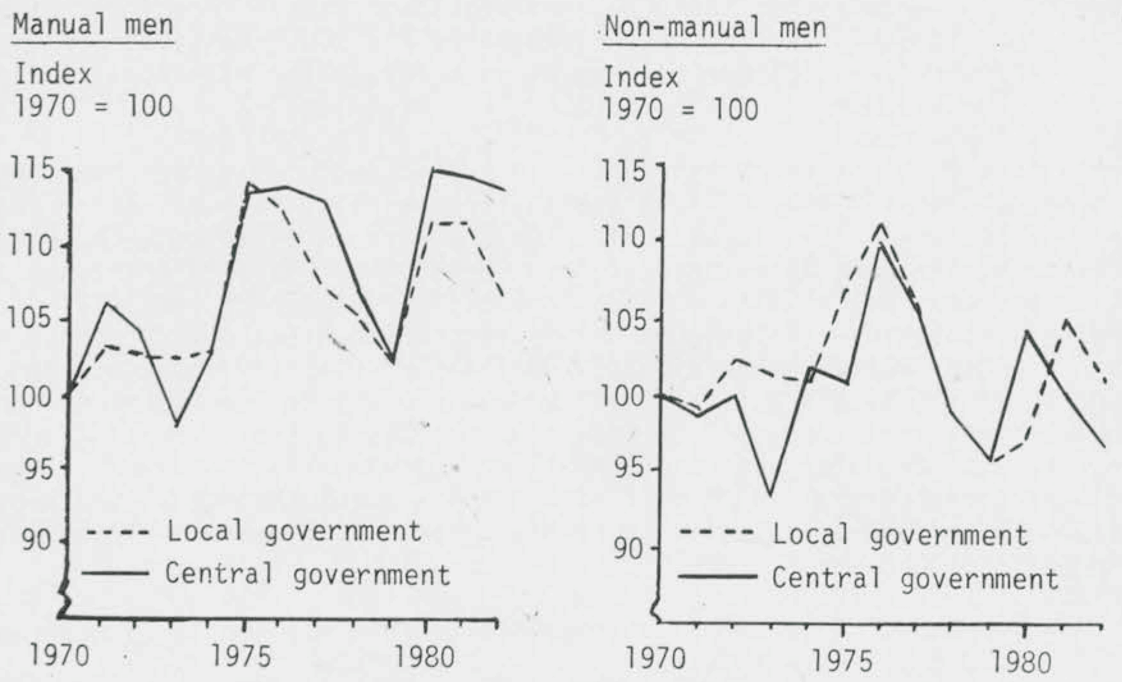
1 See page 28 of 'A Winning Budget'.

2 Source - Treasury memorandum to Treasury and Civil Service Select Committee on Civil Service Manpower, 7 December 1982.

CHART IV.2

INDEX OF PUBLIC SECTOR EARNINGS AS A PERCENTAGE OF PRIVATE SECTOR EARNINGS



Notes: The figures relate to men working full-time. Comparisons for females have been affected by moves to equal pay and have not been included.
The earnings figures (from which the percentages are calculated) include all gross pay but do not take account of pension arrangements, fringe benefits, or other conditions of service.
No allowance is made for the differences in the nature of the work done or the qualifications of the employees concerned.
The 1982 figure for local authority non-manuals has been adjusted to include the teachers' 1982 settlement.

Source: New Earnings Survey 1982 and CBI estimates.

* **We have also recommended that in the interim all public sector pension contributions be increased to the notional 8-8½% paid by the civil service. We welcome the recent increase in contribution rates for the police force, and recommend that similar action is taken in respect of local authority workers, teachers and employees of the NHS.**

IV.10 Competitive Tendering

As we have highlighted in Section IV.1, one area where there has been a persistent problem of control is local authority current expenditure. This is of particular concern to CBI members in view of its implication for rates.

In our response to the Government's Green Paper 'Alternatives to Domestic Rates'[1] we argued that local authority current spending should be reduced by:

* **Leaving the provision of some services to the market and voluntary sectors.**

* **Increasing efficiency, in part by using private contractors where appropriate.**

* **Tailoring levels of provision more closely to real consumer need.**

It is in the second area that we believe real manpower cost savings may be achieved, particularly in local authority services but also in parts of the NHS (such as catering and cleaning). We recognise that areas of the civil service such as the PSA and the Department of the Environment have already taken this course of action. We believe that opening a range of public services to competitive tendering or contracting out will encourage efficiency, even if the service continues to be provided by direct labour.

We are at present considering a recommendation that there should be an extension of the existing legislation in respect of Direct Labour Organisations which would open up a wider range of local authority services to competition.

1 CBI Submission on the Green Paper 'Alternatives to Domestic Rates' (Cmnd 8849), March 1982.

V: LOCAL AUTHORITY FINANCE

We have repeatedly stressed in these Representations that a reduction in business costs is an essential part of the strategy for improving our competitiveness so fundamental to our recovery from the recession.

Last year's Budget Representations emphasised the concern of business ratepayers about large increases in rate bills over which they had no control. Since then the rate burden on business has become an even more prominent issue. In the four years 1978/79 to 1982/83 business rates have risen by more than one and a half times as much as the level of retail prices as illustrated in Chart V.1.

CHART V.1

BUSINESS RATES[1] INCREASES COMPARED WITH INFLATION

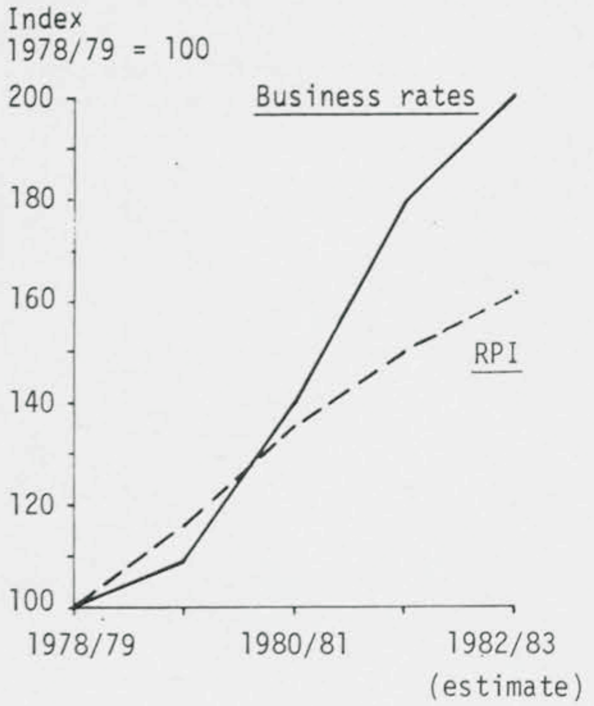
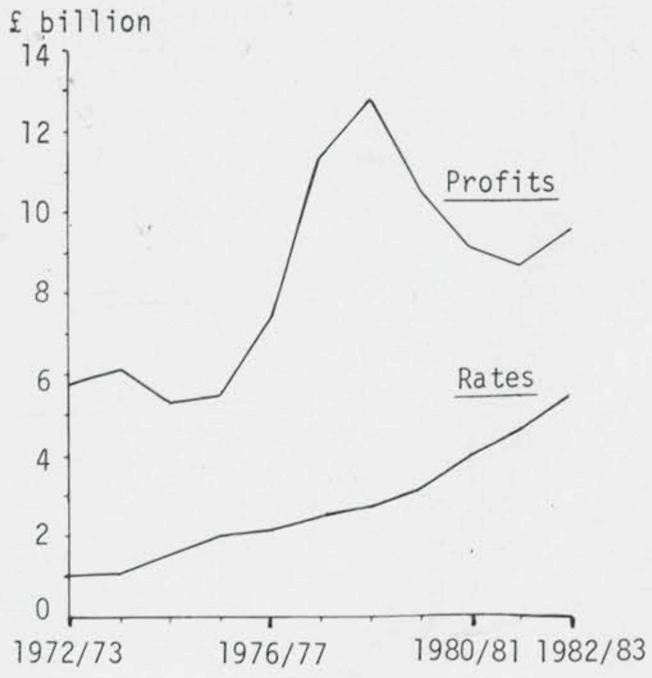


CHART V.2

BUSINESS RATES[1] AND PROFITS[2]



1. Business rates exclude North Sea activities and financial institutions.
2. Profits are gross trading profits for industrial and commercial companies less stock appreciation and capital consumption, excluding North Sea activities.

Sources: Rates - CBI estimates for Great Britain based on Department of Environment and Scottish Office data.
Profits - CBI estimates based on CSO data.
RPI - Department of Employment. Financial year averages.

First indications for 1983/84 suggest that, despite the falls in inflation, many authorities are contemplating rate rises in double figures. In some cases increases of six or more times the likely rate of inflation are being considered.

These increased costs reduce profitability, and this in turn will influence the regional location and investment of industry.

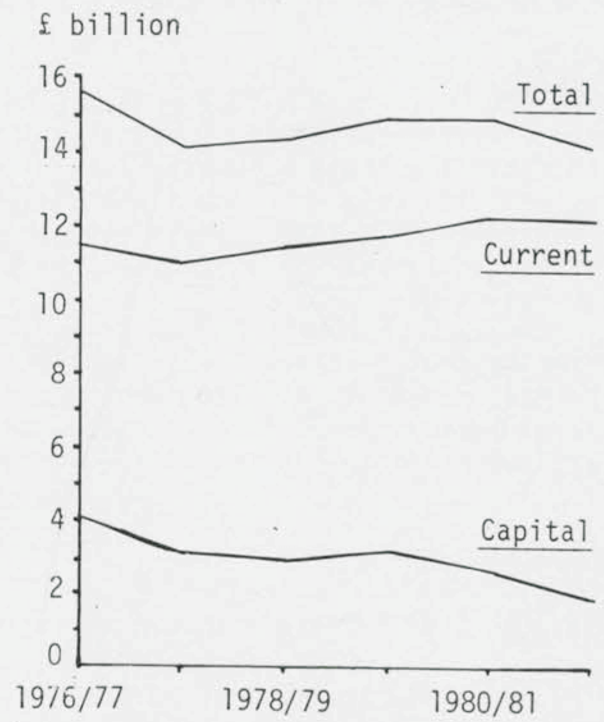
Relatively large prospective increases in rates are taking place at a time when profits are particularly depressed. Chart V.2 compares the movements in profits of industrial and commercial companies, excluding North Sea activities and financial institutions, with the rise in those companies' rate bills.

V.1 Local Authority Expenditure and Rate Levels

The main determinant of the level of rates is the level of local authority current expenditure. It has been suggested that as total local government expenditure has fallen by 10% in real terms over the last 5 years it is unreasonable to suggest that local councils have not made an important contribution to the cutting back of government expenditure. However, Chart V.3 shows that the fall in expenditure has been entirely due to cuts in capital spending whilst current expenditure remains relatively buoyant.

CHART V.3

LEVELS OF LOCAL AUTHORITY EXPENDITURE[1]



1. Great Britain only, at 1976/77 outturn prices.

Source: The Government's Expenditure Plans 1982-83 to 1984-85 (Cmnd 8494, Table 4.3).

The Government has published details of the total for the Rate Support Grant (RSG) for 1983/84. Government support for local authority spending in England will drop again in percentage terms from 56.1% in 1982/83 to 52.8% in 1983/84, though the effect of this reduction in grant will be offset to some extent by the increase in relevant expenditure from £20.5 billion to £22.3 billion. Government has also set expenditure targets for individual authorities designed to achieve a cutback of 1% in the real average level of spending.

From our calculations for 1983/84, we estimate that provided councils keep to the Government's guidelines, the national average rate level would be approximately the same as in 1982/83 and on average rates would not need to rise. Indeed, within that average, some councils could even reduce their poundages. This was also our contention last year when we calculated that, even taking account of the drop in RSG, local authorities on average could have balanced their budgets with a zero rate rise or even, in some cases, with a drop of one or two points. Yet rates increased by an average of nearly 13%. In order to achieve the target expenditures in 1983/84, authorities which have budgeted to overspend in 1982/83 will be expected to make significant real cuts - as much as 7% in a few cases - whereas councils which have kept within the guidelines will be required to make a real cut in spending of up to 2%. The CBI regrets that many local authorities still appear unwilling to accept the need for restraint in local government current spending and the practicability of cuts, and are set to raise their rates again by amounts which in some cases will far exceed the rate of inflation.

We recognise, however, that in some cases short-term increases in current spending may be justified in the interests of increasing efficiency and reducing expenditure in the long term. The CBI is concerned that local authorities should not be penalised through the grant system for expenditure of this nature.

The CBI strongly backs the Government's policy of making gradual reductions in the RSG in order to encourage restraint in local authority current expenditure and to increase the local accountability of councils to their electorates. The problem with this approach is that it has not been accompanied by measures to protect the business ratepayer who, unlike his domestic counterpart, has no formal way of influencing local authority decisions through the ballot box.

It is a matter of priority that this vital missing link in the Government's strategy is forged by measures aimed at safeguarding the business ratepayer from high spending local authorities. Rates are now the heaviest tax on business and in 1982/83 we estimate business will have paid £5.7 billion in rates.

V.2 Specific recommendations

* A ceiling on business rate increases should be introduced

This measure, which we had hoped to see incorporated in the Local Government Finance Act 1982, is necessary in order to protect business from its vulnerable position in relation to the rating authorities.

Such a ceiling would:

i reduce the uncertainty which businesses face;

ii restrain local authority spending;
iii limit overall taxation levels;
iv help to increase local accountability;
v impose no real constraint on local democracy;
vi involve no Exchequer cost to central government; and
vii contribute towards improving our competitiveness by restraining the growth of business costs.

Therefore we urge the Government as a matter of the highest priority to introduce legislation to impose a ceiling on business rate increases. The ceiling should aim to prevent business rates rising by more than the rate of inflation or the rate of increase in domestic rates, whichever is the lower.

* Partial business derating should be introduced

The CBI does not oppose rates as a tax in principle, and in general business ratepayers are prepared to pay their fair share for local authority services from which they benefit directly. But at a time when most businesses are struggling against the depressing effects of the recession, they feel strongly that they should not be taxed at a higher level than the domestic sector which enjoys rate relief granted by central government.

In the inter-war depression and up to 1963 industrial derating was granted at a time when there was no rate relief for the domestic sector. Since 1967, when domestic rate relief was introduced, the situation has been reversed. Given the budgetary constraints, our recommendation is for 15% derating to be enacted for all business (with a comparable extension of the current industrial derating in Scotland and Northern Ireland). The case for partial derating being introduced is particularly strong for industrial concerns.

The proposal for 15% derating should be financed by central government grant in the first year. In subsequent years, this grant could be phased out as the local authorities increased both their efficiency and their income from charges.

It is recognised that the introduction of partial business derating will require legislation separate from the Finance Act. We are convinced that, given sufficient political will, such legislation could be enacted in the present session and that the administrative problems for both central government and local authorities could be overcome without much difficulty.

We estimate that the cost for 1983/84 would be approximately £950 million at 1983/84 prices, representing less than 4% of total rate- and grant-borne expenditure for that year.

This measure would have an immediate effect in reducing business costs.

* Empty business property rate should be abolished and relief for "mothballed" premises and plant should be implemented

In principle, rates are a tax on beneficial occupation of property, so in our view the levy of rates on empty property is illogical and undesirable. Although some relief is given both through the initial 3-month 'free' period and the statutory maximum levy of 50% of the full rate, at a time of recession when profits are so depressed the taxation of empty property is viewed by business as being particularly harsh.

Because of depressed trading conditions it is becoming even more difficult to sell or let empty business property, especially industrial property. In fact there are widely publicised reports of companies rendering empty buildings derelict, for example by removing the roofs, so that they are not liable for rates.

The CBI considers that the existence of a tax which encourages the reduction of our capital base is unacceptable. The CBI has done all it can to persuade those local authorities who levy empty property rates to exercise their discretion to waive them but, though some have responded, many others have not. It is time for the Government to step in and abolish the rating of empty business premises. The power to prevent this type of rating already exists and primary legislation is not required.

We estimate the loss of annual revenue to local authorities arising from the abolition of empty property rate for business premises would be in the order of £30-35 million.

The arguments put forward for abolishing empty property rate for business apply equally to the rating of partially empty premises where companies cannot use the empty part because of the recession but which they wish to maintain for re-use when the economic situation improves.

We do not accept the argument that this 'mothballing' relief would be too complex to administer and too difficult to police. The CBI has put forward practical proposals for the implementation of such a measure, and for its policing, in our response to the Green Paper on 'Alternatives to Domestic Rates' (Cmnd 8449).

Help could also be given in this area by making the discretionary apportionment of rateable value between occupied and temporarily unoccupied parts of business properties mandatory, so that the overall rate bill on these properties would be lower.

We recommend that legislation is introduced to permit 'mothballing' relief for business in 1984/85. We propose that £150 million of annual relief at 1983/84 prices is given.

ANNEX 1

Government Measures to Encourage Business in 1982

In the CBI Budget Representations submitted to the Chancellor in early 1982 various recommendations were made aimed at reducing the disproportionate burden on the business sector. The table below sets out the main recommendations together with details of actual measures introduced during 1982.

	CBI 1982 Budget recommendations	1982 Budget	Autumn Statement
National Insurance Surcharge	2% immediate reduction as first step to abolition	Reduced from 3½% to 2½%	Reduced to 1½% for 1983/84 plus backdating of extra ½% reduction for 1982/83.
Income tax allowances and bands	Index by rate of inflation	Indexed by 14% (2% above inflation)	
Business derating	15% derating		
Aid for Small Firms	Extensions of Business Start-Up Scheme to encourage the development of SFICs and to help already existing small firms	Some improvements to Business Start-Up and Loan Guarantee Schemes.	
	Capital tax indexation	Capital taxes partially indexed	
Energy	Reduction of industrial users electricity prices.	Gas freeze April to December 1982. Special tariff introduced for heavy users.	Gas price freeze extended to October 1983. Standstill of average electricity prices.
Investment	Increase in planned public capital expenditure of £250m in 1982/83 and £1b in 1983/84.	Small package of measures to encourage house building	Further small package of increased expenditure on urban development and housing.

ANNEX 2

THE ECONOMIC SITUATION AND PROSPECTS

INTRODUCTION AND SUMMARY

In this annex we consider first the current economic situation; secondly the outlook on unchanged policies for the next two years; and thirdly the effects of our recommendations.

A year ago our central forecast on unchanged policies was a sluggish recovery in output, insufficiently fast to reduce unemployment. We estimated that our recommendations would improve the prospects for growth and employment but, even if implemented in full, our central forecast would still have been only modest growth. We also drew attention to three elements of the forecast where the prospects were particularly uncertain - consumers' expenditure, stockbuilding and the world economy - and constructed optimistic and pessimistic scenarios to indicate the margins of error.

In the event, although consumers' expenditure has been more buoyant than in our central forecast, the unexpected weakness of the world economy has more than offset this. The outcome for output, growth and unemployment in 1982 has therefore, been close to the pessimistic scenario which we prepared a year ago.

Meanwhile, partly because the world economy has depressed commodity prices, but also because of a number of other factors described below, (some of which might not be repeated), the fall in inflation has been in line with our optimistic scenario.

Looking ahead, we must emphasise the margins of uncertainty surrounding our forecasts as illustrated in the charts that follow.

Our central forecast on unchanged policies over the next two years is, again, one of slow growth, with inflation remaining close to the 5% level in the first half of this year.

We estimate that our recommendations would improve the prospects for output, profitability, unemployment and inflation. To the extent that any strategy carries risks, we believe our proposals would considerably reduce the danger of further widespread losses of industrial capacity, and rising unemployment, with little risk of encouraging inflation.

SITUATION, AND PROSPECTS ON UNCHANGED POLICIES

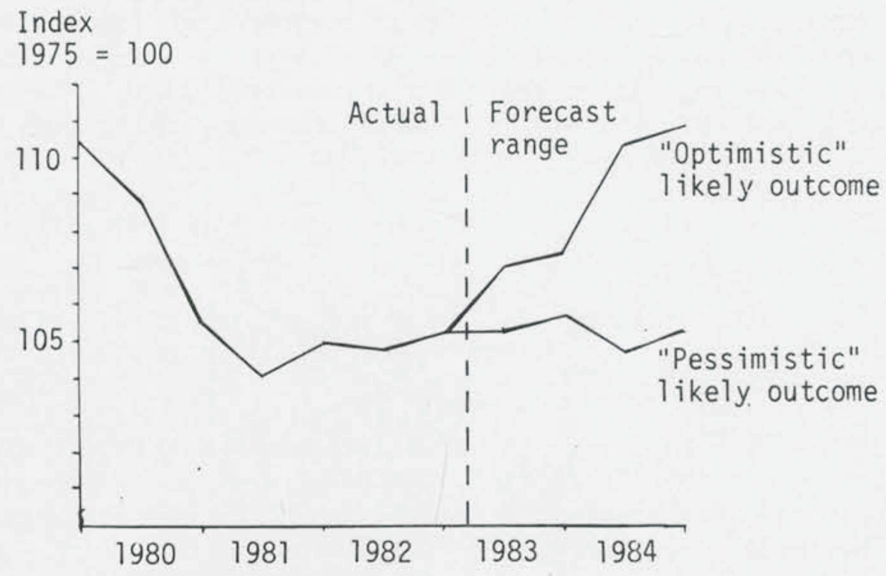
Demand and Output

The sharp fall in output in 1980 continued into early 1981 before starting to stabilise, or possibly rise slightly, from the middle of the year. Output fell sharply by historical standards in the economy as a whole and the fall was particularly great in the manufacturing sector.

During 1982 GDP has remained more or less flat. Between the two halves of 1982, consumers' expenditure grew by about 3% at an annual rate, accompanied by some growth in government current and capital expenditure. The effect on output of the growth in these demand components was however, offset by continuing destocking, growth of imports and a small fall in exports. As a

CHART A.1

GDP[1] - FORECAST ON UNCHANGED POLICIES[2]



1. Output estimate of GDP at 1975 prices, half-yearly figures.

2. See text for definition of 'unchanged policies'.

Source: CSO and CBI forecasts

consequence, we estimate that GDP was less than ½% higher than in 1981 (see Chart A1).

On the Treasury's definition of unchanged policies[1] GDP is forecast to rise by about 1% in 1983 and about 1½% in 1984. This assessment is in line with the official Treasury forecast. Chart A.1 shows the CBI staff projections for GDP on optimistic and pessimistic paths[2] and indicates how, even on optimistic assumptions, on present policies it is likely to take until the end of 1984 for production to recover to the 1979 level. Our pessimistic path shows a slight decline in output over the next 2 years.

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1 Indexation of tax allowances and revalorisation of specific duties, no change in direct tax rates and the Government's published spending plans.

2 We have increased our central GDP projections by the average error in past London Business School forecasts between February 1977 and February 1981 to give the "optimistic likely outcome" shown in Chart A.1. The "pessimistic likely outcome" shown in Chart A.1 was obtained by subtracting the average error from our central forecasts. There is about a 3 in 5 chance of the outturn falling within the range of one average error above or below the central forecast if the forecast errors are normally distributed. The Charts showing RPI, unemployment and real rate of return were derived in the same way using data on average errors in London Business School or CBI staff forecasts.

Our central forecast suggests that in 1983 and 1984 the main upward influences on demand are likely to be an increase in consumers' expenditure, a return to modest stock rebuilding and growth in public current and capital expenditure. We see imports continuing to rise strongly with only a gradual recovery of exports. We should stress that our forecast for the UK is critically dependent on our views of the world economy over this period. We forecast world trade in manufactures to rise by about 2% in 1983 and by a little under 4% in 1984. The danger of world recovery being even weaker than this is one of the factors most likely to cause the forecast to be below the central path.

Inflation

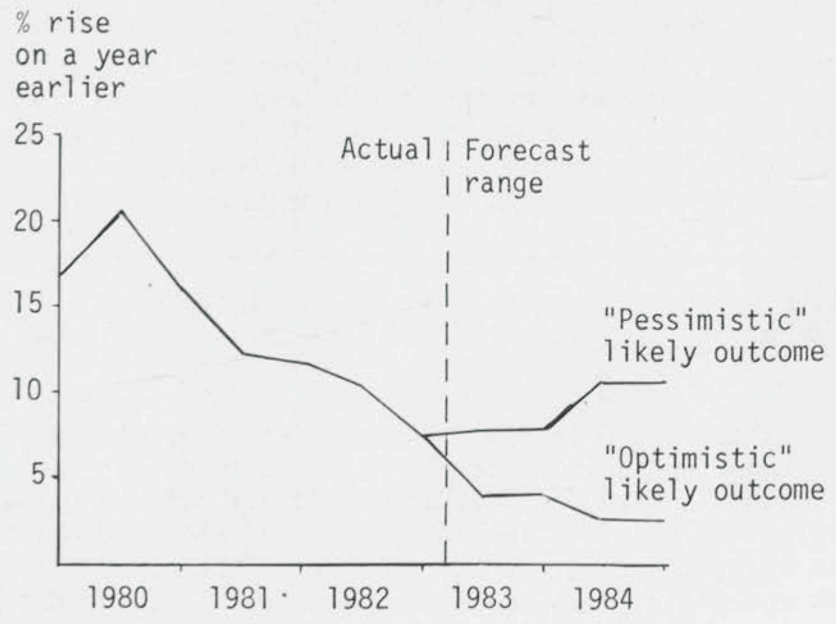
1982 witnessed a continuing decline in the rate of inflation, as measured, for example, by the percentage change in the Retail Prices Index over the previous twelve months.

By the end of the year this measure of inflation was running at 6%. The decline reflected a number of factors, including weak world commodity prices, favourable seasonal food prices and reductions in the mortgage rate, as well as lower unit labour cost increases working through.

On our central forecast some slight increase in inflation could occur from mid-1983. To a large extent this would reflect the ending of the impact of a series of recent temporary influences which have been favourable to inflation. In particular, seasonal food prices are unlikely to exert the same downward effect on prices, commodity and oil prices are unlikely to be

CHART A.2

RETAIL PRICE INFLATION - FORECAST ON UNCHANGED POLICIES



Source: Department of Employment, and CBI forecasts. See text for definition of 'unchanged policies'.

so weak (unless the world economy proves even more sluggish than expected) and mortgage interest rates are not likely to decline so rapidly. However, if retail price inflation does pick up somewhat, this should not necessarily be regarded as a return to higher inflation but more as a return to the underlying rate. By the middle of 1984, the central estimate suggests that the downward trend in inflation will again be apparent.

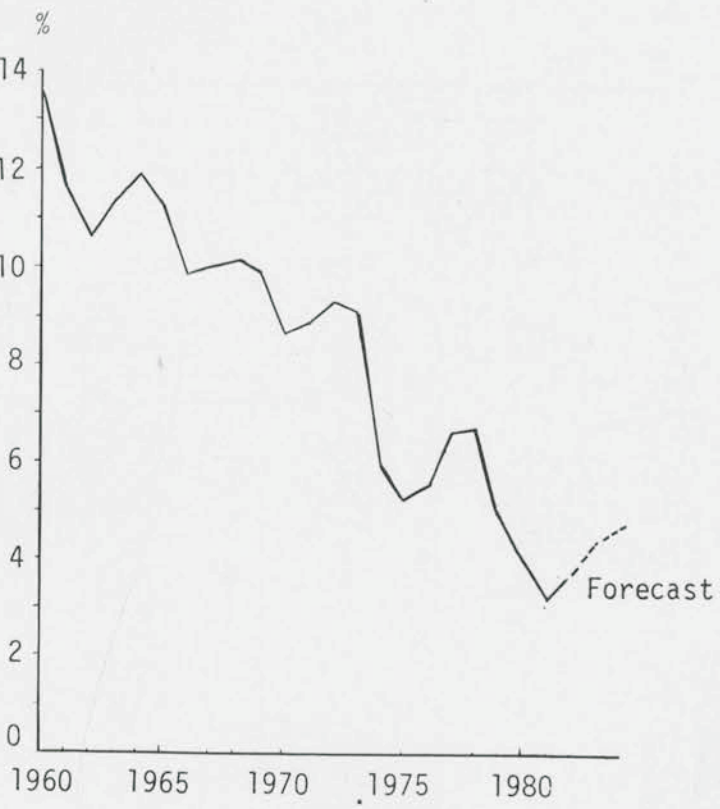
Chart A.2 shows that on optimistic assumptions, inflation could come down to 2-3% by 1984, while on pessimistic assumptions it could rise again to 10%.

Company Profitability and Investment

We estimate that in 1982, the real pre-tax rate of return for industrial and commercial companies was about 4%, excluding North Sea activities. This is some improvement over 1981, but is still very low by historical and international standards.

CHART A.3

REAL PROFITABILITY[1]



1. Gross trading profits plus rent minus stock appreciation and capital consumption for industrial and commercial companies, excluding North Sea activities, as a percentage of capital employed.

Source: Bank of England, and CBI forecasts assuming no action in 1983 Budget.

As a result of low profitability, investment and other provisions for the future have been cut sharply in the past three years by businesses. Manufacturing industry investment (even after adjusting for leasing) is estimated to have fallen by around 25% between 1979 and 1982, although investment outside manufacturing has remained relatively strong.

For 1983 and 1984 some improvement in real profitability is expected - to around 4½% on our central estimates. Chart A.3 shows that this would still be very low compared with past levels. Manufacturing investment is expected to fall by some 4½% in 1983 and private investment to rise by a modest 1% in 1983 compared with a year earlier. The outlook for 1984 is a little, although not significantly better.

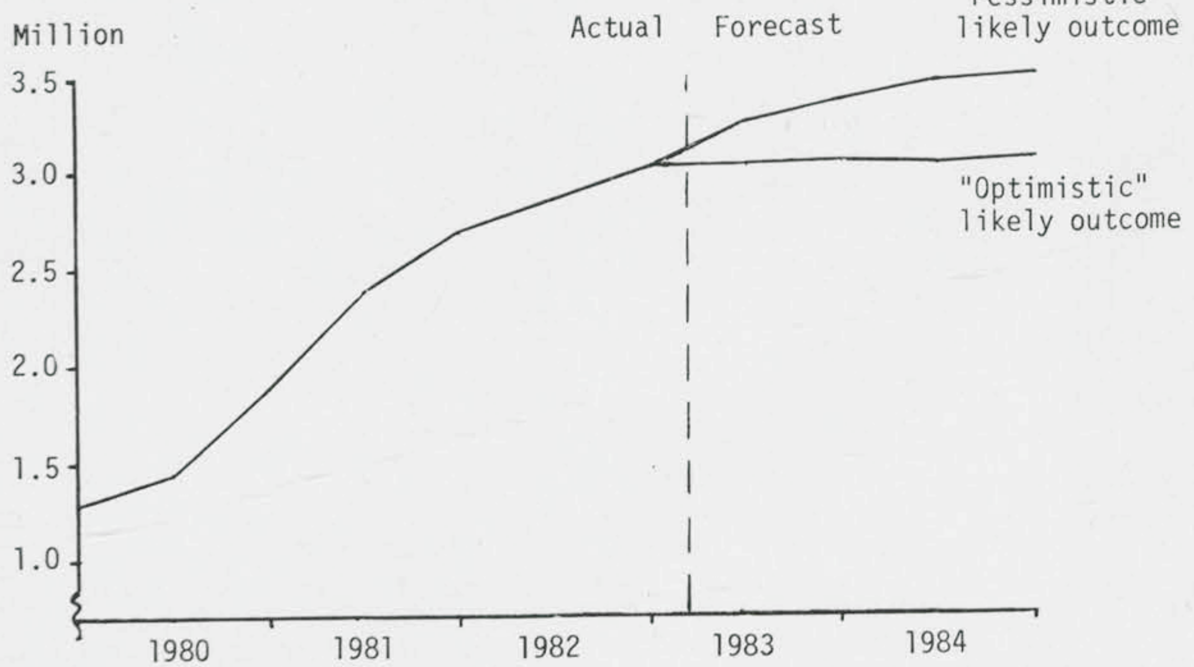
Unemployment

Chart A.4 shows the very rapid rise in unemployment from the end of 1979 and throughout 1980. Unemployment continued to rise throughout 1981 and 1982, but at a lower, though still historically high rate. By the end of 1982, the number unemployed (seasonally adjusted and excluding school leavers) was 2.95 million on the voluntary registrations method of counting. The figure on the old method of counting would have been about 3.2 million.

Unemployment on the old basis is forecast to reach a little over 3.2 million by the end of 1983. Thereafter unemployment could stabilise at around this level (see Chart A.4).

CHART A.4

UNEMPLOYMENT[1] - FORECAST ON UNCHANGED POLICIES



1. For consistency with earlier data, figures from November 1982 onwards are adjusted to include estimates of those not claiming benefit who had previously registered as unemployed.

Sources: Department of Employment, and CBI forecasts. See text for definition of 'unchanged policies'.

Monetary Situation and Public Sector Borrowing Requirement

Our central estimate, still subject to a large margin of error, is that the outturn of the public sector borrowing requirement for 1982/83 will be around £7½ billion. This compares with the Treasury's £9½ billion estimate in March 1982. The growth of Sterling M3 is likely to remain within, but probably at the top end of, its 8-12% range, and broadly in line with the growth of M1 and PSL2.

Preliminary forecasts suggest that, in the 1983/84 financial year, the PSBR will be around £6 billion, assuming unchanged policies.

Monetary forecasts are particularly uncertain, but it is likely that monetary growth, assuming some fall in interest rates, will be close to the top of the 7-11% target range for 1983/84.

HOW THE PROSPECTS WOULD BE IMPROVED BY IMPLEMENTATION OF CBI POLICIES

We described above our forecasts for GDP assuming unchanged policies. In this section we consider the likely outlook if the CBI recommendations set out in this document were implemented in the 1983 Budget. The formal assumption is made that there is no further change in fiscal stance in the 1984 Budget. In "The Will to Win" and "Agenda for Recovery" the CBI put forward medium-term proposals that would imply a fiscal expansion in the 1984 Budget. Our estimates are based on our own econometric model but we also checked them with the London Business School model and obtained essentially similar results.

HOW CBI POLICIES AFFECT OUTPUT

CHART A.5

"PESSIMISTIC" LIKELY OUTCOME

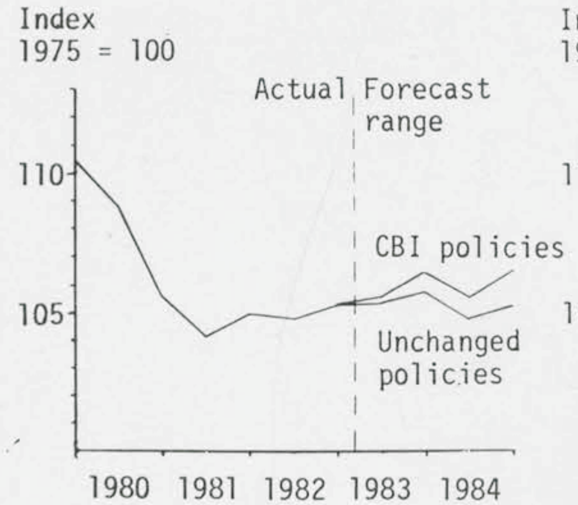
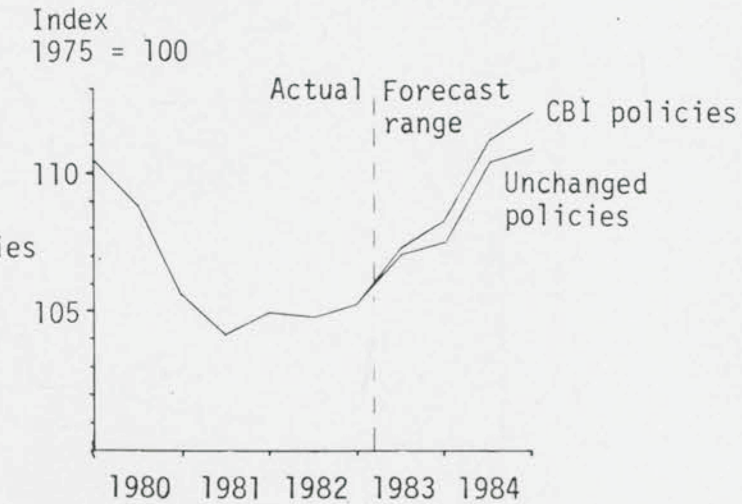


CHART A.6

"OPTIMISTIC" LIKELY OUTCOME



Notes: Sources and definitions as for Chart A.1
See text for definitions of 'unchanged policies' and 'CBI policies'.

i Effect on Output

Our proposals would increase output compared with unchanged policies through two main routes. First, competitiveness would be improved by the reductions in business costs that we are proposing. This improvement in competitiveness should lead to higher exports and lower import penetration, thus increasing GDP. Second, our measures represent an increase in the overall level of demand because of the increase in the difference between government expenditure and revenue.

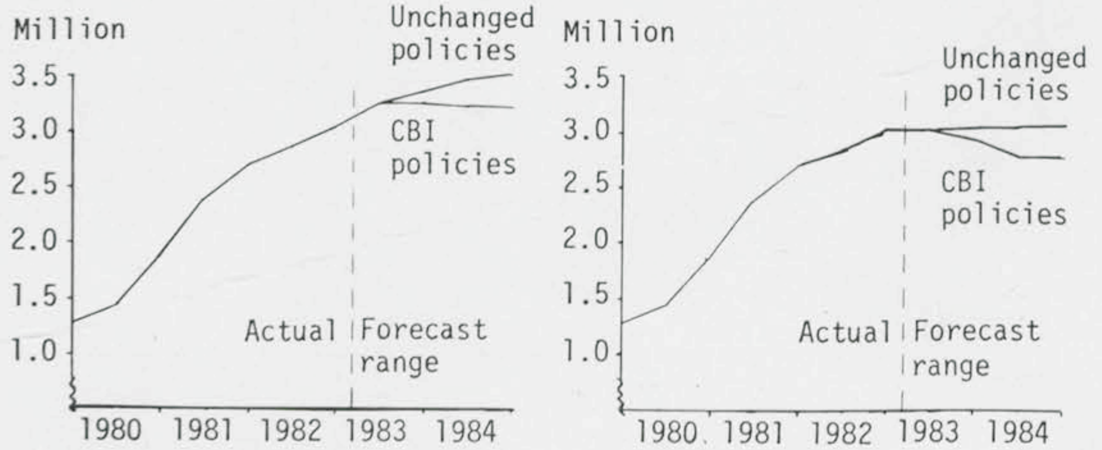
Chart A.5 shows that on present policies, if developments were at the pessimistic end of the range of likely possibilities, output by the end of 1984 would be lower than at the end of 1982. This would destroy the present hopes that unemployment could more or less stabilise in the second half of next year and it would eliminate the small recovery in profitability that we are currently hoping for. We would regard such an outcome as extremely unsatisfactory. If, on the other hand, our policies were implemented, output would rise, though only slowly. This would still be far from satisfactory but markedly better than a decline in output.

Chart A.6 shows that if the outcome were at the optimistic end of the likely range then even on present policies output would grow at a significant rate. If our policies were implemented, there would be growth of 6-7% over the next 2 years (3-3½% a year). Even this, however, would leave output only a little higher than in 1979. Because of the large margin of spare capacity existing at present, growth at this rate would be unlikely to lead to significant shortages.

HOW CBI POLICIES AFFECT UNEMPLOYMENT

CHART A.7 "PESSIMISTIC" LIKELY OUTCOME

CHART A.8 "OPTIMISTIC" LIKELY OUTCOME



Notes: Sources and definitions as for Chart A.4.
See text for definitions of 'unchanged policies' and 'CBI policies'.

ii Effect on unemployment

Charts A.7 and A.8 show the likely impact of our policies on unemployment. If unemployment turned out to be at the pessimistic end of the likely range suggested by our forecasts, then on current policies it would continue rising fairly markedly throughout the period to the end of 1984, while on our policies it would turn down slightly. At the optimistic end of the likely range, unemployment would decline slightly on current policies but on CBI policies it would fall - to around 2½ million (excluding school leavers, seasonally adjusted on the old basis).

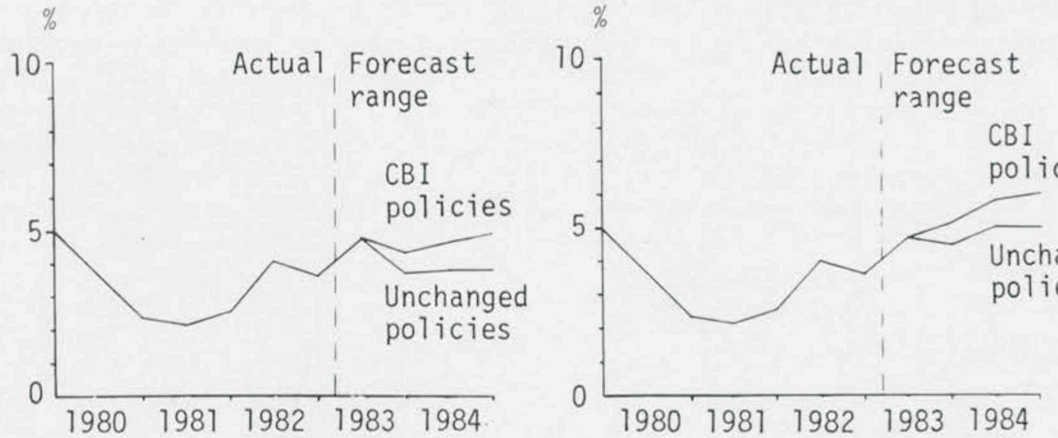
iii Effect on Profitability

Chart A.9 shows that on current policies real profitability would fall back from the expected level in the first half of 1983 if developments turned out at the pessimistic end of the likely range of outcomes, while if CBI policies were implemented, there would be little change from present levels. If events turned out at the optimistic end of probable forecasts, profitability on present policies would rise to around 5% by the second half of 1984 - still very low by historical standards - whereas on our policies it could reach 6%.

HOW CBI POLICIES AFFECT PROFITABILITY

CHART A.9 "PESSIMISTIC" LIKELY OUTCOME

CHART A.10 "OPTIMISTIC" LIKELY OUTCOME



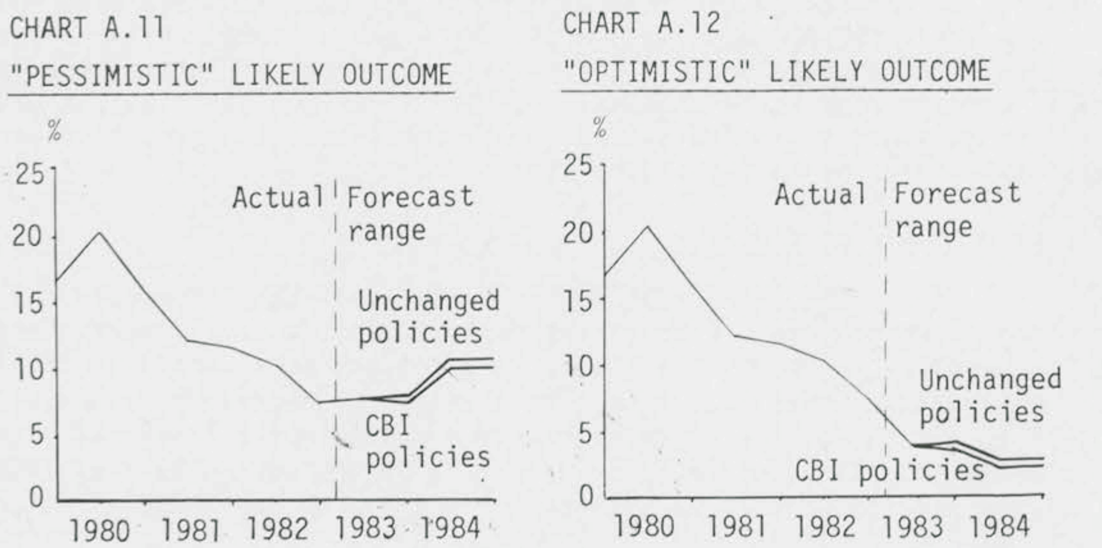
Notes: Sources and definitions as for Chart A.3
See text for definitions of 'unchanged policies' and 'CBI policies'.

iv Effect on inflation

We described above our central projection for inflation, which showed a slight slowdown from the present rate, assuming unchanged policies.

Charts A.11 and A.12 show that, if anything, our proposals would be likely to reduce inflation, because of the reduction in business costs that they imply.

HOW CBI POLICIES AFFECT INFLATION



Notes: Sources and definitions as for Chart A.2.
See text for definitions of 'unchanged policies' and 'CBI policies.

v **Effect on PSBR**

The higher output generated by our measures would, after a while, boost government tax revenue and reduce unemployment payments compared with present policies. This would partially offset the direct effects on the PSBR of the measures we are proposing, although the initial effect would probably be small. Table I.1 summarises our estimates of these "feedback" effects. The PSBR would be increased by about £3 billion in 1983/84 from the £6 billion figure we expect on current policies. In 1984/85 the PSBR would be increased by about £2 billion at 1983/84 prices by our recommendations, compared with what it would otherwise have been.

vi **Balance of risks**

The charts above give an indication of the balance of risks affecting the economy. They show that CBI policies are likely, if anything, to reduce prices compared with what they would otherwise have been by reducing business costs and increasing volume; and that even on optimistic assumptions about growth, our policies would be unlikely to lead to inflationary shortages. In any case, any risk of higher inflation has to be balanced against the risk of lower output and higher unemployment. Our pessimistic assumptions, assuming no change in policies, show output stagnant or even declining, and unemployment in the second half of 1984 some half a million higher than in the second half of last year.

Given the range of possibilities, we judge that the risk of implementing the proposals contained in this document are relatively small, whereas the dangers involved in following unchanged policies, or policies substantially more modest than those we propose, would be unacceptably great.

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From
Sir Campbell Fraser
President

(2)

CBI CONFEDERATION OF BRITISH INDUSTRY

Prime ~~Minister~~

They want a £9 billion PSBR, and ~~additional~~ a £2½b ~~bn~~ fiscal adjustment - including abolition of NIS, lower business rates, and nothing more than indexation of personal allowances.

MLS 25/1

24 January 1983

Dear Prime Minister,

I have today sent to the Chancellor of the Exchequer a copy of the CBI's Budget Representations which are to be published on 26 January, with copies to the members of the Cabinet.

I am conscious of the many proposals that the Chancellor receives at this time, and of the need to weigh many factors in the balance before conclusions are reached. The CBI proposals have the unanimous approval of its Council in the belief that they not only meet the needs of business but would be helpful to the nation as a whole. I commend them to you.

Yours sincerely,
Campbell Fraser

The Rt. Hon. Margaret Thatcher, MP,
Prime Minister,
10 Downing Street,
London, SW 1.

INSTITUTE OF DIRECTORS WITH COMPLIMENTS

Mr Scholar

R20/1

Director General
Walter Goldsmith

We thought that you might be interested to see the Institute's 1983 Budget Submission to the Chancellor of the Exchequer.

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INSTITUTE OF
DIRECTORS

BUSINESS RECOVERY THROUGH TAX CUTS FOR CUSTOMERS

JANUARY 1983

BUSINESS RECOVERY
THROUGH
TAX CUTS
FOR
CUSTOMERS

Submission to the Chancellor of the Exchequer
for the 1983 Budget and Finance Bill

CONTENTS

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INSTITUTE OF DIRECTORS

1983 BUDGET REPRESENTATIONS - SUMMARY OF PROPOSALS

Paragraphs	Item	Proposal	Cost (£M) (See Note) 1983-84	Full Year	Reasons
3-5	The economy	1. Do not reflate (ie keep to Medium-Term Financial Strategy & PSBR of £8.5b)			1. Keep interest rates down 2. Keep inflation falling 3. Steady sterling
7-12, 18		2. Use scope within MTFS for £2b tax cuts. Fiscal adjustment of £2b assumed in IOD package.			Aid business recovery
11, 49-52	Creating jobs	Promote self-employment by: 1. Extension of enterprise allowances	NM	NM	1. Success of pilot project 2. Ease transition to self-employment 3. Harness black economy energies
		2. £5,000 tax allowance incentive for new small businesses	NM	NM	1. Ease transition to self-employment 2. Harness black economy energies
		3. Suspension of Class 4 National Insurance	Nil	240	Reduce tax on self-employment
55	Freeports	Establish	NM	NM	Improve Britain's world trade position
13-15	Government spending	1. No let-up in retrenchment even where underspending	Saving	Saving	Continue transfer of resources to private sector
		2. Carry through privatisation program, including financing of capital projects	Saving	Saving	

Paragraphs	Item	Proposal	Cost (£M) 1983-84	Full Year	Reasons
16-17	Local authority rates	1. Statutory right to tender	Saving	Saving	1. Opportunities for local business 2. Reduce rates burden
		2. Abolish GLC metropolitan counties	Saving	Saving	1. Reduce rates burden 2. Eliminate wasteful duplication
19-24, 27	Income tax thresholds	Raise allowances and thresholds 6½% more than inflation	900	1,300	1. Ease poverty trap 2. Increase consumer spending to aid business
19-24,28-29	Income tax rates	Reduce basic & higher rates by 1p at least	905	1,005	1. Manifesto commitment 2. Increase incentives 3. Increase consumer spending to aid business 4. Taxpayer morale 5. Reduce pressure on wage awards 6. Directly help companies incurring unrecoverable ACT on dividends
29-32	Investment income surcharge	Abolish	15	240	1. Cost-effective stimulus to saving & investment 2. Investment income now more at risk than employment income
57	Mortgage interest relief	Raise limit above £25,000	*	*	1. Stimulate home buying 2. Help construction industry 3. Boost consumer spending

(2)

Paragraphs	Item	Proposal	Cost (£M) 1983-84	Full Year	Reasons
58	Stock options	Tax as capital gains not as income	NM	NM	Incentive for business leadership
19-24,29	National Insurance surcharge	Further reduce in longer-term only	No change	No change	1. Limited results from significant cuts already made 2. Income tax cuts more cost-effective as aid to business 3. Fears of import surge largely unfounded
29,33-35	Capital transfer tax	Increase business & agriculture reliefs to 100%	25	100	1. Capital taxes promote one-generation high-spending society 2. Capital taxes are counter-productive in reducing inequality 3. Reduce burden on family businesses 4. Complement start-up incentives 5. CTT cuts cheap by comparison with industrial or employment subsidies
		Reduce rates (top rate by 10%)	25		
36-40	Capital gains tax	Improve indexation rules	Nil	?200?	
		Cut off after 7 years	Nil		
		Reduce rate to 25%	Nil		
26,41-44	Corporation tax	Reduce rate to 50%	130	250	1. Help companies paying mainstream corporation tax 2. Encourage investment
		Improve marginal relief**	35	75	Encourage small companies to expand
		Liberalise use of tax losses	NM	*	1. Help tax-exhausted co's 2. Stimulate surge of investment
		Remove 6-year cut off of stock relief	Nil	*	

(3)

Paragraphs	Item	Proposal	Cost (£M) 1983-84	Cost (£M) Full Year	Reasons
53	Capital allowances	Extend to new commercial building	NM	See reason 4	1. Help construction industry 2. Reduce anomaly disproportionately harming service industry 3. All business expenditure should be allowable 4. Full-year cost not reached for very long time
54	Value added tax	1. Remove zero-rating anomaly between new buildings and repairs**	*	*	Help construction industry
16		2. Same treatment for private contractors as for public authorities providing same service	*	*	Remove discrimination against private sector
59-60	Directors and other in multiple employment	1. Remove anomalies on travel expenses and National insurance	NM	NM	Encourage appointment of more non-executive directors
		2. Allow Schedule D directors to join superannuation schemes	NM	NM	
(4)					

Note: 1. In addition to the above costs there would be a net cost of £300M from indexing tax thresholds and excise duties for inflation on the assumptions in the Chancellor's autumn statement.

2. For more detailed explanation of the costing of the IOD proposals, see Appendix to the submission.

3. NM = Not material
*= Insufficient information on which to base an estimate
** = only if more than £2b fiscal adjustment available (Appendix paragraph 17)

4. The costs stated relate to each measure taken separately. The actual first round cost of the package will be lower to the extent that, for instance, tax relief from increased allowances and from reduced rates overlap. The second round effects cannot reasonably be estimated, but it is reasonable to suppose that the stimulus to the economy would result in higher incomes and spending and therefore higher tax revenues, and would reduce spending on benefits for the unemployed. Again this reduces the real cost of the IOD package.

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The Rt Hon Sir Geoffrey Howe QC MP
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11 January 1983

Dear Chancellor

1983 BUDGET AND FINANCE BILL

1. I am writing to let you have the Institute's general representations for the Budget and Finance Bill 1983. Our technical representations were submitted in December, and I attach a copy for ease of reference.

2. We welcome the innovation of an autumn economic statement on the Budget of the following spring. It is helpful to bring together income and spending projections in a single document, thus emphasising the tax cost of additional government expenditure. We disagree with those who would have liked the autumn statement to take the form of a "Green Budget"; the Budget should form a coherent package, and some of the principal decisions cannot be taken until nearer the time.

The economy

3. The principal developments over the last year have been the reductions in inflation, in interest rates and in wage settlements. All are of benefit to business, and profits have begun to recover from the very low levels reached at the beginning of 1981. These results have been achieved through the Government's firmness of purpose and readiness to ignore pressure for soft options and short-term remedies.

4. We are also glad that the Government have over the last year been pursuing a more vigorous policy of correcting the structural weaknesses of the economy, notably through privatisation and the reform of industrial relations legislation. The principal cause for concern, by contrast, has been the failure (at least until recently) to control the rise in government spending and the consequent increase in the tax burden since the Budget of 1979.

5. These are the underlying ideas in our representations this year. The Government should continue to reject proposals for reflation through additional government spending and should pursue and accelerate its programme for structural reform. At the same time, the need for tax reductions is becoming increasingly urgent, especially as there is still little evidence of the economic upturn that has been predicted for so long. The tax cuts should thus be designed both to ease the process of structural change and to bring forward the upturn in economic activity; and our proposals are intended to satisfy these requirements.

6. We are conscious of the pressure to reduce business costs but are firmly of the view that our recommendations are at least as likely to achieve the objective of a healthier business climate, particularly for those companies which have carried out adequate restructuring over the last few years. Similarly, current low levels of profitability are best improved by cuts in taxes on profits and income which benefit business by strengthening the economy in general.

Short term and long term

7. During the 1960's and 1970's fiscal and economic policy were too often dominated by short-term considerations and lacked long-term direction. Our long-term aim for the British tax system is to turn it into what has been described in another context as a "privileged tax regime" - with low taxes on income and low or no taxes on capital, much as in the Channel Islands at present. This form of privilege is within the reach of any well-run economy. In the long term, at least, tax reduction should be extended to value added tax and excise duties.

8. The reduction of tax rates reduces the value of tax reliefs and allowances at the same time as it reduces the need for them. We should, however, oppose attempts to find the resources for tax cuts by reducing or abolishing reliefs and allowances. The resources should be found by retrenchment of government spending, through privatisation and otherwise.

9. The present Administration has a much more modest and realistic assessment than its predecessors of what governments can do to promote economic prosperity. The scope for improvement at present lies primarily in the withdrawal by government from functions and activities which impede the working of the market economy. The two principal impediments of this kind are the over-regulation of private business and the distortion of the market by taxation.

10. The removal or reduction of these impediments is the only sound long-term policy for the reduction of unemployment. Policies of job creation, currently costing some £4 billion a year for employment subsidies alone, are at best a second best. Even if they are well designed, they merely serve to correct distortions caused in other areas of Government policy. We share the wish to see unemployment reduced as quickly as possible, if necessary by unconventional means; but we should prefer measures to be adopted for this purpose which also serve the aims of longer-term policy. Whereas the Government are cautious in their approach to tax reductions but are willing to spend large sums of public money on programmes of job creation yielding little long-term benefit, we should prefer a more cautious attitude towards public spending on job creation and a willingness to experiment boldly with tax reductions which may be at least as effective as public spending in reducing unemployment and have the additional and overriding merit of being desirable in themselves.

11. In particular, the increase of self-employment is not only one of the simplest and potentially most effective ways of reducing unemployment; it is also socially and economically desirable both in the short term and in the long. The Inland Revenue, however, are pursuing the opposite policy of trying to reclassify large numbers of self-employed workers as employees. This policy is at least as likely to reduce tax revenue as to increase it; and unemployment is increased and recovery delayed by imposing on self-employed workers the status of employees, since the over-regulation of employers is itself a prime cause of unemployment.

12. More generally, tax cuts are now urgently needed not only to assist economic recovery and to improve incentives in the conventional sense but also to improve taxpayer morale. The process of adjustment from inflation to stable money has proved longer and more difficult than had been expected. The success of the Government's policy requires continuing popular support. Tax cuts, and specifically cuts in income tax, show that your Government is able to honour its undertakings, especially your commitment to reduce the basic rate of income tax to 25 per cent; and they provide the most tangible evidence that the Government's programme is working. Furthermore income tax cuts help to take the pressure off pay awards and will therefore contribute to lower inflation.

Government spending

13. We were glad to note that in 1982, for the first time since 1977, the annual review did not lead to an increase in planned expenditure for the coming year. We recognise the hard work and determination on the part of Ministers needed to achieve even this limited result, which should be the precursor of increasingly effective control over Government spending in the years to come. It was therefore disappointing that a few days before the November statement the Government criticised local authorities and nationalised industries for underspending on capital account. This departure from the usual message of economy and retrenchment is not only confusing to the local authorities and nationalised industries, and to the public, but in our view wrong in itself.

14. No less important than the distinction between current and capital spending is the distinction between capital spending that will reduce subsequent spending on current account and capital spending that will increase it. Capital spending of the latter kind is less, not more, useful than current spending with a limited time-span. Where capital spending yields a financial return, on the other hand, we should prefer it to be privatised rather than increased at the taxpayer's expense. Underspending on either kind of capital account should be more a matter for congratulation rather than criticism.

15. At the level of local, as of national, government, substantial economies are obtainable only by the elimination of functions and activities, through privatisation or otherwise; for local government this includes the reduction of its statutory obligations. Large economies are unlikely to be obtained through the reduction of overmanning and other forms of waste unless the activities concerned are privatised, because it is in the nature of public-sector ownership and management to lead to inefficiency.

16. Similarly, the solution to the problem of heavy and increasing business rates lies through the reduction of functions, not through a shift in the burden from business to domestic ratepayers. In our submission on the Green Paper "Alternatives to Domestic Rates" (Cmnd. 8449), we recommended inter alia that private-sector businesses should have a statutory right to tender for the discharge of local authority functions as agent or sub-contractor. Private businesses supplying such services should not be subject to value added tax where public bodies with which they are in competition are exempt. Value added tax in these circumstances is a good example of a tax which does more damage than it yields revenue.

17. Another major reform that is desirable for reasons of economy as well as on more general grounds is the abolition of the Greater London Council and the metropolitan county authorities.

Scope for tax cuts

18. Whatever the size of the fiscal adjustment in your next Budget, it should be used to cut taxes and not to increase Government spending. We hope that the fiscal adjustment will be substantially more than the £1 billion mentioned in your autumn statement. We explain in the Appendix our reasons for believing that tax cuts with a first year cost of £2.3 billion (giving a fiscal adjustment of £2 billion after allowance for inflation) would be fully consistent with the thrust of the medium-term financial strategy which we have so strongly and consistently supported. A reduction in tax rates is becoming increasingly urgent, both as a spur to recovery and as a fillip to taxpayer morale; we believe that it would be a false economy to cut taxes by less than the £2 billion we have recommended.

Nature of tax cuts

19. The argument above indicates that the tax cuts in the next Budget should have one or more of the following characteristics:- they should be desirable in the long term as improving the efficient working of the market economy; they should accelerate the short-term process of economic recovery; and they should serve to maintain and improve public confidence in the success of your economic policies.

20. A cut in the basic rate of income tax scores heavily by all three tests; a cut of not less than 1 penny should be made, and could be afforded, within your next Budget. Pay-As-You-Earn, as a tax on employment, is no less a tax on business costs than is the national insurance surcharge; but it has the decisive advantage of being much more visible to employees, and business gains a second time from a cut in income tax since employees are also customers.

21. A cut in the basic rate of income tax is needed not only for the sake of taxpayer morale but also for its own sake; indeed, there is no sharp distinction. The 30 per cent basic rate of income tax is the highest starting rate of income tax in Europe and is a prime cause of the poverty trap in its various forms; and the marginal tax rate for even the poorest taxpayer subject to the basic rate of income tax has risen from some 55 per cent in 1979 to 57 per cent now when account is taken not only of income tax but also of national insurance contributions, value added tax and excise duties. By contrast, national insurance contributions, including the surcharge, are near the centre of the European range. Indeed, we wonder whether the national insurance surcharge would have attracted so much attention in certain quarters if it had been integrated into the employer's contribution instead of being called by a separate name. A further cut in the national insurance surcharge is indeed desirable in the longer term (as is the privatisation of national insurance, and for similar reasons); but it should not have high priority in the near future.

22. We hope that you will not make a virtue of unnecessary austerity and reject a cut in the basic rate of income tax on the ground that it would be popular and thus an easy option in some pejorative sense. A cut in the basic rate of income tax would be popular for the same reason that it would strengthen the market economy: it would bring gross-of-tax income and net-of-tax income closer together. Similarly, we reject the argument that the next tax reductions should be aimed at business because business has been losing ground to workers and consumers in recent years: the argument is wrong because it is based on the fallacious concepts of corporatism. There is not a separate business interest that needs to be restored to some historical level of prosperity at the expense of its employees and customers. The interests of business are not competitive with those of its employees and customers but complementary and even identical. The reason why business has been depressed and profits low in recent years is not that it has been losing ground to workers and consumers but that it has been suffering from the cumulative effect of some twenty years of mismanagement by previous Governments.

23. The argument that there is some special virtue in tax cuts designed for business to the exclusion of workers and consumers is equally fallacious at the technical level. It is sometimes suggested that cuts in income tax would result in a flood of imports; but the statistical evidence indicates that business purchasers have at least as high an import propensity as have consumers. In addition a healthy consumer market forms an important volume base for British exporters and is an encouragement for foreign investors for whom a healthy market for their products is a fundamental criterion for the establishment of their manufacturing activity in Britain.

24. Again, it is sometimes suggested that cuts in business taxes (like the national insurance surcharge) have a more rapid effect on economic activity and unemployment than cuts in general taxes (like income tax) at the same revenue cost; but the evidence strongly suggests the contrary. The national insurance surcharge was cut twice in 1982 with no noticeable effect on economic activity. By contrast, when substantial cuts in mortgage rates last autumn put more money into consumers' pockets, the result was seen within weeks in the form of record Christmas sales. Income tax cuts are comparable in this respect with cuts in interest on house mortgages, and we would expect the result to show up just as rapidly in increased activity.

25. The tax cuts that are clearly superior to other tax cuts in the speed of their contribution to economic recovery are not cuts in business taxes like the national insurance surcharge. They are cuts in taxes whose yield accrues to the revenue in arrears, sometimes after several years' delay. Cuts in these taxes are exceptionally cost-effective as a means of accelerating economic recovery: the incentive effect begins as soon as the tax cut is announced, whereas the revenue incurs the corresponding cost only after a considerable interval, if ever. The same taxes are cost-effective in a separate sense, because they are levied on the most entrepreneurial and capitalist parts of a capitalist economy. A principal theme of our representations this year is the urgency of reducing or relieving these taxes and the cost-effectiveness of so doing. The main proposals to which this argument applies concern: investment income surcharge, capital transfer tax, capital gains tax, six-year limit on the carry-forward of stock relief, restrictions on the use of tax losses, £25,000 limit on borrowings eligible for tax relief on interest, stock options, development land tax.

26. For firms currently making taxable profits, the present rate of corporation tax is too high and should be reduced (corporation tax, below). For tax-exhausted firms, liberalisation of the restrictions on the use of tax losses is a more cost-effective relief than reductions in business costs (use of tax losses, below).

Income tax

27. The main direct tax allowances should be accorded the full statutory indexation for inflation in 1982, in accordance with the "conventional assumption" used in the autumn statement. Indeed, they should be increased by more than this in order to regain some of the ground lost in the Finance Act 1981; one of the strongest themes to emerge from a wide-ranging consultation of our membership both before and after your autumn statement was the importance of a substantial increase in tax thresholds this year. However, any further indexation beyond the statutory minimum should take into account the desirability of a cut in the basic rate of tax. The defects in the income tax schedule are at least as much in the rates of tax as in the points of the scale at which they first apply; and increasing the thresholds without reducing the rates preserves the excessive rate structure intact. The continuing credibility of the Government's commitment to tax reduction requires a cut in the basic rate.

28. A cut in the basic rate of income tax also has the advantages of reducing the taxation of dividends and other forms of investment income and thus of reducing the cost of equity finance. In order to achieve this result, a cut in the basic rate of income tax must be complemented by a cut in the rate of corporation tax (Corporation tax, below).

29. A cut in the basic rate of income tax should be carried through to the higher rates of tax and should also be accompanied by cuts in the investment income surcharge and in capital transfer tax. We reaffirm that for each percentage point reduction in the basic rate there should be a reduction of not less than 3 points in the investment income surcharge and 10 points in the maximum rate of capital transfer tax. However, this target for the investment income surcharge is unduly modest and we urge you to reconsider the advantages of its abolition.

Investment income surcharge

30. There is a strong case for abolishing the investment income surcharge both at technical level and more generally. The original argument for discrimination against investment income, namely that earned income is more precarious than income from investments, now works in the opposite sense: employment income enjoys much statutory protection, whereas investment income is fully exposed to the hazards of inflation and economic recession. In addition, it is widely resented that savings already fully taxed as earnings should be subject to a discriminatory surcharge as investment income. It is therefore not surprising that the surcharge is inequitable and unpopular. It has few convinced supporters, if any, and its abolition would be widely welcomed. Not the least of the advantages of its abolition is the consequent reduction in the scale of avoidance and anti-avoidance activities.

31. In Inland Revenue Statistics 1982 Table 1.5 the cost of exempting the first £5,500 of investment income from the surcharge is put at £930 million (for 1981-82). In the autumn statement the full-year cost of abolishing the surcharge is put at some £240 million (for 1983-84). This means that the tax is being levied on only about one-fifth of its theoretical base (or even less when allowance is made for the two-year difference between the figures). It is one test of a good tax that its actual yield should represent a substantial proportion of the theoretical maximum; by this test, as by others, the surcharge is deeply defective.

32. The abolition of the investment income surcharge is also a cost-effective tax reduction for the reason mentioned earlier (paragraph 24): the incentive effects and other benefits are enjoyed immediately while the corresponding costs in tax forgone are incurred only after an interval. The autumn statment indicates that the first-year cost of abolition would be only some £15 million, or well under one-tenth of the cost in a full year.

Capital transfer tax

33. Despite a number of welcome technical reforms in the Finance Acts 1980-82, the rate structure still rises to 75 per cent and is indexed for inflation only from December 1982. For a wide range of taxpayers above the new threshold, the effective burden of the tax is now much heavier than when the scale was first set in 1974. We urge that the reform of this tax should be pressed forward, both through cuts in the rates of tax and through the reliefs specified in our technical representations.

34. Capital transfer tax of any kind, and especially in anything resembling its present form, works counter to the driving force of a market economy, which is people taking their own decisions with their own money. It frustrates the natural and proper wish of taxpayers to transmit the results of business success to their heirs. It promotes the high-spending one-generation society, which shows capitalism in the least attractive light. It is also counterproductive for its intended purpose of reducing the inequality of wealth: lifetime transfers are generally from richer taxpayers to poorer, and this process of voluntary redistribution is obstructed by capital transfer tax. The tax on lifetime transfers is the least productive part of CTT (bringing in less than a tenth of the total yield); it is also the most damaging part, in the sense that it impedes redispositions made voluntarily and in the taxpayer's own time. We urge that the good work begun in the Finance Act 1981 be continued: the top rate of tax on lifetime transfers should be reduced to not more than half the rate on death and the period of cumulation should be reduced from ten years to seven.

35. Reductions in capital transfer tax are a cost-effective stimulus to recovery because the tax is collected in arrears and the benefits are enjoyed by taxpayers before the corresponding costs are incurred by the revenue (Paragraph 25). Improvements in business and agricultural reliefs are also very cheap by comparison with alternatives such as industrial and employment subsidies because of the modest sums involved (£20 million for business relief in 1981-82 and £35 million for agricultural relief). Improvements in business reliefs also form a logical complement to the array of incentives to taxpayers starting in business introduced by the present Government: if these incentives serve their purpose the businesses should grow, and capital transfer tax at anywhere near its present rate is a grave discouragement to growth above a modest level. The arguments against levying capital transfer tax on business assets are also valid, though perhaps less strong, for assets of all kinds; and we should like to see capital transfer tax progressively reduced and preferably abolished for taxpayers in general. But on this occasion we put the main emphasis on business assets: the lower rates of relief should be consolidated into the present 50 per cent rate of business relief, as we have argued in our Technical Representations and, on grounds of general policy, this new standardised rate should be increased to not less than 75 per cent and preferably to 100 per cent. For business assets at least, capital transfer tax is immensely destructive by any reasonable economic or social criterion, and this damage should be brought to an end by its abolition.

<u>Capital gains tax</u>

36. We warmly welcome the indexation provisions in the Finance Act 1982. Our technical representations show inter alia how these provisions should be extended in order to yield their full benefit.

37. A long-term capital gains tax has no logical justification since the case for taxing the gain becomes weaker with each additional year the asset is held. Thus, even if prices were stable, there ought to be a taper or cut-off. But under the provisions of the Finance Act 1982, pre-1982 inflationary gains are entirely excluded from relief for inflation in the past and largely excluded from relief for inflation in the future; and this will remain a serious anomaly indefinitely. As we have argued in our technical representations, the answer to the problem of pre-1982 inflationary gains is exemption for assets held for seven years or more; and this exemption should be extended to all assets and not confined to those already held in 1982.

38. The rate of capital gains tax is a survivor from a distant age and is long overdue for reduction. Reduction of the rate of capital gains tax will be unavoidable if the basic rate of income tax is reduced; but it should not be dependent on the reduction in the basic rate of

income tax; the rate of capital gains tax should be reduced to not more than 25 per cent.

39. Capital gains tax is an exceptionally cost-effective tax to reduce since the yield accrues over a period of some six years (Inland Revenue Statistics 1982, Table 4.18).

40. Quantified and unquantified reliefs from capital gains tax on individuals and trustees indicate that it is being levied on not more than some 15 per cent of the theoretical base and perhaps on as little as 10 per cent or even considerably less (Inland Revenue Statistics 1982, Tables 1.5 and 1.6); and the percentage will fall steeply as a result of the indexation provisions in the Finance Act 1982. As we have argued earlier, such a low percentage is the mark of a bad tax. For the reasons explained in 1955 by the majority of the Royal Commission on the Taxation of Profits and Income, no separate tax on capital gains is required; any boundary problems between capital gains and income should be dealt with as such.

Corporation tax

41. The rate of corporation tax is a survivor from the same distant age as the rate of capital gains tax. As the basic rate of income tax, and thus the rate of advance corporation tax on dividends, has fallen, the rate of tax on corporations as such has risen correspondingly; meanwhile the small companies rate has fallen. A rate of 52 per cent is historically and absolutely high and especially anomalous at a time when a large proportion of companies are fiscally-exhausted and not paying mainstream corporation tax or perhaps even advance corporation tax at all. There is an excessive difference between the tax treatment of companies subject to fiscal exhaustion and of those subject to the full rate of corporation tax. The rate should be reduced to not more than 50 per cent, and the case for a further reduction is strengthened if the basic rate of income tax is reduced as we have proposed.

42. It is inequitable and uneconomic that small companies relief should be clawed back by an effective marginal rate of 60 per cent on profits between £90,000 and £225,000. This is just the range over which small firms that have succeeded in establishing themselves have the possibility of expanding; and the 60 per cent marginal rate is a serious discouragement to expansion over a wide range of profits. All profits over £90,000 should be taxed at a marginal rate of no more than 52 per cent.

43. We are making a separate submission on the Green Paper on Corporation Tax (Cmnd. 8456). On the main question of the structure of corporation tax the conflicts between the different possible opinions are best reconciled if the rate of corporation tax is the same as the basic rate of income tax or only a little above; and the reduction of corporation tax to this level should be the Government's long-term aim.

44. We shall also be making a submission within the next few weeks on the new consultative document on Taxation of International Business. We are very glad that the proposals for company residence and upstream loans have been dropped. The proposals for tax havens remain gravely defective and require radical alteration.

Use of tax losses

45. Companies not currently paying mainstream corporation tax should not and need not be excluded from the scope of tax reduction. We have two proposals for this purpose, one particular and one general.

46. In particular, the six-year limitation on the carry-forward of stock relief should be abolished. The arguments are familiar to you and need not be repeated here. The case for the limitation is apparently based on the "overhang" of £30 billion of unused tax reliefs and allowances increasing at some £5 billion a year (Green Paper, paragraph 14.1); but these figures must consist largely of dead losses which could never be used to relieve current tax bills. Again, we would emphasise the cost-effectiveness of our proposal: the change could remove an anomaly which is inhibiting investment and the effect would be immediate while the corresponding cost would not be incurred by the revenue for six years or so, if ever.

47. More generally, the most economical way of helping tax-exhausted firms would be to relax the restrictions on the use of tax losses, preferably by removing these retrictions in their entirety. This measure would also be correct in principle. The fundamental defect of present restrictions (under Section 483 ICTA 1970 and elsewhere) is that they are designed to prevent precisely those alterations in business practice which are most desirable economically. We are submitting a separate paper on a market in tax losses.

Incentives for small business

48. Through the Venture Capital Scheme, the Business Start-up Scheme and the incentives for investors, the Government have introduced an imaginative and wide-ranging set of measures to assist the establishment and early growth of small businesses. They are the kind of measure best

suited to assist recovery, since they reduce or remove tax obstacles to individuals helping themselves or co-operating with each other. First-round tax avoidance has rightly not been allowed to hobble these schemes, which should eventually yield their return, not only to the economy, but even to the revenue.

49. For similar reasons, we have welcomed the enterprise allowance system under which an individual moving from unemployment to self-employment may claim £40 a week in respect of the unemployment benefit he has forfeited by this move. This system should be extended from the present five experimental locations to country-wide coverage.

50. With this background, it is all the more disappointing that the Government's response to the Institute's proposal for tax-exemption for the first £5,000 of new self-employment income has been so negative and dilatory. The Revenue's own estimate of the first-round tax loss, at some £100 million, is a modest cost which should be acceptable in view of the potential benefits for the scheme. We do not regard the scheme as wide open to abuse, because the taxpayer who seeks to benefit can do so only in so far as he submits to the disciplines of self-employment; and these disciplines are more severe than many people with a steady job imagine. Any tax advantages obtainable from self-employment are paid for by the loss of other advantages which employees often take for granted.

51. We believe that our £5,000 proposal has large potential for assisting recovery and reducing unemployment. It would be much more economical than the employment subsidies on which the Government are at present spending some £4 billion annually. More than a year has gone by with no action taken on our proposal, which could have made a substantial contribution to reducing unemployment by now. If the proposal is to make progress, it requires the sympathy and interest from Ministers which it deserves.

52. We regret that the Class 4 national insurance contribution levied on the self-employed is still in force without abatement and that the rate of contribution and the ranges of income over which they are levied have been successively increased since the present Government came to power. The self-employed obtain no benefit from these contributions, which are simply a tax on self-employment as such. For many self-employed people in a small way of business, Class 4 contributions are a large proportion of the total tax bill; they are directly in conflict with other measures designed to encourage taxpayers to start in business. Reform in this area should not await the outcome of the current review: the

removal of the fiscal impediments to self-employment should be an important part of any programme for hastening economic recovery. We therefore recommend the abolition of Class 4 national insurance contributions on incomes earned in accounting periods ending in the tax years 1983-84 and 1984-85. The levy need not be reintroduced thereafter if the results of the current review indicate that it should be abolished permanently. As with a number of our other recommendations, the incentive effects would be immediate whereas the cost would not be incurred until a year or more later. We are writing again on this matter to the Secretary of State for Health and Social Security.

Construction

53. Given the low level of activity in the construction industry and the low import content of expenditure on construction, this industry offers the prospect of a rapid return to any fiscal stimulus. We do not recommend any additional government expenditure on construction; but we urge again our long-standing proposal that capital allowances be extended to new expenditure on commercial buildings. This would not only be helpful to the economy in the short term; it would also be right in principle.

54. We also ask you to give more serious consideration to removing the present anomaly by which value added tax is charged on repair and renovation but not on new construction. This discrimination has created a most unsatisfactory boundary; and it makes no economic sense, since it constitutes an artificial incentive to pull down buildings which would be worth repairing under a neutral tax regime. The removal of value added tax on repairs and renovations would also have the advantage of being a fast-working stimulus to the construction industry.

Freeports

55. Freeports in other countries are obtaining a rapidly increasing share of world trade. The introduction of freeports, as we have been urging Ministers, would give Britain the opportunity to participate in this growth and to improve its world market share; failure to do so would leave us at an increasing competitive disadvantage. We hope that you will be able to announce at the time of your Budget statement the Government's commitment in principle to the establishment of several freeports at British sea and air ports. The benefit to Britain would in our view be greatest if they were established in areas which already have growth potential which would be increased by freeport facilities rather than in depressed "lame duck" areas.

Personal tax - Directors and others

56. I end with several points of particular interest to Directors. Unlike a number of other bodies, the Institute seeks to benefit its members primarily by strengthening the capitalist economy, and our representations are not domestic in character. The following points likewise do not concern all Directors or Directors to the exclusion of other taxpayers; but they are more important to Directors than to taxpayers in general, and they are all measures that would strengthen the economy at a modest revenue cost. They are also important inasmuch as Directors are inevitably charged with the task of leading the recovery of the economy, so that tax alleviations and incentives of interest to Directors should receive sympathetic consideration.

Mortgage interest relief

57. The continuation of the £25,000 limit on loans qualifying for mortgage interest relief is deeply unsatisfactory; it is quite wrong that relief from income tax should be available only up to this limit. On previous occasions we have drawn to your attention the injustice suffered by taxpayers who are locked into arrangements undertaken in good faith under a more liberal tax regime. No less important is the obstacle to the mobility of labour represented by such a low ceiling. There is no logical case for a ceiling at any level. Tax reliefs of this kind become less important as tax rates fall; and this is the right long-term policy.

Stock options

58. We urge you to reintroduce the legislation for share option schemes in Sections 77-78 and Schedule 12 FA 1972, so as to make the benefits from these schemes liable only to capital gains tax rather than to income tax as at present. These provisions represent tightly drawn incentives from which the taxpayer can benefit only if his company, and thus the economy, has benefited already. Similar provisions are important in the United States, where they represent a principal method of employee motivation. The 1972 legislation was rescinded for ill-judged political reasons and should be restored.

Travel expenses etc.

59. I would next emphasise the importance of the recommendations on travel expenses and Superannuation Funds Office rules in Part I of our Technical Representations. On the question of travel expenses, relief should be given to anyone with multiple employments along the lines suggested by the 1955 Royal Commission on the Taxation of Profits and Income. On the question of Superannuation Funds Office rules, the present rule preventing non-executive Directors from participating in a superannuation fund if their remuneration is not taxed under Schedule E should be abolished. The present situation is difficult or impossible to justify, and amending legislation should be introduced in the next Finance Bill.

National Insurance

60. We have written to the Minister of State, Department of Health and Social Security, explaining why the proposed draft regulations on national insurance contributions on Directors' earnings are profoundly unsatisfactory and why they should be withdrawn, and fresh proposals brought forward which do not discriminate against Directors and which deal with the problems of persons in multiple employment. The National Insurance rules in conjunction with the travel expenses treatment (paragraph 59) of non-executive Directors add significantly and unfairly to the cost, particularly to smaller companies, of appointing such directors. This is surely wrong at a time when all are agreed that the use of non-executive directors should be actively encouraged.

Conclusions

61. The proposals in this letter would in our view serve to consolidate and extend the successful elements of the Government's economic policy. Nothing must be done to jeopardise the gains of the last few years in the battle with inflation. But the control of inflation is not a self-sufficient policy, economically or otherwise; it needs to be complemented by reductions of government spending and of taxation. Our recommendations offer the best way of helping both business and the private taxpayer. The main emphasis is put on increasing income tax thresholds; but it is important that tax reduction should be resumed over a broad front, and in addition to an increase in the thresholds and a cut in the basic rate of income tax we have put forward a number of proposals which would do much to strengthen the economy at little cost in tax forgone, especially in 1983-84.

Yours sincerely

WALTER GOLDSMITH

APPENDIX

REVENUE IMPLICATIONS

1. The Institute has consistently supported the Medium-Term Financial Strategy for reducing monetary growth, public sector borrowing and inflation. This remains our position. In our recent canvass of membership opinion there was a strong consensus that the success already achieved in reducing inflation should not be jeopardised by a relaxation of fiscal and monetary discipline.

2. There are nevertheless a number of reasons why consistent with the broad thrust of the MTFS, the "fiscal adjustment" should in our view be somewhat higher than the £1 billion for 1983-84 mentioned in the November economic statement, if necessary at the expense of a slightly higher public sector borrowing requirement than the £8 billion mentioned in that statement.

3. First, whereas monetary policy is ahead of schedule in the control of inflation and the public sector borrowing requirement, the tax-cutting programme is far behind; indeed, the tax burden has risen substantially since 1979, both absolutely and as a proportion of national income. Tax reduction ranks as a high priority together with control of inflation.

4. Second, we are not neutral between a reduction in taxes and an increase in government spending. A fiscal adjustment of £1 billion would be excessive if it were used to increase government spending, but an adjustment of significantly more than £1 billion would be welcome if it were used to cut taxes, because of the benefit of tax cuts to the economy.

5. Third, although the public sector borrowing requirement, as the difference between two large magnitudes, is inevitably subject to a wide margin of error, it has been overestimated rather than underestimated in recent years, especially in 1981-82. If this pattern is repeated in 1983-84, the PSBR target of £8 billion will be more restrictive than it seems.

6. Fourth, the cause of this "overfunding" is underspending on the part of government authorities, whether by accident or design. Underspending should be encouraged and actively pursued, and we much regret that Ministers have followed the opposite policy, especially in statements made at the beginning of November. Governments, like households, have the opportunity to economise throughout the year and not merely at intervals of six months or so. If these opportunities were exploited instead of being wasted, the scope for tax reduction would be correspondingly increased.

7. Fifth, the indexation of personal allowances is not an economic cost from year to year because it merely restores the previous position; but it is an economic cost at the time that it is made, because it reduces taxes, and it is part of the budgetary arithmetic. Owing to the Government's success in reducing inflation, the cost of indexation will be less this year than for many years past. This is an easement of financial constraints at the time of the Budget, even though it is ignored in the "fiscal adjustment".

8. Sixth, further scope for tax reductions can be provided by accelerating the sale of assets. Sale by tender is a defence against the criticism that assets are being sold too cheap. Funds from this source are particularly suitable to underwrite reductions in taxes on capital.

9. Seventh, conventional budgetary arithmetic cannot handle the effect of incentives and other changes in relationships, which are a main purpose of the tax reductions we are proposing. This consideration is especially important for an increase in tax thresholds, a principal effect (and purpose) of which is to relieve the poverty trap in its various forms.

10. Some of the foregoing considerations cannot be quantified and, while others could be, the process would be beyond the scope of the present paper. We nevertheless believe that they are sufficiently weighty to justify increasing the 1983-84 fiscal adjustment from £1 billion to £2 billion.

11. As we have explained, an increase of this order should be possible without an increase in the PSBR. But if necessary, we should accept an increase in the 1983-84 PSBR from the £8 billion in the November economic statement to the £8½ billion in the Financial Statement and Budget Report 1982-83 as the price of securing more significant tax reductions in your next Budget, not least because the PSBR is subject to a wide margin of error.

12. We also favour exploiting the advantages obtainable from tax cuts with a low first year cost or no first year cost at all. Tax cuts of this kind have a double advantage. They yield benefits to taxpayers long before the corresponding cost is incurred by the revenue, and they impose a salutary discipline on government spending by giving ample warning of a loss of tax revenue in future years.

13. In the figures below, we put the main emphasis on the first year cost of our proposals, following the November economic statement which gives detailed figures for 1983-84 but not for later years. The additional full-year costs are added where they are known and material.

14. The figures for indexation of tax allowances and the valorisation of indirect taxes are taken from the November economic statement, except that we have abated the increase obtainable from beer and spirits, which are not buoyant sources of revenue.

COST OF TAX CHANGES 1983-84

		£ Million
Indexation of income tax allowances and thresholds (6%)		
Main personal allowances		835
Basic rate limit		45
Further higher rate thresholds		30
Investment income surcharge threshold		-
		910
Indexation of CTT thresholds and bands		15
Indexation of CGT exempt amounts		-
		925
Revalorisation of indirect taxes (6%)		
Beer	- 83	
Wine	- 25	
Sprits	- 30	
Tobacco	-115	
Petrol	-225	
Derv	- 55	
Vehicle excise duty	-107	
	-640	
Adjustment for beer and sprits	+ 15	
	-625	-625
Net cost of indexation and revalorisation		300

	£ Million
Institute of Directors recommendations	
Further increase in main personal allowances (6½%)	900
Reduce basic rate and higher rates of income tax by 1p	905
Abolish investment income surcharge	15
Increase CTT business and agricultural reliefs to 100%	25
Reduce rates of CTT	25
Reduce corporation tax by 2 points	130
	2,000
Recommendations with little or no first-year cost	
CGT cut rate to 25% and other reliefs	-
£5,000 of new self-employment income tax-free	-
Suspend Class 4 National Insurance contributions	-
Liberalise use of tax losses	-
Capital allowances for new commercial buildings	-
Reintroduce 1972 legislation for share options	-
TOTAL COST OF INSTITUTE RECOMMENDATIONS	2,000
Net cost of indexation and revalorisation on the assumptions in the November statement	300
TOTAL COST OF TAX CUTS	2,300
Comprising:	
Increases in income tax thresholds	1,735
Other tax reductions net of revalorisation	565
	2,300

15. A number of these items would impose significant further costs in a full year. The most substantial of these items is income tax, with additions of ± £400 million for thresholds and £100 million for the reduction of the basic rate to 29p. The 2 point reduction in corporation tax would cost a further £120 million and the abolition of the investment income surcharge a further £225 million. The cost of the reductions in capital transfer tax is assumed to rise by £50 million. This gives a total of ± £900 million, say £1,000 million, to cover minor items. We regard an additional tax cost of this order as acceptable and indeed desirable.

16. The items listed in the table as having little or no first-year cost mostly reach their full-year cost only after a number of years. In the case of capital allowances for new expenditure on commercial buildings the eventual full year cost indicated in paragraph 15.45 of the Green Paper on Corporation Tax (Cmnd.8456) would not be reached for a very long time.

17. Two further items would have a significant first-year cost, abolition of the 60 per cent intra-marginal rate of corporation tax and abolition of value added tax on repairs. We recommend these if there is scope for tax reduction in excess of £2 billion.

18. We have not tried to cost all our technical representations: the cost is mostly unquantifiable or negligible. Where the cost is known and substantial, it is included above.

INSTITUTE OF DIRECTORS

TECHNICAL REPRESENTATIONS
FOR THE 1983 BUDGET

December 1982

PART I: INCOME TAX - DIRECTORS

TRAVEL EXPENSES

1.1 The expenses of travelling from home to work are not an allowable deduction from taxable income under Schedule E because they are not regarded as being incurred in the performance of the duties of the employment as required by section 189 ICTA 1970. It has long been recognised that this can be inequitable where a person has more than one place of work. Extra-statutory concession A5 allows the expenses of travelling to places of work other than the individual's main one provided that his work is all for the same employer or for 'associated' employers. However, no such relief is granted where the employers are not associated as defined for this purpose. Multiple directors are particularly caught by this because (a) it is desirable for a non-executive director to be drawn from a non-associated company, (b) the travelling distances involved may be substantial, and (c) such directors are likely to have high marginal tax rates.

1.2 The Royal Commission on the Taxation of Profits and Income in its Final Report (Cmnd. 9474 June 1955, paras. 238-241) expressed clearly its view that relief based on the extra-statutory concession should be extended statutorily to all those with multiple employments. The Commission discussed the matter in detail with the Revenue, and concluded that it was feasible to give relief on the following outline:-

1. The relief should extend to all persons who derive income from more than one source of earnings.

2. It should be based on the conception that all sources of such income are, for this purpose, one source: that a main source should be selected from among the various sources to represent the normal place of employment: and that all extra expense thrown upon the taxpayer by travelling to the subsidiary sources of employment should be a deductible expense.

3. The main source should be determined by the circumstances of the case, in particular, the relative amount of time devoted to it and the relative return from it by way of income. The taxpayer should be required to nominate his main source in the first instance: if the Inspector does not accept it, the taxpayer should have a right of appeal to the General Commissioners.

4. The cost of travel to and from home from and to the main job would not be allowed.

1.3 Nothing has happened since that would invalidate the Commission's reasoning and recent developments in board structures and remuneration make it more necessary than ever to mitigate the tax problems in this area. There is unanimity in political and business quarters that the appointment of more non-executive directors to big and to small companies should be actively encouraged.

1.4 The days of the NED appointed to grace the notepaper for a nominal fee are gone. NEDs are expected to turn up to board meetings and to devote a significant portion of their working time to the company (typically 12-15 days for a "basic" NED and 20-24 days for a NED with special responsibilities). Their responsibilities and potential personal liabilities are increasingly onerous and there is a shortage of people of appropriate calibre able and willing to accept such appointments. It is therefore accepted that those who are prepared to do so should be properly remunerated. Whilst it is not appropriate for a NED to be paid such large fees by any one company that his independence is compromised, a director with several NED positions may now depend for a significant portion of his living on his aggregate remuneration therefrom.

1.5 The difficulty, however, remains of putting the NED adequately in pocket. At present the gross cost to the company of doing so is out of all proportion because of the cumulative effect of the income tax treatment of travel expenses and the National Insurance treatment of fees (each company pays full employer's contributions up to the annual limit regardless of how much other companies are contributing for the same person). The basic fee may therefore be dwarfed by the cost of monthly airflights grossed up for 60% tax and employer's NI contributions. Take the case of a small company, say in the North East or Scotland, which requires the expertise of an engineer from the Midlands or a specialist in Latin-American markets based in the South East. The company neither needs, nor could afford, such expertise full-time. Yet the proprietor may find that the gross cost to the company of appointing such a NED approaches the amount he draws from the company for working five, six or seven days a week. There is no question that the cost does deter small companies from appointing NEDs. Any unnecessary addition to that cost by the government is therefore an impediment to economic recovery.

1.6 We recognise the difficulties in tampering with the fiscal frontier around travel to work. However it makes no sense when at least four main government Departments and the Bank of England are encouraging the voluntary appointment of more NEDs for the tax authorities to inhibit this process by not making a change which is desirable in itself. The Institute has received more representations from its members than usual on this subject in the past year. We strongly urge that relief be given along the lines suggested by the Royal Commission for anyone with multiple employments and would welcome the chance to discuss this in more detail.

1.7 We have made separate representations to the Department of Health and Social Security concerning the National Insurance aspects of NED fees, but it is if anything more urgent to deal with the travel expenses problem because of its disproportionate impact on small companies in the remoter and more depressed regions of the country.

SUPERANNUATION FUNDS OFFICE RULES

2.1. The SFO insists that non-executive directors cannot be in a superannuation fund if their remuneration is not taxed under Schedule E. The concession whereby professional people in particular are permitted, for ease of administration by both the Revenue and them, to include such remuneration in their profits taxed under Schedule D, Case I or II is thereby rendered nugatory. Moreover any such individual, to whom admission to an approved scheme is offered, has in effect to suffer tax on the same income twice in the year of charge and, depending on his practice year end, in the following year in some cases. This is quite unnecessary and it is urged that the SFO rule be changed.

PART II: INCOME TAX - GENERAL

INVESTMENT INCOME SURCHARGE

1.1 The Surcharge is obsolete and should be abolished. The differential in tax rates on earned and investment income was first introduced to reflect the fact that at that time the income from investments was relatively predictable and secure whilst income from employment was variable and insecure. If anything the opposite is now true, yet the tax on investment income is currently higher relative to that on earned income than it has ever been. Although a sufficient case for abolition can be made at the technical level we recognise that the yield is of some Budgetary significance and progress is therefore subject to Budget constraints.

TAXATION OF HUSBAND AND WIFE

2.1 As yet there have been no visible results of the Green Paper on this subject. Clearly there are long term issues involved which require careful consideration. However, we urge that no further delay be made in extending the arrangements for separate taxation of wife's earnings to cover investment income as well. For the reasons already given, we see no justification for taxing investment income more harshly than earned income, and there is neither moral nor economic justification for encouraging partners - especially those with children - to live in sin.

PERMANENT HEALTH INSURANCE

3.1 At the technical level it is wrong to disallow the premiums on such insurance when the benefits are taxable as investment income (after initial relief).

3.2 In terms of social policy the protection of those who fall victim to long term illness or disability, and their dependants, should be a high priority. Individuals should not be discouraged by the tax system from making their own provision against such misfortunes.

RETIREMENT ANNUITY PREMIUMS

4.1 Employees eligible to join approved occupational pension schemes are entitled to deduct from their pay before tax such contributions as together with any contributions made by the employer (which are deductible for corporation tax) are necessary for the scheme to fund on retirement a pension of two-thirds of final salary. As the effective limit is on the amount of the pension not of the contribution, the contributions can be increased to make good the damage done to the funding of the scheme by a higher than budgeted rate of inflation - as happened in the 1970's.

4.2 By contrast the self-employed and others not eligible to join such schemes are entitled to deduct from their pay before tax a certain proportion of their 'relevant income', if used to purchase a retirement annuity. For them the limit is imposed on the contributions not the pensions. The contribution limit has been so low that even with low inflation the value of the annuities purchased could not generally be expected to match the two-thirds of final salary which the employee receives; with the very high inflation prevailing for most of the 1970's, those now approaching the end of their working lives face the prospect of a derisory post-retirement income from what should be their main source of such income.

4.3 The principle is simple. It is only equitable that employees and the self-employed should have the opportunity to purchase equivalent retirement pensions out of pre-tax income.

4.4 In practice the only problem is the cost in lost tax revenue. We recognise and welcome the major improvements made by the present Government, first in raising the normal limit on contributions from 15% to 17½% and then in reducing from 65 to 50 the age from which a higher percentage applies. There is still a long way to go, but the cost of relaxing the limits further should not be exaggerated. Few of those eligible to increase their premiums would in practice have sufficient income to do so in this time of recession.

4.5 We therefore recommend further progress in relaxing the limits with emphasis on the over fifties who have suffered most from the inflation of the 1970's.

BUSINESS START-UP SCHEME

5.1 The Scheme was introduced as a temporary incentive for the three years 1981-82 to 1983-84. However the complexity of the Scheme is such that it was not until this autumn, half-way through the period, that the Institute of Chartered Accountants published its lengthy Tax Digest on the subject to help professional advisers to give proper advice on the Scheme. Professional advisers, stockbrokers and others have now made a substantial investment of time, money and effort in gaining a proper understanding of how to apply the provisions in practice and how to set up approved funds. That investment will be largely wasted if the Scheme ends in April 1984. We recommend that it be extended for a further two years.

COMPENSATION PAYMENTS

6.1 It is a general principle of income and capital taxation in the UK that tax is assessed on net gains or profits. This is not the case where a person incurs costs in fighting a case for compensation before an employment tribunal or the courts. The person is assessed on the gross compensation awarded (less the statutory exemption) with no relief for the cost of legal representation which the person reasonably believed would materially improve his chances of winning the case or obtaining higher compensation. The judge in Warnett v. Jones (1980) S.T.C.131 clearly felt that this was unfair. We urge that the law be changed to permit the deduction of the costs of obtaining compensation from the amount brought into charge, if any.

STOCK OPTIONS

7.1 We urge that the tax treatment of stock options in the Finance Act 1972 (as amended in 1973) be restored. The present treatment discourages the remuneration of directors and senior executives in what is often the most appropriate form. The pre-tax rewards from stock options are highly geared to the company's longer term performance and can therefore, given reasonable tax treatment, be a very effective incentive for those taking the strategic decisions about the business. Savings - related schemes approved under FA 1980 are not effective for this purpose because of the numerous restrictions (in particular the low maximum contribution and the requirement that all employees can join on the same terms) which prevent such schemes being tailored to stimulate boardroom performance.

"NOTHINGS"

8.1 Just as no genuine business expenditure should be denied relief in the case of incorporated businesses subject to corporation tax as dealt with more fully in Part IV para 3.1, so no such expenditure should be excluded in the case of unincorporated businesses subject to income tax.

PART III: CAPITAL TAXES

GENERAL

1.1 Capital Transfer Tax and Capital Gains Tax continue to have substantial structural defects. The fact that curing those defects would make the taxes no longer worth the effort and cost of collection is not a good reason for not dealing with them. It brings the whole tax regime into serious disrepute when taxes intended to be levied on capital instead derive most of their yield from inflation, asymmetry and other obvious defects and inequities.

CAPITAL TRANSFER TAX

2.1 The following structural defects in Capital Transfer Tax should be dealt with as a matter of urgency:

1. All business reliefs should be standardised at 50%.

2. The tax on lifetime transfers should be half that on death at all points on the scale and should not be integrated with tax on death. We do not accept the need for either a tax on gifts or a tax on death, but if there are to be such taxes it is wrong that the tax payable on the involuntary occasion of death should be geared to the extent to which the deceased has previously voluntarily redistributed part of his wealth (redistribution being the underlying purpose of the tax).

3. The rate schedule should be fully adjusted for inflation since 1974.

4. The balance of the threshold exemption unused by one spouse should be available to the other.

5. There should be no grossing up on gifts. Tax should be levied on the gift and not on the tax as well.

6. Donors should be able to pay by instalments in the same way as donees and without interest charge except on instalments overdue.

7. The present concessions for the payment by instalments of CTT on business assets should be extended to all assets.

TAXATION OF CAPITAL GAINS

3.1 The introduction of an indexation allowance for post-April 1982 inflation in the FA 1982 was a welcome but belated and partial recognition that the proper tax base for CGT is real not inflationary gains. This was, however, coupled with a retrograde step towards taxing gains gross rather than net of losses in that the indexation allowance is not available on losses and is not allowed to turn a gain into a loss.

3.2 Pre-April 1982 inflation: Much the simplest remedy for the injustice of taxing pre-April 1982 inflationary gains would be to introduce a holding period after which the whole of any gain on any asset would be exempt. In previous years we have suggested a three-year taper period, but in recognition of last year's increase in the annual exemption we consider that a seven-year cut-off would not be unreasonable. Ten years would be the maximum period before exemption which could adequately remedy the effects of inflation in the 1970s.

3.3 The two simple changes in paragraphs 3.7 and 3.9 would be sufficient to create a rational structure with regard to future inflation. Apart from their economic advantages they could sweep away the whole concept of pooling with all the problems posed by pooling in relation to the indexation allowance. The impact on the Revenue's costs and staff numbers would therefore be beneficial, rather than as adverse as the "scare story" figures quoted by the Financial Secretary in the FA 1982 Standing Committee debate in relation to indexing losses.

3.4 Relief for Losses: The most serious defect with the provisions as enacted is that indexation cannot result in a loss. This violates the principle of symmetry. It is central to an equitable and efficient tax system that tax should be levied on net profits and that losses should be offsetable against profits. This applies with no less force to indexed gains. If an investor buys two security holdings for £100 and some years later (when the RPI has doubled) sells one for £250 and another for £150, he has made a nil real gain on his portfolio and should not, therefore, be taxed. Under FA 1982, he would be taxed on the £50 real gain on Security A without relief for the £50 real loss on Security B.

3.5 The Chancellor said "It is intolerable for people to be permanently condemned to pay tax on gains that are apparent but not real - gains that exist only on paper." It is equally intolerable to deny relief on losses which are real.

3.6 It may be argued that the investor could avoid this trap by investing through a unit trust or investment trust. This would be an economic distortion. Those who manage investment intermediaries should sell their services on the basis of superior investment skills rather than as a means of dealing with a tax anomaly.

The tax system should surely be neutral as between the investor who chooses his own securities and the investor who invests via investment trusts, life assurance policies or other intermediaries. There is already a slight bias (justifiable in the cause of simplicity) in favour of investment trusts and this should not be extended.

3.7 To deal with this anomaly it would only be necessary to repeal subsection 86(5) Finance Act 1982 and to delete the reference to it in paragraph 2(1) of Schedule 13.

3.8 Delayed Indexation: It is accepted that the indexation allowance should not apply to securities bought and sold within a year. The administrative cost would be excessive in relation to the tax at stake. However, FA 1982 goes further and denies indexation for the first year on securities which do qualify. This is unacceptable and amounts to a "wealth tax" of 30% of the first year's rate of inflation every time a security holding is switched. Moreover the Chancellor's declared intention was to eliminate the taxation of gains due to post-April 1982 inflation. That aim is not achieved unless the above change is made. Apart from the inequity and discouragement of investment in the first place, this will inhibit capital market activity.

3.9 We urge that provision be made in next year's Finance Bill to remove the words 'which is the twelfth month after that' from the definition of 'RI' in Section 87(2) Finance Act 1982. (The requirement for the minimum twelve month holding period is in Section 86(1)(b) and would not therefore be affected by this amendment).

3.10 The CGT proposals in FA 1982 have been widely criticised for their complexity which is causing considerable difficulties for stockbrokers, investment advisers and others who have to re-program their computers. This provision excluding the first twelve months from the indexation calculation is a major complication in respect of quoted securities where there may be frequent changes in a particular holding through transactions in the market, rights issues, takeovers, etc. Each addition has to be excluded for a year when calculating the indexation allowance. The changes proposed would greatly simplify the calculation and would better achieve the Chancellor's aim.

3.11 Annual Exemption - Companies: In his 1982 Budget Statement, the Chancellor said -

> "Because we have not found it possible to extend the new scheme (of indexation for the capital gains tax) to cover past gains, I propose also that the exempt slice should be increased to £5,000".

Just as, again to quote the Chancellor -

> "It is intolerable for people to be permanently taxed on gains that are apparent but not real,"

so it is equally intolerable for companies so to be taxed. If indexation is not to apply from a date earlier than 5th April 1982 (1st April in the case of companies), then companies should surely be given the same, or an equivalent, measure of exemption as individuals to enable them to mitigate the effect of inflation gains on assets acquired in the past.

3.12 Annual Exemption - Business Assets: Holdings of quoted investments are capable of being realised in parcels year by year to utilise the annual exemption. This is not so easy for business assets and family companies. We suggest therefore that any unused annual exemptions for 1982/83 onwards should be allowed to be carried forward for relief on the disposals of such assets held throughout the years in question.

3.13 Alternatively a similar relief could be given by permitting taxpayers to elect to make a deemed disposal and immediate re-acquisition of an asset on a certain date at its then value. This could be particularly helpful for business assets where there is no market in which actual disposals and re-acquisitions can be made.

3.14 Carry-back of Losses and Group Relief: The bias in favour of the Revenue would be greatly mitigated if, as we urge, losses could be carried back and set against the taxpayer's gains in the two previous years and, in the case of companies, surrendered to other companies in the same group. The availability of group relief would save the unnecessary costs incurred by groups in transferring assets between group companies solely for taxation reasons prior to disposal to a third party.

3.15 Section 151, CGTA 1979: The effect of this anti-avoidance provision (formerly paragraph 16, Schedule 7, Finance Act 1965) is to penalise severely innocent transactions in many cases. We have suggested before that the section would achieve its object without such penal side effects if it were amended by deleting the words in the first line "from one or more persons" and substituting for them the words "directly or indirectly from a person".

DEVELOPMENT LAND TAX

4.1 The yield of this tax is derisory in relation to the heavy compliance and collection costs and the tax is a significant disincentive. Failing abolition we would draw attention again to the Chancellor's 1981 Budget speech in which he presented what is now section 133 FA 1981 as one of three changes intended to benefit the construction industry. That purpose (which is just as urgent now) was then partly frustrated in the drafting of the section: the size of extension which is exempt was increased from one tenth to one third in respect of extensions where the existing building is retained (paragraph 5(1)(a) Schedule 4 DLTA 1976) but <u>not</u> in respect of extensions made when the existing building is rebuilt (paragraph 5(1)(b)). The latter situation surely generates more work for the construction industry than the former. Moreover, there is no sense in encouraging industry to tack on extensions to buildings which may well be outdated or otherwise unsuited to current needs when they could take the opportunity to rebuild a larger, more modern and efficient building from scratch. We therefore urge that sub-section (1) be extended to cover paragraph 5(1)(b).

PART IV: CORPORATION TAX

GREEN PAPER ON CORPORATION TAX

1.1 The Green Paper has been used as an excuse to delay changes which were already urgent in March 1980 when the Chancellor first announced that the Paper would be forthcoming. It is already apparent that there is no consensus, as there would need to be, for major restructuring of Corporation Tax. We therefore urge that there be no further delay in making a start on the following changes which are both urgent and have wide support in the business community.

SMALL COMPANY RATE

2.1 The high marginal rates of tax on the intermediate band of profits should be avoided by making the "small company" rate on the first band of profits available to all companies. The cost would be modest, while a major deterrent to the expansion of small companies would be removed.

3.1 "NOTHINGS"

No expenditure incurred bona fide for the purposes of a business should be excluded from appropriate tax relief. Items at present excluded include:

- expenditure on abortive capital projects
- incidental costs of raising equity finance
- discounts and other expenses on acceptance credits
- post-trading expenditure

and, most significant of all,

- expenditure on commercial buildings.

3.2 In the latter case we accept that for reasons of cost it may be necessary to confine relief initially to new expenditure on such buildings.

LOSSES ON FOREIGN CURRENCY BORROWING

4.1 The Government has persistently refused to consider any relief to tax for the losses incurred by a business on the repayment of loans in a foreign currency. At the same time it taxes exchange gains arising from investment of the proceeds by the borrower. This is out of line with normal practice in developed countries in those cases where such losses arise from transactions forming part of the normal business activities of borrowers.

4.2 The Government has rejected representations year after year on this issue and has claimed that the amendments suggested to them would carry a heavy budgetary cost. But it is well known that no serious attempt has been made to discover this cost, nor to find out the span of years over which it would be spread. It is likely that the cost now would be less than a few years ago.

4.3 We do not accept that the loss falling upon a taxpayer from a loan repayment falling at some time in the future can be called "retrospective". However, with a view to meeting objections based on the "retrospection" argument, we suggest that a taxpayer should in future be able to elect that:-

a. Exchange profits and losses arising from the repayment of foreign currency borrowing should be taxable or allowable to the extent that they arise from currency fluctuations which have taken place after a date to be determined.

b. When a taxpayer repays a loan and can show that a loss has arisen on the repayment from currency fluctuations occurring before the determined date, that loss may be deducted from any profit arising under the terms of (a) in determining the amount of that profit.

4.4 The present rules are the product of many years of neglect which cannot be divorced from the fact that, for the past decade, they have operated mainly in favour of the Revenue. The amendments we propose would increase symmetry and fairness within the tax system in a field where they are noticeably absent.

CHANGES OF OWNERSHIP - SECTIONS 483 ICTA 1970 AND 101, FA 1972

5.1 These anti-avoidance sections disallow the carry forward of losses and unrelieved ACT where there has been a change in ownership of the company within three years of a major change in the nature or conduct of its trade. The criteria for what constitutes such a change are unnecessarily wide, including major changes in the type of property dealt in, services supplied, customers, outlets or markets, any one of which is sufficient to trigger the provision even though it may have happened for reasons unconnected with the change of ownership (or indeed before the ownership change was contemplated).

5.2 This is particularly causing problems in the present economic climate since

(a) manufacturing companies frequently are having to make alternative arrangements for the marketing/ distribution/retailing of their products following the closure of their previous distributors/outlets,

(b) many companies faced with the collapse of UK domestic demand have survived only by turning to export markets,

(c) the normal commercial process of rationalising existing parts of the business while developing new products and markets has been greatly accelerated so that changes are being made which would be acceptable under the present criteria if phased over many years but may constitute a "major" change if concentrated in a shorter period.

5.3 Sections 483 ICTA 1970 and 101, FA 1972 would be less of an inhibition on the changes which companies must make to survive and remain competitive, and would still fulfil their anti-avoidance role effectively, if amended as follows: a company's losses and unrelieved ACT should not be forfeit in circumstances where the change(s) in products, markets etc would not have been treated as a cessation of the trade if there had been no change of ownership. Preferably this should be dealt with by amendment to the legislation, but failing that we urge the Revenue to adopt this approach in practice and confirm that they have done so by issuing an extra-statutory concession or statement of practice.

RELIEF FOR ACT, DOUBLE TAXATION AND LOSSES

6.1 Tax exhaustion and double taxation of overseas income have become serious problems in recent years because of the unnecessary restrictions on the utilisation of reliefs to which companies are entitled. ACT for many companies has become a tax in its own right because of the restrictions on set-off. We urge that the present rules be liberalised to allow

- set-off of ACT against mainstream tax without restriction

- surrender of brought forward as well as current ACT to subsidiaries

- set-off of ACT against next mainstream payment after the date of distribution

- set-off of ACT against the tax on chargeable gains

- set-off of double taxation relief against ACT to the extent that distributions are made out of foreign source income

- carry forward of unused double taxation relief

6.2 In addition to the above we consider that carry-back provisions and group relief for capital losses should be available (see Part III para 3.14) and the consortium relief rules relaxed (see next paragraph).

CONSORTIUM RELIEF

7.1 At present it is not possible for a company in respect of the same year to claim both group relief under subsection (i) and consortium relief under subsection (ii) of section 258 ICTA 1970 by virtue of section 263. There would appear to be no reason for this restriction applying in bona fide cases where losses cannot be immediately relieved in other ways, other than that it would involve some difficult drafting to confine it to bona fide cases. This restriction has caused difficulty in actual cases, and we urge that it be removed.

STOCK RELIEF

8.1 We remain totally opposed to the six-year limit on the carry forward of stock relief. Reliefs to which a taxpayer has become entitled in respect of economic costs actually incurred should not arbitrarily be removed in this way, especially since the reason for the taxpayer being unable to utilise the relief sooner may well be the unnecessary restrictions referred to in paragraph 6.1 above. The six year restriction should be abolished so that companies can plan ahead without having to worry about taking steps to avoid losing relief.

REPURCHASE OF OWN SHARES

9.1 Relief under the FA 1982 provisions is not available in the case of non-resident shareholders. We can see no reason to restrict relief in this way, given that there is the prior clearance procedure, if the company can show that not make the repurchase would adversely affect the company. There must be many cases where a foreign distributor or agent has been permitted to participate in the UK company's equity and their ways have subsequently parted.

PART V: INTEREST RATES AND APPEALS

INTEREST RATES

1.1 The system of charging interest on late payments of tax and granting repayment supplement on late repayments of tax is heavily biassed to the disadvantage of the taxpayer; section 69 FA 1982 increased the bias further. If, in addition to the lack of symmetry in the rules and the non-deductibility of such interest, the rate of interest is well above market rates, then it becomes a substantial tax in its own right which it was never intended to be. Whilst an element of penalty may be necessary to encourage the taxpayer to settle his tax affairs promptly, the taxpayer should not be unduly penalised for the many tax delays that are often the inevitable consequence of the complexity of tax law and the seasonal work burden on accountants; such delays are in no sense the fault of the taxpayer.

1.2 We recognise the administrative arguments for keeping changes in the interest rates on late payments and repayments to a minimum (though we note that interest rates on certificates of tax deposit have been altered several times a month in recent months); but the recent reduction in such rates was by any criterion overdue and was only sufficient to recognise the fall in market rates to that date. We urge that a further reduction be made as soon as market rates fall again. The recession combined with positive real market rates makes any delay particularly damaging at present. Moreover, a further reduction would be an indication that the Government believes its forecasts that inflation and interest rates will be lower in 1983 and thereafter.

1.3 Similar considerations apply to the 'official rate' which determines whether, and if so the extent to which, an employee receives a taxable benefit in relation to the interest on a staff loan.

COSTS OF APPEALS

2.1 If a taxpayer has won at any stage of the appeal procedure, from the General Commissioners up to the Court of Appeal, and the Revenue wish to appeal to the next higher tribunal, the Revenue should bear all the costs of that next stage only. We recognise that there is some concern lest taxpayers who indulge in ingenious and artificial schemes of tax avoidance might benefit from such a provision. We are strongly of the opinion that this factor is far outweighed by the injustice which the present rules produce in cases (as do occur) of small amounts of tax and individuals, who are by no means wealthy, where the Revenue's insistence on taking an appeal to the High Court or higher on a technical point can mean that the taxpayer will lose more than the tax at issue in unrecoverable costs, even if he wins.

10 DOWNING STREET

1

Prime Minister

The Budget

Do you want the same tight security within no 10 which we had last year? That is, only Robin & I and Alan, and no-one else whatever apart from Alan's secretary, would see any of the papers?

Yes

MLS 19/1

MT

SECRET

19 January 1983

ALAN WALTERS

8

PRIME MINISTER

THE BUDGET - FIRST THOUGHTS

In a week or so the Treasury will be producing its first forecasts for next year, as the background to the Budget discussions. I believe that little credence should be put on any of the particular forecasts; they tend to extrapolate historical relationships, whereas we know that such relationships have changed considerably.

But I do not think that the forecast should have any substantial influence on the main target variables in the March Budget, in particular the PSBR. The outcome of the PSBR this year (1982/83) may be as much as £1½bn-£2bn less than the target, giving a realised borrowing requirement of about £7½bn.

I believe there is a consensus emerging in the Treasury that we should aim for about £8bn for 1983/1984. On present guesses this would mean that, in addition to one Rooker-Wise, there would be around £2bn, perhaps even £2½bn, for additional tax cuts etc.

However, I think it would be wise to aim for a figure of about £7bn. One of the main reasons for a lower figure is that the savings rate of households has been falling quite dramatically in recent months. From highs in the region of 13%-17% over the last decade, it has fallen to about 9%. This compares with the long run average, before 1972, of about 8%. We seem to be getting back to a "normal" savings ratio.

A second argument for the £7bn is that it would provide a useful pointer to the markets that, as we run towards the election, there will be no vestige of an inflationary package. We should actually show that we are making room in the market for corporate borrowers. (There are other good technical reasons, which I will not burden you with, but will develop on request, for heading for a low PSBR when inflation is lowered.)

I suspect that if we suggest a PSBR of £7bn we shall be urged to raise it to at least £7½bn as a compromise between the Treasury view and ours. I regard £7½bn as a little on the high side, but one that is not inconsistent with the basic strategy. May I suggest then that in your discussions with the Chancellor you might suggest £7bn as the appropriate target?

SECRET

If we adopted a £7½bn target then the present very tentative indications are that we could make tax reductions of round about £1½bn-£2bn. This would enable us to raise the thresholds to their 1979 real values and leave round about £½bn or a little more over for other tax reductions.

AW

19 January 1983

ALAN WALTERS

Bcc PJ JV

Northern Ireland Office
Stormont Castle
Belfast BT4 3ST

Secretary of State

NBPM

MLS 20/1

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

17 January 1983

Dear Geoffrey

I have just seen a copy of Arthur Cockfield's letter to you of 29 October suggesting fiscal measures to assist in the tourist industry, and copies of Nicholas Edwards' and George Younger's letters on the same subject.

I fully support the views expressed by Arthur and have no doubt that his proposals would be of considerable benefit to the Northern Ireland tourist industry. As you will appreciate tourism in Northern Ireland has suffered greatly from the image of the Province created by the security situation. During the early and mid-1970s there was a substantial decrease in visitor numbers. Of recent years there have been distinct signs of an increased interest in the Province as a holiday destination and strenuous attempts are being made by the Northern Ireland Tourist Board and by local travel and holiday interests to restore the flourishing tourist industry which existed here in the late 1960s.

I believe that there is considerable potential for the development of tourism in Northern Ireland and that the industry is capable of making a very useful contribution to employment in the Province. The improvement in the building allowances for tourist accommodation, which is proposed in Arthur Cockfield's letter, would be particularly useful to us and should help to reduce the dependence of investors on Government grants.

I would add that I am convinced that there is an important link between these tourism promotional activities and our efforts to attract inward industrial development to Northern Ireland. A successful tourist campaign can correct misconceptions about conditions here and provide valuable reassurance to potential investors and their managers, and their families.

I am copying this letter to the recipients of Arthur Cockfield's letter.

Yours

Jim

Econ Pol

Budget

20 JAN 1983

JH 615

c JV

CONFIDENTIAL

Prime Minister (2)
MJS 15/1

Econ
P81

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB
TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

12 January 1983

Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

Dear Geoffrey,

1983 BUDGET

In your reply of 10 December to my letter of 6 December, in which I set out my views on industrial measures for the Budget, you invited me to let you have early in the New Year my further thoughts on major taxation measures and my proposals for items that might be included in an expenditure package to encourage innovation.

not copied to No 10

Taxation Measures

2 So far as taxation measures are concerned there is in fact little that I want to add to my earlier letter at this stage. Developments in the economic situation since early December have not I imagine made it easier for you to judge what room for manoeuvre there will be at budget time, nor have they encouraged me to think that the prospects for industry have improved, despite the recent fall in sterling.

3 I need not go over the domestic and international grounds for concern which are all very familiar to you, but I thought the CBI presentation at NEDC on Wednesday brought out starkly the serious implications for the corporate sector of persistently inadequate profitability and liquidity. Terence Beckett's point that the liquidity ratio for the corporate sector as a whole in the third quarter of 1982 was far below what an individual company would regard as the danger point serves to confirm indications we are getting that a further surge in closures and redundancies could be in the offing.

4 Against this still sombre economic background it remains my view that further help to industry should remain our highest priority. And I would place the emphasis emphatically on providing that help by reducing industry's costs rather than on stimulating consumer demand. You are aware of my continuing concern about energy costs and non-domestic rates, but unfortunately there seems little realistic prospect of major

changes here in industry's favour in the near future. This makes it the more important that the Budget should include at least one major measure that will bring significant benefit to industry.

5 In my view abolition of the NIS is far and away the best of the taxation possibilities. It would be generally welcomed by industry, as have been the successive reductions you have already been able to make. Equivalent concessions through reductions in Corporation Tax would be less well received and they would be of less help to many of the manufacturing sectors in greatest difficulty.

6 Presumably a reduction in personal income tax is the main alternative you will be considering. I appreciate that this too would benefit industry, but the benefit would be less direct and less certain. The main effect would be to increase consumers' expenditure, which would mean that a significant part of the benefit would be lost to imports. Abolition of NIS, by contrast, would directly and immediately improve industry's cash flow, competitiveness and profitability.

Innovation

7 I very much hope that, as last year, it will be possible to include some expenditure measures in an innovation package, and I welcome your willingness to look at our further proposals. These are shown in the annexed list.

8 My main priorities are SEFIS (and I am pleased that you recognise this as something of a special case), the "Alvey" programme of support for research in advanced Information Technology, and holding the level of grant support for our "Support for Innovation" programme at 33⅓% beyond the one year period ending in May this year.

9 You are familiar with the SEFIS concept: the annex describes some adjustments to its terms we should wish to propose. Despite my high priority for the Alvey programme, funding it - or any major new measure - is difficult for the DoI programme. Even after assuming a lower build-up of spend than in the Alvey Report we cannot provide all the DoI contributions we consider necessary without cutting other innovation support programmes. It would make little sense to cut, for example, our programme of support for Space - an important form of Information Technology - in order to finance Alvey. Indeed we see scope for usefully increasing support for Space, for example, through "demonstration projects". Over the past two years or so our Support for Innovation programme has achieved a considerable momentum. In order to maintain that we believe that it is very necessary to hold the level of our grant support at 33⅓% beyond the one year period ending in May this year. Certainly industry would welcome an announcement to that effect.

10 The remaining items in the Annex (items 4 - 12) are listed in no particular order of priority. They are all proposals to stimulate innovation and, given the general state of industry, and the priority this Government has given to the stimulation of innovation as a means of helping industry to become more competive, I believe that further help along these lines could not but have a beneficial impact. I have included, as item 4, a possible investment support facility for "pulling through" the development of new products and processes that have successfuly completed the R&D stages but need further help to surmount the investment stage. Again, the need for something on these lines arises primarily because of the very low levels of profitability which we discussed at NEDC on Wednesday. Unlike the R&D support, I would not see this as permanent but as something aimed at a carefully defined target for a limited period of time.

11 Estimates of possible costs are shown against each of the dozen measures listed but of course these give only orders of magnitude. Some of our posposals will need further working up, at which point I should be happy for your officials to be associated with mine; but I believe the list contains the ingredients for a very effective and presentable package of expenditure support.

Loan Guarantee Scheme

12 I should also like to take this opportunity of mentioning the desirability of raising the limit on loans supported under the Small Firms Loan Guarantee Scheme. The current £300m limit may well be reached in the next month or two, and an increase by another £250-300m would provide the assurance necessary to take us over the three years to May 1984. Of course, any extra expenditure arising from such an extension would be very much smaller, as premia will largely offset any calls on our guarantees. We shall have an opportunity to discuss this scheme at our Health of Industry meeting on Tuesday 11 January.

13 I am sending copies of this letter to the Prime Minister, Sir Robert Armstrong and John Sparrow.

Yours ever

Patrick

ANNEX

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BUDGET INNOVATION PACKAGE - POSSIBLE EXPENDITURE MEASURES

Measure	Proposal	Possible Spend (£m) (1983/84, 1984/85, 1985/86)
1 Small Engineering Firms Industry Scheme	Reintroduction of 1982 SEFIS scheme with shorter timescale and possible minor modifications, eg increase size limit to community figure of 500 employees for small and medium-sized firms, and extension to cover use of similar machinery in wood-working industries.	30/40/30
2 Alvey - a programme of pre-competitive research in advanced IT	About half of the desirable DoI contribution consistent with the likely build-up in Alvey spend could be provided from existing DoI PES provisions, without cutting other innovation support programmes. But extra funds are needed to make the full DoI contribution likely to be needed if other support is not to be foregone.	0/10/15
3 Support for Innovation guidelines	First, the level of SFI grant should be maintained at 33⅓% beyond May 1983. It would be a significant blow for our promotion of Innovation if the grant were now reduced. Our PES forecasts were partly based on the presumption of holding the present level, so the cost would not be large. Secondly, there would be advantage in introducing a new element of innovation support - ie for market assessments prior to the undertaking of R&D.	3/10/15

CONFIDENTIAL

Measure	Proposal	Possible Spend (£m) (1983/84, 1984/85, 1985/86)
4 A new facility for supporting innovation-linked investment	Support would be available at 20-25% of project costs for investment resulting from the development of new products and processes with significant innovation. This would fill a gap in our array of support measures and enable successful R&D projects to be "pulled-through" the investment stage. Support would also be available for the initial marketing of the new products.	6/16/20
5 Advisory Services	Existing advisory services, including the Manufacturing and Design Advisory Services and the Small Firms Technical Enquiry Service, would be extended, and a new Marketing Advisory Service introduced.	7/8/9
6 Advanced equipment for education centres	The "micros in schools" approach would be followed with micros and computer numerically controlled equipment and computer-aided design and manufacture equipment in higher education and further education.	5/6/8
7 Computer-Aided Equipment in Industry	The existing support scheme for computer-aided design and testing would be extended; a new scheme for computer-aided production management, possibly leading to linked business schemes, would also be introduced.	4/12/19
8 Robots for Small Firms	A possible development from the machine tools in SEFIS to robots.	2/6/2
9 Electronics	The existing Software Products Scheme would be extended, and support provided for the stimulation of the medical instrument area.	5/6/9

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Measure	Proposal	Possible Spend (£m) (1983/84, 1984/85, 1985/86)
10 Quality Assurance	A new scheme to help small companies to implement QA systems, thus improving the quality of UK manufactured products as recommended in the White Paper "Standards, Quality and International Competitiveness".	1/6/8
11 Space	Support for "demonstration projects" for remote-sensing receivers for Third World markets, satellite business ground stations and mobile terminals, etc.	2/5/5
12 Science Parks	Support for equipment facilitating the support for the development of science parks and innovation centres, and for the creation of "incubator units" enabling several small firms to tackle high technology projects with minimum overheads.	2/3/5
	Theoretical Total	67/128/155
		= £350m overall

Econ Policy

Econ Pol
Budget

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10 DOWNING STREET

From the Private Secretary 14 January 1983

1983 BUDGET DAY

Thank you for your letter of 12 January.

The Prime Minister does indeed remain content with 15 March for Budget Day. She is also content that this should be announced in the first Business Statement after the Christmas Recess.

I am sending copies of this letter to David Heyhoe (Lord President's Office) and Murdo Maclean (Chief Whip's Office).

M. C. SCHOLAR

John Kerr, Esq.,
HM Treasury

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Prime Minister

Agree 15 March?

MCS 13/1

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

Michael Scholar Esq
No 10
Downing Street
LONDON SW1

12 January 1983

Dear Michael,

1983 BUDGET DAY

We have as you know been working towards a Budget on 15 March, and the Prime Minister earlier indicated that she was content with this (your letter of 1 October). Our consultations show no major difficulties in terms of overseas visits, awkward announcements of economic statistics and so on. If the Prime Minister remains content, the Chancellor is inclined to think that the date of 15 March should be announced - as in the last two years - in the first Business Statement after the Christmas Recess, which is likely to be Thursday, 20 January this year. I understand that the normal form is for the announcement to be made in reply to a Question by the Leader of the Opposition, who is prompted in advance by the Chief Whip.

I am sending copies of this letter to David Heyhoe and to Murdo Maclean. If the Lord President also agrees to an announcement being made on 20 January, I should be grateful if the Chief Whip's Office could make the necessary arrangements.

Yours ever,

John Kerr.

J O KERR

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ECON POL. 2

Prime Minister:

To note. I have acknowledged

30/12.

THE BUILDING SOCIETIES ASSOCIATION

34 Park Street, London W1Y 3PF
Telephone: 01-629 7233

22 December 1982

Dear Prime Minister

1983 Budget Representations

I am enclosing for your information, the Association's 1983 Budget Representations which are, today, being sent to the Chancellor of the Exchequer. The Association has greatly welcomed your recent statements on tax relief and I am sure you will find our representations on this point to be of interest.

Yours sincerely

Alan Cumming

J A Cumming
Chairman

The Rt Hon Margaret Thatcher MP
Prime Minister

THE BUILDING SOCIETIES ASSOCIATION

December 1982

REPRESENTATIONS TO THE CHANCELLOR OF THE EXCHEQUER ON THE 1983 BUDGET BY THE BUILDING SOCIETIES ASSOCIATION

1. Since 1978 the Association has requested Chancellors of the Exchequer to act in respect of two fiscal measures which are not in harmony with the policy of encouraging owner-occupation and which also can have adverse effects on the mobility of labour -

(a) Stamp duty on the purchase of owner-occupied dwellings.
(b) The £25,000 ceiling on loans qualifying for tax relief.

2. The Association was encouraged by the measures contained in the Finance Act 1982 to reduce the impact of stamp duty. In these Budget Representations, the Association renews these requests. The state of the housing market and the general economic recession mean that action in respect of these two points is particularly appropriate. House prices have begun to move upwards, albeit slowly, thus increasing the burden of stamp duty and meaning that the £25,000 ceiling for loans qualifying for tax relief is being further reduced in real terms. Stamp duty and the tax relief ceiling hit hardest at those buying in London and the South East where house prices are considerably higher than the national average. They can also have a particularly adverse effect on first-time buyers and those forced to move house for job reasons.

Stamp Duty

3. The costs of buying a house are considerable. They may include valuation, survey and legal fees and Land Registry charges and, first-time buyers apart, there are the expenses of selling the present house. They will include stamp duty where the price of the house exceeds £25,000. The duty is levied on the whole of the price (not just the excess over £25,000) and is at the rate of ½% where the price is over £25,000 and up to £30,000, 1% where the price is over £30,000 and up to £35,000, 1½% where the price is over £35,000 and up to £40,000 and 2% where the price exceeds £40,000. In many cases, the largest single item of expense will be the stamp duty.

4. The latest figure (October 1982) for the average price of houses mortgaged to building societies is £26,502. The purchaser of this average house would therefore pay £130 in stamp duty. In the third quarter of 1982

The evidence is that the £25,000 limit deters potential house-buyers in that there is a bunching of mortgage loans just below that figure. Presumably this means that some purchasers are able to find the additional resources themselves, but others are probably excluded from the market. The number excluded will rise as house prices increase.

14. There is the further point that next April, as a result of the Finance Act 1982, the method by which house purchasers obtain tax relief on their mortgage interest will change. Instead of making a gross payment to the building society and recovering tax relief through the PAYE system, borrowers will pay a net rate to their society. Societies have made a substantial investment in this change of system and are enabling the Government to save some 1,000 civil servants. If the £25,000 limit is not increased this work will be wasted as an increasing proportion of new loans will be outside the new arrangements and will have to be treated as special cases by building societies and will be subject to tax relief through PAYE as at present, thereby necessitating an increase in the number of civil servants. The Association and building societies have worked to bring in the new mortgage tax relief system, believing it to be in the interests of the great majority of their borrowers. The value of this work, and the new system as a whole, will be nullified if it is not the Government's intention to increase the £25,000 limit.

15. If the Government feels unable to restore the limit to nearer its real value in 1974 then the Association urges that the limit should be increased modestly to £35,000 so as to continue to embrace the vast majority of first-time buyers and not to undermine the changes in the tax relief system. The limit should then be further increased to take account of inflation year by year.

ECON POL JD
c HMT

10 DOWNING STREET

THE PRIME MINISTER

20 December 1982

Dear Bob,

Thank you for your letter of 22 November.

I'm afraid that, on general grounds, which have nothing to do with life assurance premium relief, I cannot give you the assurance you seek.

The fact is that we cannot give, unqualified, assurance after assurance about taxes or tax reliefs any more than we can about particular public expenditure programmes. No responsible government could do so.

I hope you will understand.

Yours ever
Margaret

Robert McCrindle, Esq., M.P.

B

File

Econ Pol
DSG

c. Mr. Mount

CONFIDENTIAL

10 DOWNING STREET

From the Private Secretary

20 December 1982

Dear Jill,

CHILD SUPPORT AND THE POVERTY TRAP

The Prime Minister has seen a note from Ferdinand Mount dated 17 December of which I understand Mr. Mount has sent you a copy.

The Prime Minister would be grateful for a note on the possibility of introducing an income tax allowance for child support, a proposal which she strongly favours; and on the possibility of reintroducing lower rate bands of income tax.

Yours sincerely,

Michael Scholar

Miss Jill Rutter,
H.M. Treasury.

CONFIDENTIAL

3

10 DOWNING STREET

Prime Minister

Bob McCrindle M.P.

I have had a go myself at the difficult draft letter to Mr McCrindle. The problem is how to decline giving the assurance he seeks without stirring up anxieties. I hope this does so.

MCS 17/12

Prime Minister

(1)

Agree / enquire about X ?

MCS 17/12

17 December 1982

Policy Unit

– I am very much in favour of (i). (ii) will be solved when we get the basic rate down.

PRIME MINISTER

CHILD SUPPORT AND THE POVERTY TRAP

In our discussions on unemployment, taxation and family policy, we are again and again led back to the same impasse. The plight of the married man with two children on average and below-average earnings is already an embarrassment to us in the House. It will be an embarrassment in a General Election campaign, unless we do something in this Budget.

1. The heavy burden of income tax on poorer working families is a scandal. At times, it leads to marginal tax rates of 100% or more. This is not only a disincentive to work, it is absurd and unjust.

2. This poverty trap affects principally families with children. So does the unemployment trap.

3. Yet at present the only specific way of concentrating help on families with children is via child benefit. But this does not help their income tax position. It is a transfer from earned income to welfare benefit, and thus unappealing to many of our supporters.

4. Increasingly, we regret the abolition of child tax allowances. Without something of the sort, it is hard to see how we shall ever raise the thresholds high enough to be clear of the FIS taper. Of course, those allowances were of extra value to higher-rate taxpayers; but that was not unwelcome to Conservatives, who believe that working for one's children's future is commendable.

With hindsight, the abolition of the lower rates of income tax seems increasingly dubious, too. It has given us the highest starting rates in the world which, combined with the lower thresholds, has a lethal effect.

A married couple start paying income tax

in the UK at	£2,446 pa and at 30p in the pound
in France at	£3,480 pa and at 7.2p in the pound
In West Germany at	£8,235 pa and at 18p in the pound.

The abolition of both the lower rates and the child tax allowances was and is defended largely on the grounds of the Inland Revenue's convenience. The Treasury's line, eg in Tim Flesher's letter to

Squadron-Leader E G Clark of 26 November 1982, is that "Child benefit is not only simpler to administer, but it also helps parents with incomes below the tax threshold who would get no benefit from a tax allowance".

In reality, there are now relatively few parents with incomes below the tax threshold (£50 a week) and they qualify for FIS, in any case. Only unemployed families would get no benefit and, for them, the dependants' allowances plus child benefit are reasonably adequate.

Administrative simplicity is an admirable principle, but it should not be allowed to take precedence over the construction of a rational, internally consistent system of taxation.

5. There would be some embarrassment if we revived child tax allowances - although it was not we who abolished them. But it might be simpler to bring in a family responsibility allowance, payable to all tax-payers who have a child for whom they now receive child benefit.

This would be a relatively cost-effective way of raising thresholds for those families who suffer most from the present system.

6. If, at the same time, we indexed the other personal allowances, there would be no losers in absolute real terms. Families would gain, and the present humiliating gap between our aspiration and our achievement would be largely closed. And family support would come increasingly from earnings and less from benefits.

7. Likely further advantages would be:

(a) a reduction in recorded public expenditure if we gradually shifted from benefit to tax allowance;

(b) a reduction in wage demands, since the real family take-home pay tends to be the standard on which wage claims are based.

8. I suggest that the Treasury , and DHSS ? be asked:

X

(i) to review the possibility of introducing an income tax allowance for child support;

(ii) to review the possibility of reintroducing lower rates of income tax.

FERDINAND MOUNT FM

10 DOWNING STREET

From the Private Secretary

26 November, 1982

The Prime Minister has asked me to thank you for your letter of 1 November about tax relief for parents of students in advanced education.

You expressed concern about the non-availability of a tax allowance for parents of children attending full-time courses of education between the ages of 16 and 19+. Nicholas Ridley has already explained the history behind the present child benefit system which was introduced in 1977. The switch from tax allowances to tax-free child benefit was welcomed by all the political parties on the grounds that it would provide a better system of family support. Child benefit is not only simpler to administer but it also helps parents with incomes below the tax threshold who would get no benefit from a tax allowance.

The great majority of families have gained from the introduction of the child benefit scheme. Since child benefit is payable in respect of any child who is under 19 and in full-time education you will, I presume, have been in receipt of this tax-free benefit for your son until last February. You are already aware that as a matter of general policy the Government does not favour creating special tax reliefs. They prefer instead to use any available resources in reducing the burden of direct taxes right across the board - which helps everybody.

While the Prime Minister has noted the points which you make in your letter and applauds the support you have given your son to enable him to continue his education, for the reasons I have given she cannot agree that any form of new tax allowance should be re-introduced along the lines you suggest.

(Timothy Flesher)

Squadron Leader E.G. Clark, MBE RAF (Ret'd)

SUBJECT

cc Master

Econ Pol 889

bc: Mr. Walters

cc J. Sparrow

10 DOWNING STREET

From the Private Secretary

10 December 1982

TAXATION OF INTERNATIONAL BUSINESS: COMPANY RESIDENCE, TAX HAVENS AND UPSTREAM LOANS

The Prime Minister held a meeting yesterday evening to discuss the proposals in the Chancellor's minute of 26 November on this subject. The Minister of State (R)(Mr. Wakeham), Mr. Middleton (H.M. Treasury), Mr. Green (Inland Revenue) and Mr. Alan Walters were also present.

The Prime Minister said that she was concerned that the Chancellor's proposals were too complicated and vexatious to the taxpayer; that they would lead to over-general avoidance clauses in the 1983 Finance Bill, and thus impose an arbitrary system on the taxpayer. The Chancellor said that the proposals he was now putting forward were a substantial modification of the original proposals, and represented a middle course which, while recognising the legitimate requirements of the Exchequer, would not damage UK business generally, nor the position of London as a financial centre. These proposals had been the subject of a series of informal discussions with influential and informed individuals outside the Government, and in the main these people had expressed themselves content. In addition, a number of the major representative bodies, including the CBI, the IOD, and the Consultative Committee of Accountancy Bodies, had also expressed themselves broadly in agreement.

In discussion it was noted that the proposals for a general re-definition of company residence had now been dropped. Instead it was now intended to take the more limited action of blocking the specific avoidance devices of profit and loss importation. Although the blocking action proposed might in the event not save the Exchequer the £50 million which had been estimated was being lost through this device, failure to take action would lead to a larger and growing revenue loss, since a number of large companies might well conclude that the Government saw nothing wrong in the employment of these devices. On upstream loans it was proposed to do precisely what the critics on the proposals had asked the Government to do - to think further how best to deal with the problem. The aim would be to identify the demonstrable abuses in this area, and to design action specifically to deal with these.

/ On

CONFIDENTIAL

On tax havens what was proposed was to publish revised draft clauses for the Finance Bill and so to initiate a further period of public consultation. These clauses would incorporate clear protections for genuine business transactions. Although the burden of proof would be on the company to show that it had good reason for operating in a tax haven, there would be a number of tests, qualification under any one of which would exempt a company from the proposed new tax charge.

In further discussion it was noted that the tax avoidance measures which had been taken in the past three Finance Bills had saved a revenue loss of around £1 billion. The problem was to block off abuses before they grew into large revenue losers, but at the same time not to damage genuine business activity. In principle, there would be much to be said for a regime with few exemptions and allowances and a much lower standard rate of company taxation levied across the board. Such a change, however, would be unwelcome to much of industry, in particular to manufacturing, and it was agreed that there was a strong case for preserving stability in the taxation of companies.

Summing up the discussion, the Prime Minister said she continued to have considerable misgivings about these proposals. Before the proposals on tax havens were introduced there would need to be an assessment of their effect on the territories concerned; this assessment should take account of the defence and overseas policy implications. She also remained very concerned about the proposals which had been made in relation to licenced depositories and rents and dividends from overseas. On this point it was agreed that there could be no question of returning to a licenced depository system and that it would be important to allay the fears aroused by the Consultative Document that the re-imposition of exchange control was being prepared for. So far as company residence, tax havens and upstream loans were concerned, however, she was ready to agree to the publication of a further Consultative Document inviting comments on the new draft clauses on tax havens, and explaining what was proposed on the other two matters. She wished to be kept closely in touch with developments on these matters.

M. C. SCHOLAR

Miss Jill Rutter,
H.M. Treasury.

CF/ For Chancellor's mtg Tues.

SECRET

PA

MCS 15/12

Econ Pol ②

Prime Minister

7 PA

Worth mention at your next weekly meeting with the Chancellor.

MCS 9/12

PRIME MINISTER

TAX THRESHOLDS AND THE BUDGET

1. The Chancellor is coming under considerable pressure to "do something for industry". When I met the CBI last ~~Monday~~ at which, they urged me to do the usual things:

- elimination of the NIS (even a negative NIS!);

- yet more reductions in the price of electricity, gas etc;

- an expansion of public investment, particularly railway electrification, and civil works.

2. I pointed out that the government had already brought about many of the conditions the CBI had thought to be of crucial importance:

- reduction of inflation;

- reduction of interest rates;

- more "realistic" value for sterling;

- lower NIS and fuel prices.

Public investment, provided it was worthwhile had also been encouraged.

3. The CBI are particularly disparaging about the need to increase personal tax thresholds. It was perfectly clear that McDougal, the Chief Economist, had not even heard of, let alone read, Hermione Parker's work. The CBI view is that what is needed is a reduction in benefits, not a reduction in tax thresholds.

4. In view of all the pressures being brought on the Chancellor, not only by the CBI, but also by the Department of Industry, Trade etc, I think it would be a good idea to reiterate that raising the tax thresholds is the first priority, not the last, in the Budget process.

AW

9 December 1982

SECRET

ALAN WALTERS

PERSONAL AND CONFIDENTIAL

CF/
For the Chancellor
mtg on Tues/Wed 14/15
MCS 10/12

Prime Minister

Agree to discuss with the chancellor - at the next weekly meeting?
MCS 9/12

1

Yes not

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

PRIME MINISTER

LIFE ASSURANCE PREMIUM RELIEF

William Rickett wrote to Jill Rutter on 24 November asking for a draft reply to the letter Bob McCrindle sent you on 22 November. Replying to his letter seems to me to raise two important issues of principle.

2. First, on substance. Ferdie Mount has recently been drawing attention to a number of our fundamental objectives in this area. At last week's meeting of the Family Policy Group we were clearly confronted with the huge cost of making any significant progress on tax thresholds. Yet that is only one of our objectives. We want to see a fall in the proportion of shares and other investments held by anonymous - often inefficient - investing institutions. We want instead to promote the wider spread of individual share ownership in all sections of the population. We want to create a greater sense of personal identification with the wealth-creating private sector.

3. With the help of Treasury colleagues, I have therefore been looking at all the possible long term tax reforms which would favour developments of this sort. One possible component of reform might be the phasing out of life assurance premium relief. For its effect is certainly contrary to our objectives. Its nominal cost is already some £600 million a year. And that figure is growing, on the basis of the present life assurance premium relief, by up to £70 million a year (By coincidence, that is about half the revenue cost of a one per cent increase across the board on tax thresholds.)

4. Phasing out life assurance relief is, of course, at this stage, no more than one possible candidate for inclusion in a possible package. Like everything else, as I fully appreciate, it raises its own political problems. That is why any change could only be considered as part of a wider package. But if we are ever to be able to construct such a thing, we must take care not to "give away" or concede in advance every possible revenue-increasing item for a package, the overall effect of which might be revenue-neutral or revenue-reducing.

5. This means that I would not want now entirely to rule out abolition of life assurance premium relief, particularly in relation to what we might do after an election. At the same time, there should be no hint of such a move in the reply to Bob McCrindle. It would upset investors and insurance companies in a most unhelpful way.

6. This leads me to my second point - the general stance we should take in replying to letters of this sort. It was clearly quite right to squash the alarm created so mischievously by the Daily Express on mortgage interest relief. But I think we need to avoid going further down this road by establishing a principle that we do not give long term "blocking" pledges of this sort. Without this backbenchers will be encouraged by pressure groups to seek more and more commitments of the same kind. This would increasingly box us in when we are looking at policy options and restrict our freedom of manoeuvre. At the moment the sort of commitments being sought may seem individually to be fairly unexceptional, but if we show a readiness to respond the demands will inevitably escalate.

7. Bob McCrindle's letter provides an excellent opportunity to establish such a principle.

8. Perhaps I might have a word with you about this. In the meantime I attach a draft reply to McCrindle.

...

G.H.

8 December 1982

DRAFT LETTER FROM THE PRIME MINISTER

TO: ROBERT McCRINDLE, ESQ., MP

Thank you for your letter of 22 November.

I have decided, on general grounds that have nothing to do with life assurance premium relief, that it would be wrong to give you the assurance you seek.

Let me explain. The habit of asking for assurances about future intentions is catching on. It poses Ministers with a choice between boxing themselves in, on a wide range of issues, which is not helpful, or creating what often proves to be unnecessary alarm, by declining to give an assurance in a particular case.

So I think it right to establish the principle that we are entitled not to give assurances, without being misconstrued. I intend to apply this principle fairly widely.

I am sure that you will understand. And please do not construe this as suggesting that we are just about to abolish life assurance premium relief!

CONFIDENTIAL

Econ Pol

JH 447

DEPARTMENT OF INDUSTRY
ASHDOWN HOUSE
123 VICTORIA STREET
LONDON SW1E 6RB

TELEPHONE DIRECT LINE 01-212 3301
SWITCHBOARD 01-212 7676

Secretary of State for Industry

6 December 1982

The Rt Hon Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Parliament Street
London SW1

(2)

Prime Minister

Worth reading, at least the yellowed bits.

MCS 7/12

Dear Geoffrey,

1983 BUDGET

It may be helpful to you at this stage if I set out the main industrial measures I hope you will consider for the next Budget and give an indication of my priorities.

2 Both your last Budget and the further measures you announced on 8 November gave considerable help to industry. Both packages were well received - not just by industry itself, but by the public generally. Help to make industry more enterprising and more competitive is widely seen as helping to save and create jobs. I hope, therefore, you will feel it right to use the 1983 Budget to give further substantial help to industry. In my view the industrial situation and prospects would justify such an emphasis. Despite improvements in productivity and efficiency, profitability is still much too low. There is still a long way to go to recover lost competitiveness. Reports suggest that in a number of sectors British firms are too weak to take advantage of any upswing in demand.

3 My suggestions are grouped under 3 broad headings. First, I hope you will be able to include at least one major measure affecting industry as a whole, as you were able to do in this year's Budget with the NIS reduction. Second, I hope you will be able to repeat the concept of including in the Budget an "innovation" package which you successfully introduced this year. Third, I hope you will build on the momentum of previous Budgets by including a further package of measures to encourage enterprise and small firms.

4 In addition, I have already written proposing a review of motoring taxes and, subject to the outcome, this might possibly be a fourth area where useful measures could be taken.

Major Industrial Measures

5 I intend to write to you again in the New Year with more detailed proposals under this heading when the convergence may be a little clearer. Developments on interest rates and the exchange rate will need to be carefully watched. The fall of interest rates (and of course of inflation) during the year has brought considerable benefit to industry and I certainly would not urge any measure which could put these helpful developments in jeopardy. Subject to that important point, I believe that so far as room for manoeuvre allows, the policy of reducing the costs imposed on industry remains the most valuable contribution we can make. The successive reductions of NIS to 1½% from next April have been very welcome. My preliminary judgement is that to make further reductions of this tax should be the highest priority. Indeed, I hope you will consider announcing in the Budget the abolition of the NIS from the earliest convenient date in 1983. NIS adds directly to costs; it is a tax on exports as well as on employment; its abolition would be a further direct enhancement by Government of industry's competitiveness.

6 You are obviously considering full revalorisation of the personal income tax allowances in the Budget, and the possibility of going further on this or related fronts. I would not wish to argue against these measures in any way on their own merits. But despite the improvement to personal disposable income such measures would bring, I would not regard them as the best available way of helping industry at this stage. Industry's main problems remain on the supply side, as we appreciated before 1979, and our principal industrial measures should, I suggest, continue to be directed there. I have been impressed by the number of industrialists who reject the view that income tax cuts are likely to make a significant difference to wage settlements.

7 The main alternatives to further action on NIS are perhaps a reduction of the Corporation Tax rate (or the introduction of new allowances, eg on commercial buildings) or some action on non-domestic rates. On Corporation Tax, I believe we should have a reduction in mind for the longer term. But in present circumstances it would not substantially help many of the sectors facing the greatest competitive gaps. On rates, while we still await Michael Heseltine's proposals, I have reserved my position on cutting or capping non-domestic rates, which are now the biggest tax paid by industry and commerce. At this stage I believe action on the NIS should continue to have priority.

Energy Prices

8 Despite the useful measures announced on 8 November, this remains an area we must keep a close watch on. If by next spring it seems clear that further action is required to keep British industry's energy costs in line with competitors, I would hope you would give the necessary measures high priority.

INNOVATION

9 Under this heading I hope you will consider repeating the successful format you adopted this year of a combined package of tax and expenditure measures. I would certainly like to propose as a high priority that you announce a revival of the Small Engineering Firms Investment Scheme (SEFIS) in the Budget. This would be very well received in industry and would help this important sector to modernise itself. Some detailed changes to the previous scheme would probably be made and I will let you have these separately.

10 If you are willing to pursue the combined package approach, I should like to make further proposals for measures involving expenditure. The possibilities I am considering include:

- i support for other innovation - linked investment in addition to SEFIS;
- ii an expansion of our support for R&D, possibly including a response to the Alvey proposals;
- iii increased support for technology transfer;
- iv support for the development and improvement of management skills.

If you could let me know whether you favour this approach, I will develop these proposals further into more precise suggestions.

11 On the tax side I should like you to consider a further extension of the 100% first year capital allowance for rented teletext receivers. While recognising the general case for removing preferential capital allowances for rented consumer goods I believe special consideration should continue to be given to the position on teletext receivers. I am especially concerned to maintain the growth in the market in this area where British products compete successfully with imports, because it may prove to be the first stage in a succession of technological developments leading to cable TV, direct broadcasting by

satellite and interactive home terminal uses. Teletext and viewdata lost their marketing advantage over other sets with the removal of HP controls. An extension for a further year of the 100% first year allowance for teletext would bring it into line with viewdata. You will recall that I proposed a two year extension before this year's Budget with the same object in mind, but you only felt able to grant an extension for one year at that time.

12 My officials have prepared a paper setting out the arguments on teletext in more detail and will be in touch with yours shortly.

ENTERPRISE AND SMALL FIRMS

13 For convenience I am dividing my proposals under this important heading into major and minor items. I list the major items below in order of priority, and Annex A carries further details. The minor items are set out in Annex B. This distinction is purely for convenience and does not imply that I regard all the minor items as lower priority than the major. Some of the minor items should, I believe, have a high priority, as indicated in Annex B.

Share Option and Incentive Schemes

14 I attach the highest priority to improving the tax treatment of share option and incentive schemes. The present relatively unfavourable treatment of such arrangements is a major obstacle to the development of "growth" companies in the UK and contrasts unfavourably with the position in the US. The existing schemes are useful but they are tied to comparatively low limits and must be widely available to employees. I should like to see companies able to offer substantial schemes restricted, if they wish, to key executives to give them a real interest in the success of the company without incurring heavy income tax charges. I am convinced that this would give a strong incentive to executives to improve the performance of their companies. It would also help growing companies attract key managers by being able to offer attractive overall renumeration terms even though they may only be able to provide a modest salary in the early years.

15 I know that some companies are offering such schemes despite the present tax position. Even in such cases I believe a more generous tax treatment would so enhance the incentive effect of these schemes that the loss of revenue will in no sense be "wasted".

16 More details on this proposal are at Annex A. It goes beyond the small firms sector, of course, and could I believe form a major element in your Budget in its own right.

Encouraging Investment in Equity Capital

17 My second priority is that you should develop the valuable measures you have already introduced to encourage outside investment in the equity capital of small firms. The Business Start-Up Scheme is now proving its worth but is still being taken up relatively slowly. I hope you will announce in your next Budget that the scheme will be continued beyond its present expiry date in 1984, otherwise the uncertainty surrounding the scheme's future will inevitably affect it badly during 1983/84. I also hope you will be able substantially to increase the annual maximum allowed under the scheme and introduce the other improvements detailed at Annex A.

18 In parallel with this improvement to the Start-up Scheme, I believe we should extend the incentives to equity investment in established unquoted companies. This would simultaneously ease the provision of finance to established companies aiming to expand (and reduce their dependence on bank borrowing) and help to avoid the criticism that too many of our measures are directed towards start-ups.

19 I am attracted by the CBI's proposals on Small Firms Investment Companies which I know you have already considered. I hope you will consider introducing a scheme on the lines of these proposals. This would, I think, be particularly helpful if we are unable to meet the CBI on reducing the burden of non-domestic rates substantially, which is likely to be another of their main Budget proposals.

Loan Guarantee Scheme

20 The existing allocation to this valuable scheme is likely to be exhausted in February or March 1983. I am sure we should extend the scheme at least until its original 3-year term is completed, though we may wish to make some detailed adjustment to the scheme. This might require a further £150m, though I would need to re-examine this estimate nearer the time. This is, of course, an expenditure measure, subject to the normal conventions governing the treatment of guarantees for public expenditure survey purposes.

Stamp Duty

21 I consider that stamp duties on property conveyance should be reviewed again, both because a reduction would give a welcome boost to the construction industry and because it would assist labour mobility. I see particular merit in the suggestion that

stamp duty should be reduced for first-time buyers, to assist the buyers themselves and to provide a stimulus to the construction of smaller "starter" homes.

22 While on the subject of stamp duty, I would like to put on record my view that the tax bias against holding industrial shares and in favour of other forms of saving is something we must examine in the longer term. I am sure that this is one of the reasons for the decline of the individual investor in favour of the institutional investor.

The Self Employed and Agency Workers

23 I hope you will agree not to re-introduce the draft 1981 legislation on agency workers operating through companies. I am becoming concerned that current Inland Revenue policy is giving the wrong signal to the self-employed about Government attitudes towards them. The Inland Revenue must, of course, administer the law correctly as it sees it but I believe we must take care not to harass the self-employed and press-gang them into Schedule E unless this is fully justified by the facts.

Enterprise Bonds

24 The preceding three items I would rank as equal third in priority after the first two under this broad heading. Finally, I hope you will consider the proposal for "enterprise bonds" raised by John Loveridge, Graham Bright and others last year, though I believe it is of less importance than the previous measures. It is widely acknowledged that expenditure is sometimes incurred which may not be commercially justifiable in timing simply for the purposes of saving tax in a particular year. Enterprise bonds would be tax-deductible but taxable on redemption. In this way expenditure could be deferred until the most opportune time but the Treasury would have had use of the money meanwhile.

Minor Items

25 These are listed at Annex B, with an indication of my priorities between them.

CONCLUSION

26 I very much hope you will be able to include items from each of the broad headings I have suggested. I shall write to you again about possibilities for major industrial measures in the new year. In addition I shall develop detailed proposals for a

package of "innovation" expenditure measures if, as I hope, you see advantage in this course; and I may wish to return to the question of motoring taxes subject to the outcome of the review I have suggested.

27 I am copying this letter to the Prime Minister, Sir Robert Armstrong and John Sparrow.

Yours ever

Peter

ENTERPRISE AND SMALL FIRMS

Further Detail of "Major" Measures Proposed

Share Option and Incentive Schemes

1 My detailed proposals are as follows:

i a new scheme increasing the permitted maximum of approved share incentive or option schemes to £10,000pa or £50,000 overall.

ii companies to be able to restrict eligibility for approved schemes to key executives if they wish.

iii deferral until the shares are sold of any charge to tax arising on exercise of an option. Such charge to be to capital gains rather than income tax.

iv a review of the rules relating to the growth in value charge particularly the definition of "restrictions" and the application of this charge to transactions involved in management buy-outs.

v particular consideration to be given to charges facilitating shcmes within groups of companies.

vi particular consideration to be given to relaxing the present tax treatment of "partly-paid" schemes which can at present be adversely affected by the 1972 and 1976 Finance Acts. In most cases the employee in a "partly-paid" scheme is at risk from the value of shares going down as well as up, which would seem to justify capital gains treatment (I do not seek to disturb the "stop-loss" arrangements in the 1976 Finance Act).

Business Start-Up Schemes

2 I propose the following improvements:

i increase the annual limit qualifying for relief to £50,000;

ii increase the maximum shareholding permitted to any individual to 49%;

iii abolish any restriction on the proportion of a company's shareholding eligible for relief;

iv relaxation of the relationship rules which determine who are connected persons. I think it is especially important, given our commitment to the family which has emerged from the Family Policy Group, that lineal antecedents and descendants should be eligible for relief;

v abolition of the requirement for a trading company to have traded for at least four months before relief can be granted (to be replaced by a mechanism to withdraw relief retrospectively if the company turns out to be non-qualifying). Experience shows that the existing requirement has a severe disincentive effect;

vi companies which license out a process not to be treated as disqualified. Particularly important in the new technology field;

vii extension of relief to trustees of family and similar settlements;

viii allow differentiation into classes of share capital other than merely as to voting rights; and admit participating preference shares and redeemable fixed rate preference shares;

ix abolition of the requirement that subsidiary companies of the qualifying company must be wholly owned provided the departure relates only to minority shareholdings taken by company employees.

ENTERPRISE AND SMALL FIRMS

"Minor" Items

1 The first two items listed below are high priority:

i) Small Firms' Corporation Tax

Much has already been done to bring down the rate in the marginal field; but this remains a continuing source of complaint. It is suggested that the marginal rate should be reduced still further by widening the band to £475,000 (upper) and £95,000 (lower) producing a marginal rate of 55%.

ii) VAT Threshold

Revalorisation would suggest a new main VAT registration limit of around £17,850. It is proposed that the limit be raised to £18,000 with suitable increases in the other limits.

2 The next group of items are roughly of equal importance, lower in priority than the first group:

iii) Scientific Research Allowances: Definition

At present these allowances are restricted to 'activities in the field of natural or applied science for the extension of knowledge'. This definition is too restrictive and uncertain, and excludes, for example, much expenditure of development (as opposed to original research) character; yet development is precisely the field in which our industries' efforts are often found lacking. It is proposed that the allowance should be suitably redefined along the lines of research and development, as many of our overseas competitors do.

iv) Interest Relief

Useful relaxations in the provisions relating to interest on loans taken out for the purpose of investing in a close company have been made over the last few years but these do not go far enough. It is proposed that the requirement that the company be close should be replaced by its merely being unquoted; and that all full-time employees (not merely managers) should potentially qualify for relief. Further, now that sleeping partners can qualify for interest relief on loans for partnership investment there seems to be no reason why limited partners should be discriminated against and this should be removed.

v) Business Formation and other Legal Costs

Relief should be made available to those relatively minor capital costs which are incurred for reasons such as setting up the framework of a business or establishing an incentive scheme. These are legitimate business costs and there seems to be no reason why they should not be allowed.

vi) <u>Capital Gains Tax Rollover Relief</u>

It is unfortunate that, while relief is available on disposal of business assets which are replaced, no similar relief is available on disposal of shares in unquoted trading companies even though these may be replaced by other unquoted trading company shares or business assets. The proposal is that rollover relief should be extended to include rollover into or out of unquoted trading company shares, subject to safeguards similar to those which apply to retirement relief.

vii) <u>Loss Relief Carry Back for new Companies</u>

At present the special relief for losses sustained in the first few years of a new business is available only to unincorporated traders. It is undesirable that normal commercial considerations as between incorporation and non-incorporation should be affected by fiscal distortions. I propose that the relief should be available according to participants' interests in a newly-trading company.

3 Finally, the following item is lower priority but has nevertheless caused problems in particular cases:

viii) <u>Assets Acquired in a Series of Transactions</u>

A problem sometimes arises, particularly with family company shares, that a series of disposals to a connected person falls foul of the special capital gains tax rules such that the value to the disposers is taken to be the (higher) proportionate majority holding value rather than the (lower) minority holding value. This can result in excessive CGT burdens on the disposing minority holders, and this should be remedied.

10 DOWNING STREET

Prime Minister

MT

International Taxation

This is the meeting the Chancellor asked you to have to allow John Wakeham and Peter Middleton (and John Green from the Revenue) to explain themselves.

Their presentation has, obviously, been very poor; and they are backtracking on the substance.

There is some way to go - but

PTO

we shall have to be careful

to avoid any accusation

– however ill-founded – that

the government's failure to act

will benefit the Postgate's etc.

MCS 6/12

Econ Pol

s/c JV

SECRETARY OF STATE FOR EMPLOYMENT

Prime Minister (2)

Caxton House Tothill Street London SW1H 9NA

Telephone Direct Line 01-213 7789

Switchboard 01-213 3000

MJS 30/11

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

30 November 1982

D Geoffrey,

I have only just seen a copy of Arthur Cockfield's letter to you of 29 October suggesting a number of fiscal measures to assist the tourist industry. I should like to support Arthur's proposals. These would do a great deal at comparatively little cost. And they would have the added advantage of helping the hard-pressed construction industry.

In general, there is no doubt that tourism is one of the main areas to which we shall be looking for new jobs in the future, and that it will be a particularly important source of jobs for young people and the low-skilled. In view of this, I think it must be admitted that overall Government assistance for tourism compares very unfavourably with what is available to individual sectors of manufacturing industry. This seems to be a good illustration of the need to achieve a more equitable balance between service industry and manufacturing as far as Government aid is concerned.

I am copying this letter to the Prime Minister, the Secretaries of State for Trade, Industry, Environment, Scotland, Wales and Education, the Minister of Agriculture, Fisheries and Food and Sir Robert Armstrong.

Yours

Norman

Econ Pol
Budget

Econ. Pol. GK JV

SECRETARY OF STATE FOR THE ENVIRONMENT

NBPM

Mes 1/12

2 MARSHAM STREET
LONDON SW1P 3EB
01-212 3434

My ref: H/PSO/17446/82
Your ref:

30 November 1982

Dear Geoffrey

Arthur Cockfield sent me a copy of his letter to you of 29 October about financial assistance for the hotel industry, by means of improved building allowances.

I agree that a "holiday package" of the kind he proposes would not only assist the tourist industry, but that the building activity it would generate would also be welcome to the hard-pressed construction industry. I know you need no reminding of the extent of the industry's problems.

It is important that the package should be tailored to fit the market. My impression is that the particular areas of demand are, on the one hand, well-located hotels geared to the business market, and holiday hotels with a wide range of leisure facilities and, on the other, self-catering accommodation. There may be some over-capacity in other sectors of the market. The demand at the upper end of the market is also reflected in a trend for hoteliers to add costly new recreational and leisure facilities to existing larger hotels.

Arthur Cockfield's proposals for extending the scope of initial building allowance to cover the construction of self-catering establishments therefore seems particularly valuable. Allowances for the production of self-catering units might be particularly beneficial to the small hotel operator, who would otherwise be unable to afford the outlay. Both for self-catering and hotels I would strongly support the extension of allowances to buildings with fewer than ten bedrooms.

More generally, the hotel industry would benefit from the effects of improved allowances on the substantial hotel extensions which are currently being undertaken to improve facilities. And although there is little new building at the moment, we may hope for a noticeable upturn in the level of activity once the economy begins to pick up. An increase in the level of building allowances may then tip the scales sufficiently to allow marginal projects to go ahead.

/ I am copying this letter to Arthur Cockfield and the other recipients of his letter.

Yours ever

MICHAEL HESELTINE

DEC

Econ Pol

Budget

2F.

The Rt Hon Sir Geoffrey Howe QC MP

CONFIDENTIAL

Prime Minister

Relevant to tomorrow's meeting with the Chancellor

MES 6/12

MR. SCHOLAR

MEASURES AGAINST TAX AVOIDANCE

Item 1 first of all is the Yellow Paper on Company Residence, Tax Havens and Upstream Loans. The Chancellor's memorandum of 26 November is a great step back from the proposals which we saw before the Budget of 1982. Now the suggestions are somewhere near the range of tolerable.

The major difficulty is, however, that it still leaves a great deal of room for interpretation in the hands of the Inland Revenue. Although the suggestion that decisions should be moved to head office, instead of leaving it to individual inspectors, may remove some of the persecution which some companies genuinely feel, there will still be considerable power in the hands of the officials of the Revenue.

On the specific measures referred to in paragraph 8:

a. On company residence

I think it is entirely right to drop the idea (for ever?) of a general redefinition of company residence. We have a working definition which is valuable and understood by everyone. But we must ensure that the "limited action against specific avoidance" which the Chancellor refers to, is appropriately limited and not an open season for the Revenue.

b. On upstream loans

It is quite impossible to differentiate between genuine upstream loans and those which are designed to avoid dividend taxation. The vast majority of upstream loans are genuine loans and are advantageous both to the lending subsidiary and the borrowing parent, irrespective of tax arrangements. Since after a great deal of diligent work, we cannot find a formula which would identify those which are carried out for tax avoidance purposes, I would suggest that we simply cease our search at this stage. Instead of promising to "publish more daft clauses as a basis for further consultation", we should say now that we are not going to introduce any such distinction. And we cease consultation and consideration of any measures against upstream loans immediately.

CONFIDENTIAL

/c. On tax havens

c. On Tax Havens

On tax havens, the best procedure is to test any proposed legislation to see whether it puts the onus of proof of the use of tax havens on the Revenue rather than the company. Underkill would be much better than overkill. The measures being suggested by the Chancellor move in the right direction, but I am afraid they give the Inland Revenue considerable power in determining the motives for having a foreign subsidiary. Similarly, they do not take into account the fact that in many cases a company will set up subsidiaries, in Malaysia for example, and pay virtually zero tax. But the company is not really avoiding tax by setting up in Malaysia, since the Malaysian Government is anxious to promote industry by these tax remissions. It is part of normal commercial activity.

I am very much an amateur in this area of corporate tax avoidance. It would be a good idea for the Prime Minister to get some independent advice, possibly from Peter Rees, or John Chown. In the case of John Chown, this would have to be done on a very confidential and closed basis, since he has lots of interests outside.

Rents and Dividends from Overseas - Licensed Depositories

The Treasury, in the shape of John Wakeham, was just as alarmed by the tone of the Inland Revenue letter of July 1982 as we were. The Treasury propose to do nothing yet. But John Wakeham argued that the elimination of exchange control had, as the Inland Revenue suggested, created opportunities for evasions which had not hitherto existed. He agreed, however, that the basis for some of their figures was slim or non-existent.

I suggested that one way of dealing with this would be to make the penalties for evasions of property income received from overseas much higher than for any other tax evasion. This is the way these matters are dealt with in the United States where, as you know, there is no restriction on interest and dividends received from overseas. But the penalties, if such dividends and interests are not reported, are enormous. This seems to do the trick, since the Internal Revenue in the United States does not complain of any significant tax loss from this source.

It would create a very bad impression if we set up a system of licensed depositories. It would certainly be interpreted as the first stage, at least, in a return to controls on exchange rates.

Conclusion

The Treasury have made very big strides in changing their perception of and proposals for tax avoidance legislation. I still think there is room for modification. But as a general proposal, they are on the right lines.

AW

29 November 1982

ALAN WALTERS

CONFIDENTIAL

BM

file

hc: J. Vereker

10 DOWNING STREET

From the Private Secretary

29 November 1982

TAXATION OF INTERNATIONAL BUSINESS:
COMPANY RESIDENCE, TAX HAVENS AND UPSTREAM LOANS

The Prime Minister was grateful for the Chancellor's minute received here on 26 November on what changes are proposed on the taxation of international business: company residence, tax havens and upstream loans.

The Prime Minister has minuted that she remains very concerned about this. She fears that the Government would, if it went ahead on this basis, be replacing one set of anomalies with another. She has further commented that some points in the minute and its attachment are unclear: for example, the proposal that the Government should take limited action, in blocking the specific avoidance devices of profit and loss importation. She has also enquired about what is meant by "significant reduction" of tax in item 8. under "Tax Havens" in the attachment to the Chancellor's minute. The Prime Minister has also noted that this minute does not deal with the other tax issue which has recently caused her concern, the proposal that dividend and interest receipts must be made through a licenced depository. Finally, as I mentioned to you on the telephone this morning, the Prime Minister will wish to think further about these proposals before reaching a conclusion.

M. C. SCHOLAR

Miss Jill Rutter,
HM Treasury

CONFIDENTIAL

2.21

CONFIDENTIAL

Prime Minister 2

I remain very concerned about this. We shall be replacing one set of anomalies with another.

I shall need some professional advice about these – the memorandum is not clear to me.

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

cc J. Sparrow

PRIME MINISTER

TAXATION OF INTERNATIONAL BUSINESS: COMPANY RESIDENCE, TAX HAVENS AND UPSTREAM LOANS

The purpose of this letter is to let you know how matters now stand with our tax proposals on company residence, tax havens and upstream loans.

2. You may recall that, shortly before the last Budget, we had some discussion of the best way to handle these issues. Our original intention was to follow up our November 1981 draft clauses (the yellow paper) with legislation in the 1982 Finance Bill. But, in view of the widespread anxiety amongst the business community those draft clauses created, we decided to defer action for the time being.

3. Accordingly I announced in my Budget Statement that there would be no legislation this year. I made it clear that the company residence issue needed to be looked at again. On tax havens and upstream loans, I said that our objective was to find the "right middle road" which, while recognising the legitimate requirements of the Exchequer, would not damage UK business generally, nor the position of London as a financial centre. In the subsequent Finance Bill debate on these issues John Wakeham intimated that revised draft clauses would be published later in 1982, so as to leave open the option of including legislation in the 1983 Finance Bill.

4. With the aims I outlined in my Budget Speech in mind, we have over the last few months been looking again at these three related issues. In this period, too, the report of a working party, set up by the Institute for Fiscal Studies specifically to examine these issues, has appeared. While making all the expected noises about need for further study, this broadly supports our November 1981 proposals on tax havens and company residence but recommends rather more limited action on upstream loans.

5. In recent weeks John Wakeham has tested the water by conducting a series of informal discussions with informed and influential individuals. Bruce Sutherland, John Chown, John Avery Jones, Keith Carmichael and William Clark have all been invited to give their views on the best way to approach these problems. In addition John has sounded out a number of the major representative bodies, including the CBI, the IoD, the Consultative Committee of Accountancy Bodies and the British Bankers' Association.

6. These discussions revealed a substantial degree of support for our revised proposals amongst those representatives of the business and financial worlds. There was agreement that, on company residence, we were right to be dealing with specific abuses, rather than proposing the upheaval of a statutory redefinition. Everyone felt that upstream loans would need a good deal more consideration before we could act. Nobody quarrelled with our view that there was a serious problem on tax havens, and all welcomed the revisions we have made to protect genuine business activity.

7. Against this background, I think we can feel that the package we have put together represents a reasonable response to the business community's criticisms of the November 1981 proposals.

8. At the same time it should go sufficiently far to forestall accusations that we have failed to protect the taxpaying public generally by not dealing with an important source of revenue loss. What I have in mind is:

> on company residence, as a response to the particularly acute fears engendered by our original proposals, to drop the idea of a general redefinition of company residence. Instead we should take the much more limited action of blocking the specific avoidance devices of profit and loss importation, which are currently costing the Exchequer around £m50 a year. It would seem appropriate to do this in next year's Finance Bill;

?

> on upstream loans, we should do precisely what the business community are asking us to do and give ourselves time to think again how best to deal with the problem. The sums of money involved are large: we have already

identified over £m400 of overseas profits which have been repatriated in (non-taxable) loans form over recent years. Even though the annual tax loss which these represent is a much lower figure, we would undoubtedly be open to criticism if we now abandoned all prospect of action. But, in the absence of any consensus on what form that action should take, we should make it clear that we do not propose to deal with the issue in the 1983 Finance Bill. In due course we would publish revised draft clauses as a basis for further consultation;

on tax havens, there is sufficient broad agreement to go ahead with publishing revised draft clauses and so initiating a further period of public consultation. These new draft clauses would differ from the original draft legislation on several important respects; in particular they would incorporate clearer and more certain protection for genuine business transactions. They would be accompanied by much fuller explanatory material which would set out the case for action, highlighting the current £m100 or so annual tax loss, much more fully than hitherto. Initially the aim would be to keep open the option of legislation in 1983 but the decision on that would be taken in the light of the representations we receive.

9. I attach an appendix which shows in summary form our current package alongside the original proposals. As this demonstrates, no one can really claim we have not listened or failed to act on the advice we have been given. I therefore propose to authorise the publication, later this month or earlier next, of a further consultative document which will set out all three elements of the package. The main purpose of this document will be to invite comments on the new draft clauses on tax havens. But at the same time it will explain that we are not proceeding with a statutory definition of company residence, outline our decision to postpone action on upstream loans and describe in detail the reasons why we feel our tax havens proposals are needed.

10. I shall, of course, keep you closely informed of any further developments in these three related issues.

GH

(G.H.)

November 1982

Original Proposal	Criticism of Original Proposal	My Proposal
COMPANY RESIDENCE		
1. Repeal Section 482 ICTA.	Repeal of Section 482 and consequent redefinition of company residence not necessary.	Retain Section 482 (possibly with minor modifications in the 1984 or subsequent Finance Bill).
2. Replace current case law with statutory definition based on place where company's business as a whole managed.	Unnecessary, and would create widespread uncertainty (would the company be taxed as UK resident or not?), which would be damaging to UK-based enterprises generally.	Drop idea of a general redefinition of company residence, and instead introduce specific legislation to deal with the specific avoidance devices of loss and profit importation. ?
TAX HAVENS		
3. Introduce new tax charge on the income of certain tax haven companies under United Kingdom control.	In principle case for action on tax havens accepted, but proposals criticised as too far-reaching and hence damaging to genuine businesses.	Retain charge, but significant changes of detail to meet criticisms.
4. Tax charge may fall on any UK company with at least 10% stake in the tax haven company.	The 10% figure is too low : it would bring in many shareholders who had no control over the haven company's distribution policy.	Stick to 10% figure to prevent manipulation through fragmentation of holdings.
5. Define "privileged tax regime" by comparing tax actually borne by haven company with the tax it would have paid under the UK regime.	a. This would bring in many countries (eg Netherlands) not normally thought of as tax havens. b. Complicated calculations would be needed to ascertain whether any company was enjoying a PTR or not.	Retain basic approach but Revenue to issue a non-statutory list of non-havens to provide a greater degree of certainty.

6. Only those tax haven companies which satisfied a fairly rigid set of criteria deemed to be "genuinely trading" and therefore exempt from the tax charge.	The test is right in principle, but too restrictive in its application and many bona fide companies could not satisfy it.	Modify test to provid greater protection for banks insurance and some holding companies.
7. A haven company which distributes a reasonable proportion of its profits to the UK should be exempt from the charge.	a. Test should be retained, but with some provision for special circumstances eg profits retained for the business requirements of the haven company. b. Wrong that, in looking at the profits available for distribution, UK measure of taxable profits can be substituted for profits per accounts.	Meet point b, but otherwise leave test unchanged - its value to groups with haven subsidiaries lies in its being a simple, mechanistic test.
8. A company will not be caught if it can show that avoidance of UK tax was not one of the "main purposes" of any of its transactions.	a. Language of test too vague. b. Wrong that a company could fail because of a single avoidance motivated transaction.	a. Language of test to be made clearer and less emotive - eg to talk in terms of a "significant reduction" of tax. b. Trivial amount of avoidance income no longer to taint whole of haven company's profits.
9. Scheme to operate at Board of Inland Revenue's direction.	Gives too much discretion to Revenue (this criticism based largely on misunderstanding of the provisions as drafted).	Retain provisions more or less as drafted, and explain just how limited are the Revenue's discretionary powers in explanatory notes.
10. Tax charge on UK shareholder should be appropriate proportion of haven company's notional UK tax bill.	Some critics argued for apportionment of income (on US lines) rather than apportionment of tax.	Retain present approach, and try to demonstrate that it is both simpler and fairer.

11. A UK company assessed to the haven charge should not be able to set off any ACT against its haven tax.	Denial of ACT set-off is unreasonable.	Allow ACT set-off.
12. In computing the haven company's notional UK tax, there should be certain restrictions on the reliefs and allowances available.	These restrictions unreasonable in the context of a tax charge which purports to focus on the UK tax a haven company would have paid had it been UK resident.	Restore full range of UK capital allowances, subject only to a specific anti-abuse provision.
13. If haven company subsequently pays a dividend, haven tax should be treated as underlying tax for the purposes of double taxation relief.	In some circumstances - eg where the overseas country levies a withholding tax on the subsequent dividend - this approach would result in some "wasted" DTR.	Retain general approach, but meet "wasted" DTR point by permitting surplus to be set against original haven charge.
14. The scheme should not incorporate a formal clearance procedure.	A clearance procedure is necessary to prevent widespread uncertainty and unreasonable compliance costs.	Offer no clearance procedure, because of the staff cost it would involve.
15. Meet problem of avoiding the haven charge by dressing up income as gains by extending Section 15 CGTA.	Probably because there was no draft clause to this effect, there was little comment on this aspect of the proposals.	On Revenue advice, leave issue in abeyance pro tem, but reserve right to return to it is evidence of abuse in future.

UPSTREAM LOANS

16. To tax as income a loan made to a UK resident out of the profits of an overseas company controlled directly or indirectly by the borrower, and to deny relief for any interest paid on the loan.	Many commentators did not accept the case in principle for legislation of this kind and there was more criticism on the detail of the proposed provisions.	Defer legislation beyond 1983 but continue consultation on a revised version of the draft clauses. These would be modified to meet at least some of the criticism on points of detail (see Annex B to Mr Taylor-Thompson's 18 August note). For example the "loans in the ordinary course of business" exclusion would be widened; the charge would be confined to companies; "downstream" and "cross-stream" loans would be specifically excluded.

Robert McCRINDLE, MP

1 6/12
2 13/12

File No

29/11

10 DOWNING STREET

Chased 2/12
with the Chancellor 2/12

From the Private Secretary

24 November 1982

Chased today - understand Chancellor minuted PM on 8/12. CF asked for pps.
16/12

You will have seen the reply the Prime Minister gave to Mr. Tim Smith, M.P., during Question time on 18 November, in which she said that tax relief on mortgage interest would not be removed by any Government of which she was Prime Minister. Robert McCrindle, M.P., has now written to ask whether her reply also covers tax relief on life assurance premiums.

I should be grateful if you could let me have a draft reply for the Prime Minister to send to Mr. McCrindle, if possible by Monday, 29 November.

W. F. S. RICKETT

Miss Jill Rutter,
H.M. Treasury.

10 DOWNING STREET

From the Private Secretary 24 November 1982

I am writing on behalf of the Prime Minister to thank you for your letter of 22 November.

I shall place this before the Prime Minister and you will be sent a reply as soon as possible.

W. F. S. RICKETT

Robert A. McCrindle, Esq., M.P.

Econ Pol

NEW ST. ANDREWS HOUSE
ST. JAMES CENTRE
EDINBURGH EH1 3SX

The Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
Treasury Chambers
Parliament Street
LONDON
SW1P 3AG

NBPM

Mr 23/11

23 November 1982

I have seen a copy of Arthur Cockfield's letter to you of 29 October suggesting fiscal measures to assist the tourism industry, and of Nicholas Edwards' supporting letter dated 9 November. I entirely share Arthur's assessment of the importance of tourism as a long-term viable sector of the economy; and I strongly support his suggestions for measures to encourage the industry and to achieve more equitable treatment as between manufacturing and service industries.

On the question of VAT, a measure of relief for the tourist industry would be keenly appreciated by the Scottish trade and particularly by the small hoteliers who comprise the great majority of tourist business north of the Border. The trade here, with the full backing of the Scottish Tourist Board, is doing its utmost to increase the numbers of foreign visitors to Scotland because it appreciates the importance of expenditure by them for our overseas earnings. Any VAT concession which you might feel able to make towards the tourist industry would I am sure be a fillip for our overseas tourist business. If I might identify one particular area within the ambit of the tax where a concession might be of especial benefit to the trade, I would suggest that a reduction in the rate of VAT on the food element in meals in restaurants (including restaurants attached to hotels) would considerably enhance the competitiveness of the catering side of the industry and could make the all-in-tariff rates available to tourists rather more attractive. It would also imply no change of principle in that food (other than in restaurants) is already zero rated.

I believe the extension and enhancement of building allowances along the lines suggested by Arthur Cockfield could be of particular advantage to Scotland where we have an unusually high proportion of small, family-run businesses excluded from the scope of the current allowances. It is in my view vital to stimulate new investment in such businesses, particularly in rural areas where the opportunities for increased income and employment are few and where tourism is an essential element in the local economy. I would be grateful if my officials could be included in any discussions you may arrange on the re-definition of eligible establishments and the relaxation of allowances criteria.

I am copying this letter to the recipients of Arthur Cockfield's letter of 29 October.

GEORGE YOUNGER

Econ Pol. Budget, Pt 9.

ROBERT A. McCRINDLE, M.P.

HOUSE OF COMMONS
LONDON SWIA OAA

R 23/11

22 November 1982

The Right Honourable Margaret Thatcher MP
Prime Minister
10 Downing Street
London SW1

Dear Prime Minister

As you may know, I have close associations with the insurance world and several senior executives have drawn my attention to your Answer to Tim Smith on the 18th November, confirming that it is not the government's intention to terminate mortgage tax relief but making no reference to life assurance. As you may know, the reports upon which I suspect Tim based his question referred to both and an interpretation has been put on your Answer by the Daily Express suggesting that the government is opposed to the phasing out of either of the tax reliefs. I should be greatly obliged if you could confirm that this is so because I should like to reassure the insurance interests that this encouragement to thrift is likely to continue.

Yours sincerely

Bob McCrindle

ECON POL

NBPM

MS 12/11

From the Government Chief Whip

House of Lords

12 November 1982

Dear Lord President,

NATIONAL INSURANCE SURCHARGE BILL

I have seen Geoffrey Howe's minute to you of 9 November about Parliamentary handling of this Bill. I was not able to respond before the deadline mentioned in paragraph 7 of the minute but I do not think that my comments could possibly have affected the timing of Introduction in the Commons.

I am pleased to see that the Bill is expected to be certified as a Money Bill. This means that it will be debated on Second Reading in the Lords with all other stages being taken formally. This will enable us to avoid the timing difficulties which we experienced on the Social Security (Contributions) Bills of 1980 and 1981. Indeed, if the Bill completes its Commons stages before Christmas, it should be possible to achieve Royal Assent before the recess.

However, it is as well to point out that Mr Speaker does not certify Bills until after Third Reading in the Commons and until then it is impossible to say for sure that he will certify. I know that Parliamentary Counsel will alert us between now and Third Reading in the Commons if there is any doubt about certification. In those circumstances we would have to have another look at the timetable although I understand that the chances are very high that the Bill will be certified.

I am copying this letter to Geoffrey Howe and the other recipients of his minute to you of 9 November.

Yours sincerely

Michael Pownall

DENHAM

Approved by Lord Denham and signed in his absence

The Rt Hon John Biffen MP
Lord President of the Council

Econ Pol

Budget

12 NOV 1982

CONFIDENTIAL

Econ Pol

NBPM

MCS 12/11

DEPARTMENT OF HEALTH & SOCIAL SECURITY
Alexander Fleming House, Elephant & Castle, London SE1 6BY
Telephone 01-407 5522
From the Secretary of State for Social Services

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

November 10 1982

Dear Geoffrey.

NATIONAL INSURANCE SURCHARGE BILL

You asked for agreement by tonight to your draft Bill circulated under cover of your minute of 9 November to The Lord President.

I am generally content with the Bill. I understand that my officials are in touch with yours on the details of the Bill. Subject to any minor drafting amendments that may be agreed between them, you have my agreement.

I am copying this to recipients of your minute.

Yours ever,

Norman.

NORMAN FOWLER

Econ Pol
Budget
Pt 9

Privy Council Office,
Whitehall,
London, SW1A 2AT

NBPM

With the Compliments MCS 10/11

of the

Lord President of the Council

Econ Pol

PRIVY COUNCIL OFFICE
WHITEHALL, LONDON SW1A 2AT

10 November 1982

Dear Geoffrey

Thank you for your minute of 9 November seeking the agreement of Legislation Committee to the introduction of the National Insurance Surcharge Bill on Friday. In the absence of any objection from colleagues by 6.00 pm tonight, you may take it that you have the Committee's agreement to making arrangements with Michael Jopling accordingly. Given that this is a money Bill, I foresee no major difficulty about the timetable which you outline in paragraph 6 of your minute, and we shall, of course, do our best to keep to it.

I am copying this letter to the recipients of your minute.

Yours

John Biffen

JOHN BIFFEN

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

Econ Pol: Budget Pt 9

Econ Pol

(2)

Prime Minister

To note X and Y

MCS 9/11

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

LORD PRESIDENT OF THE COUNCIL

NATIONAL INSURANCE SURCHARGE BILL

In my minute of 5 November to the Prime Minister and Cabinet colleagues I referred to the need for urgent legislation to give effect to the proposals, announced yesterday, to reduce the National Insurance Surcharge this year and next. I now attach the draft of the Bill: the explanatory and financial memorandum is being drafted.

The Bill

2. The proposals - which were spelt out in more detail in my minute of 5 November - are as follows:-

(i) The Bill provides for the Surcharge to be reduced by one percentage point to 1½ per cent from next April. Private sector employers will benefit by about £700 million in 1983-84. Public sector employers will pay the 1½ per cent rate but the saving to them will be offset by changes in cash limits, external financing limits and the RSG.

(ii) The Bill also provides for a further reduction in 1982-83 broadly equivalent to ½ per cent off the NIS for private sector employers, and worth about £350 million to them. The public sector will be treated precisely as when the rate was reduced earlier this year - local authorities and certain other bodies will continue to pay at the old rate through 1982-83; other public sector bodies will be entitled to the reduction but there will be offsetting changes in their cash limits and EFLs.

3. There must be some risk of amendments proposing larger reductions. But I am advised that it is not possible to restrict the scope of the Bill so as to prevent them. A proposed reduction in a tax does not need any kind of financial resolution so there will be no resolution by reference to which amendments could be ruled out of order; as this Bill will deal with the rate of the tax, anything to do with the rate must be within its scope.

4. Parliamentary Counsel has confirmed that it will be a money Bill. There are no European Community implications.

Timing

5. To give effect to the 1982-83 reduction, the Inland Revenue need to send to the printers by 17 December their leaflet of guidance and instructions to employers. This leaflet will be issued on 26 January to around 1 million employers who will make their first deductions from payments any time from 6 February. DHSS will issue their detailed NIS/NIS tables for 1983-84 at the beginning of February.

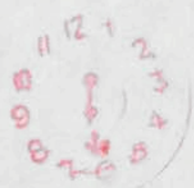
6. This timetable points to completing Report Stage by the Christmas Recess and securing Royal Assent before 26 January. With this timetable in mind I understand that you wish to have Second Reading in the week beginning 22 November. and to introduce the Bill this Friday, 12 November. This in turn means that we need agreement to it by tomorrow night, to allow for printing on Thursday.

7. Hence this minute, which I am copying to all members of the Legislation Committee. I am sorry that the timing appears to preclude discussion in Committee; and I should be grateful for your confirmation of the timetable, and agreement to the terms of the Bill, by tomorrow night.

8. Copies of this minute and draft Bill also go to the Prime Minister, other members of Cabinet, Parliamentary Counsel and Sir Robert Armstrong.

G.H.

9 November 1982



RESTRICTED

DRAFT

OF A

BILL

TO

Reduce the surcharge imposed by the National Insurance Surcharge Act 1976.

A.D. 1982

BE IT ENACTED by the Queen's most Excellent Majesty, by and with the advice and consent of the Lords Spiritual and Temporal, and Commons, in this present Parliament assembled, and by the authority of the same, as follows:—

Reduction of national insurance surcharge. 1976 c. 85.

1.—(1) In section 1(1) of the National Insurance Surcharge Act 1976 (surcharge on earnings in respect of which secondary Class 1 contributions are payable) for the words "$2\frac{1}{2}$ per cent." there are substituted the words "$1\frac{1}{2}$ per cent.".

(2) Subsection (1) above has effect in respect of earnings paid on or after 6th April 1983.

1982 c. 39.

(3) Every person (other than a body mentioned in section 143(4) of the Finance Act 1982) who pays, or is liable to pay, in respect of earnings paid within the period beginning with 4th January 1983 and ending with 5th April 1983, the surcharge imposed by the Act of 1976, shall be entitled to a reduction in the amount of his liability in respect of the surcharge for the tax year 1982–83 calculated in accordance with the following provisions of this section.

(4) The reduction to which a person is entitled under subsection (3) above shall be an amount equal to 3 per cent. of the aggregate amount of—

(a) the primary and secondary Class 1 contributions paid by him, or which he is liable to pay, as a secondary Class 1 contributor in respect of any earnings paid in the tax year 1982–83; and

(b) the surcharge paid by him, or which he is liable to pay, under the Act of 1976 (disregarding subsection (3) above) in respect of any such earnings.

(5) The Schedule to this Act has effect for the purpose of supplementing subsections (3) and (4) above; and any amount to which a person is entitled by virtue of subsection (3) above shall be recoverable in accordance with the provisions of that Schedule.

Short title etc.

2.—(1) This Act may be cited as the National Insurance Surcharge Act 1982.

(2) This Act extends to Northern Ireland.

SCHEDULE

Supplementary Provisions

Methods of recovery

1. Any amount to which a person (the "employer") is entitled by virtue of section 1(3) of this Act shall be recoverable—

(a) by deduction in three stages in accordance with paragraph 2 below; or

(b) from the Commissioners of Inland Revenue in accordance with paragraph 3 below.

2.—(1) The amount recoverable by deduction at the first stage shall be equal to 3 per cent. of such part of the aggregate amount mentioned in section 1(4) of this Act as is attributable to earnings paid before 6th February 1983.

(2) The amount recoverable by deduction at the second stage shall be equal to 3 per cent. of such part of the aggregate amount mentioned in section 1(4) as is attributable to earnings paid before 6th March 1983 but shall be reduced by any amount recovered at the first stage either by deduction or under paragraph 3 below.

(3) The amount recoverable by deduction at the third stage shall be so much of the amount to which the employer is entitled by virtue of section 1(3) of this Act as remains unrecovered.

(4) The amount recoverable by deduction at any stage shall be deducted by the employer from the contribution payments which he is liable to make in the appropriate period.

(5) In sub-paragraph (4) above—

"contribution payments" means payments by way of primary and secondary Class 1 contributions for which the employer is liable as a secondary Class 1 contributor and any surcharge payable with those secondary Class 1 contributions; and

"appropriate period" means the period of 14 days beginning—

(a) in relation to the first stage, with 6th February 1983;

(b) in relation to the second stage, with 6th March 1983; and

(c) in relation to the third stage, with 6th April 1983.

3. Where, at any of the three stages, the employer fails to recover the whole, or any part, of the amount which he is entitled to recover at that stage by deduction under paragraph 2 above he may recover from the Commissioners so much of that amount as remains unrecovered.

Treatment of primary Class 1 contributions for which secondary contributor is not liable

4. For the purposes of subsection (4) of section 1 of this Act, any primary Class 1 contributions for which a secondary contributor is not liable in the first instance but which are payable in respect of earnings paid by him in the tax year 1982–83 shall be treated as contributions falling within paragraph (a) of that subsection.

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Record of deductions made under paragraph 2(4)

5.—(1) Every person who purports to be entitled to any amount by virtue of section 1(3) of this Act shall show, in the statement and declaration which accompanies his contributions return, the aggregate of the amounts (if any) deducted by him in accordance with paragraph 2(4) above.

(2) In this paragraph " contributions return " means the return required by regulation 30 of the Income Tax (Employments) Regulations 1973 as applied to earnings-related contributions under the Social Security Act 1975 by Schedule 1 to the Social Security (Contributions) Regulations 1979.

S.I. 1979/591.

Effect on liability for Class 1 *contributions*

6. Nothing in this Act shall affect the liability incurred by any person in relation to secondary or primary Class 1 contributions in respect of the tax year 1982–83; but the amount of any deduction made under paragraph 2(4) above shall be treated as having been duly paid by that person towards the discharge of that liability so far as it exceeds the amount of the surcharge comprised in the contribution payments from which that deduction is made.

Interpretation

7.—(1) In this Act " tax year " has the same meaning as in the Social Security Act 1975.

1975 c. 14.

(2) For the purposes of this Act the period within which any earnings are to be treated as paid shall be the period within which they are so treated for the purpose of determining the liability (if any) of any person to pay primary or secondary Class 1 contributions in respect of those earnings.

RESTRICTED

National Insurance Surcharge

DRAFT

OF A

BILL

To reduce the surcharge imposed by the National Insurance Surcharge Act 1976.

I—D (2)

9th November, 1982

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The Rt Hon Nicholas Edwards MP

WELSH OFFICE
GWYDYR HOUSE
WHITEHALL LONDON SW1A 2ER
Tel. 01-233 3000 (Switchboard)
01-233 6106 (Direct Line)
From The Secretary of State for Wales

9th November 1982

Dear Geoffrey

Arthur Cockfield sent me a copy of his letter to you of 29 October about relief for the tourism industry.

I fully support what Arthur says. The tourism industry, as the CBI have recently emphasised, is an important contributor to employment - with scope for expansion - and would I believe respond to a new incentive. Certainly a concession on building allowances would remove a source of grievance and by channelling help direct to new investors in the industry would strengthen our position in our efforts to get the industry to do more to help itself and not to rely over much on the Tourist Boards.

/ I am sending copies of this letter to the Prime Minister, the Secretaries of State for Industry, the Environment, Trade, Scotland, Education, Employment, to the Minister of Agriculture, Fisheries and Food and to Sir Robert Armstrong.

Yours

Nick

Rt Hon Sir Geoffrey Howe QC MP
Chancellor of the Exchequer
HM Treasury
LONDON SW1P 3AG

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The Economy

3.30 pm

The Chancellor of the Exchequer (Sir Geoffrey Howe): With permission, Mr. Speaker, I should like to make a statement.

As the House knows, it is customary at this time of year to publish outline public expenditure plans and proposed national insurance changes for the year ahead, together with the economic forecast required under the Industry Act 1975. This year, as foreshadowed in the Government's reply to the report of the Treasury and Civil Service Select Committee on budgetary reform, we are bringing these together and publishing them in an autumn statement which I shall today be laying before the House. I am grateful to my right hon. Friend the Member for Taunton (Mr. du Cann) and the Select Committee for the initiative which has led to that development.

During the past year, monetary conditions have exerted downward pressure on price rises and substantial progress has been made against inflation. In January the rate of inflation was 12 per cent.; it is now around 7 per cent.; and we envisage a 5 per cent. rate early in 1983. Interest rates have fallen even more sharply, with bank base rates down a full seven points from their peak of 16 per cent. last year to 9 per cent. today. The CBI has calculated that each percentage point fall benefits British industry by around £250 million in a full year. We shall continue to maintain downward pressure on the monetary aggregates to achieve further success in the battle against inflation. Interest rates will continue to reflect the indicators of monetary conditions which I described in my Budget speech.

As the statement explains, the growth in output this year—in this country and throughout the Western world—has been lower than anticipated. For next year the Industry Act forecast now suggests a 1½ per cent. increase in our GDP. That is close to what is expected for most other industrialised countries. Unemployment remains the nations's most distressing problem. As in other countries, further rises are expected to continue into next year, although they should moderate as output picks up in response to lower inflation and lower interest rates.

Public borrowing remains under firm control, which of course is one reason for the fall in interest rates. We expect the PSBR this year to be within the figure of £9½ billion expected at the time of the Budget. Final decisions about the level of next year's borrowing requirement will not of course be taken until my 1983 Budget. The current forecast suggests that the scope for possible tax reductions in 1983-84 could be of the same order as was indicated at the time of the last Budget. That is on the basis of conventional assumptions as to the revalorisation of direct taxes and excise duties. It also assumes the same 1983-84 PSBR, as a percentage of GDP, as was assumed at the time of the last Budget, and takes account of the decisions which I am announcing today.

The public expenditure planning total for 1983-84 will be £120·06 billion. That is lower than the provisional figure for 1983-84 published on Budget day this year. It is the first time since 1977 that a Government have been able to stop expenditure plans for a particular year rising with each annual review. Compared with the plans for the current year, the new total is a slight fall in cost terms—that is, in constant prices. The ratio of public expenditure to GDP will come down from 45 per cent. to 44 per cent.

Details of the changes in individual programmes are summarised in the statement. Social security programmes have been adjusted to take account of the rapid reduction in inflation. This month's benefit uprating is 11 per cent. Even allowing for the 2 per cent extra to compensate for last year's shortfall, that is well over the current rate of inflation. We accordingly intend to make an adjustment to next year's uprating. Meanwhilé, those in receipt of benefits will continue to receive payment at a rate above that needed to compensate for price rises in the last year. As is customary, the exact size of next year's uprating will not be decided before Budget time.

The House will be glad to hear that the resources that we had planned to make available for a number of important programmes have been increased. We plan additional gross expenditure of £260 million on two new special employment measures—the community programme and the job splitting subsidy—which were announced earlier this year. For housing, the provision of an extra £49 million and a continuing high level of receipts from council house sales will allow gross capital spending to be at least 10 per cent. higher than the expected level this year.

More money will be made available for the urban capital programmes to support the new urban development grant programme and the urban development corporations in London docklands and Merseyside. These two changes represent a significant new boost to the construction industry.

In addition, £96 million more has been allocated to law and order programmes, mainly on police and prisons. In the Health Service we are providing an extra £80 million in England, which should continue the growth in the level of services that has already taken place under this Government. Comparable increases will be made for the rest of the United Kingdom.

Finally, provision for defence in 1983-84 has been increased by £622 million because of extra costs following the Falkland Islands action. That increase is over and above our commitment to meet the NATO 3 per cent. per annum real growth target. It will fund purchases of equipment to replace losses this year and will ensure the future security of the Falkland Islands.

To find room for these increases within an unchanged total, we have been able to secure economies elsewhere. We have also transferred to programmes part of the provisional contingency reserve set aside in the 1982 White Paper, but we have left a substantial contingency reserve of £1·5 billion, which we shall review again nearer the Budget.

Full details of public spending plans for next year and for 1984-85 and 1985-86 will be set out in the public expenditure White Paper which we expect to publish early in the new year.

My right hon. Friend the Secretary of State for Social Services is this afternoon announcing details of changes in national insurance contribution rates and limits for next year, and will be publishing the report of the Government Actuary on the national insurance fund. If we were fully to balance the fund for next year, increases in employers' and employees' contributions of nearly 0·4 per cent. each would be required. But we are anxious both to minimise additional burdens on industry and to diminish the effects

[Sir Geoffrey Howe]

of contribution increases for employees, so we have decided that the increases should be limited to 0·25 per cent. each for employers and employees. The upper earnings limit will go up only to £235, rather than £245 which would be the maximum permitted by statute.

Taken together, these measures mean that contributors will pay a little over £200 million less next year than would have been required fully to balance the fund. The cost to the PSBR has been taken into account in the forecast.

I turn now to the national insurance surcharge which was introduced and then increased to 3½ per cent., by the previous Government. It has long been criticised, and rightly so, by commerce and industry. As I said in my last Budget statement, it raises production costs, it is not rebatable on exports, and it either puts up prices or cuts into profits.

I was able in March to announce an effective reduction of 1 per cent. in the rate for private sector employers, from 3½ per cent. to 2½ per cent., for the year 1982-83. I am pleased to inform the House that we can now take another substantial step in the right direction, by reducing the rate for 1983-84 by a further 1 per cent., so bringing it down to 1½ per cent. The cost of this to the PSBR has been reflected in the forecast.

The public sector will not gain from the change, but the benefit to private employers in 1983-84 will be around £700 million. Overall, this will more than offset the increase in their costs due to the new NIC rates and levels. A table showing the overall effect for employers and employees of the NIC and NIS changes for next year has been put in the Vote Office today.

That is not all. I intend that for private sector employers ½ per cent. of the NIS reduction from April 1983 should be brought forward and made effective for 1982-83 also—that is to say, for the current year. Hon. Members will know that to change the NIS rate at this time of year presents considerable administrative problems, but we have found a way of overcoming them. The equivalent of a ½ per cent. reduction for the whole year will be given by reductions in employers' payments of national insurance surcharge and national insurance contributions for January, February and March next year. Details and guidance will be sent in due course to employers.

That further benefit will be worth £350 million in the current year. Legislation will be needed for the new arrangements both this year and next. A Bill will be introduced at an early date. I am sure that it will commend itself warmly to the House as providing a substantial reduction in the costs faced by private sector commerce and industry.

The House will want to study the autumn statement carefully. The format is new and, I hope, helpful and the scope rather wider than before. It demonstrates that we are determined, within the framework of our monetary and fiscal policies, to continue to do what we can to relieve the burden of taxation so as to move towards renewed growth and more employment. I hope to be able to say rather more if I am fortunate enough to catch your eye, Mr. Speaker, later in the course of our current debate.

Mr. Peter Shore (Stepney and Poplar): The Chancellor has made a long statement. It is as full of information and documentation as it is remarkably empty of any promise or hope for the British people or for the rescue of our savagely damaged economy after 3½ years of the Chancellor's regime at the Treasury.

It is a depressing statement. It marks the fact that we have often brought to the attention of the House—the failure of the strategy and judgment of this year's Budget. It also marks the failure of the past 3½ years of Government economic policy. The Government's Budget was based on the premise that there would be an upturn and a bottoming out of the economy. The Opposition said that that would not happen. The Chancellor has now had to confess that the rate of growth in Britain in the past year has been 0·5 per cent. We all know that we are in the middle of a massive recession. The Chancellor has done virtually nothing, apart from a couple of cosmetic touches to the national insurance surcharge, to face that challenge.

I have several questions to ask the Chancellor. The first relates to what he said about the adjustment to next year's uprating of old-age pensions. Is he aware that the cost of not adjusting that uprating will be only £250 million during the present fiscal year? Is he further aware that the cost for a full year would be only £500 million? Is he aware that the cost of living affecting retirement pensioners and most people on low incomes is much higher than the proposed increase because their pattern of expenditure is different from that of the rest of the country?

It is monstrous for the Chancellor to claw back from people, the great majority of whom are having a more difficult time than they can recall, this year's so-called overpayment. Can he justify making yet another major statement and failing to make good the 5 per cent. that was taken away from the unemployed? The Chancellor said that he is worried about the number of unemployed. It is a scandal that so many people should be made unemployed, but, having made them unemployed, he takes away a substantial part of their benefit. What type of generosity is that?

I shall now deal with the changes in the national insurance surcharge. I had hoped that, at the very least, the Chancellor, if he cannot bring himself to do anything else to assist British industry, would have removed the national insurance surcharge in next year's Budget. He said that, apart from a relatively small, once-and-for-all three months' cash injection in the first quarter of next year, the net result would be that, minus the increased employers' national insurance payments, the cash flow of firms throughout Britain will be no more than £175 million higher than it is now. I should be grateful if he would confirm that. I believe it to be the case.

I turn now to a rather surprising omission from the Chancellor's long statement. He said nothing about the rate support grant for the coming year. Last year we were told what the percentage rate support grant would be. We were also told of the anticipated increase in council house rents. What are the present estimates for both those important items? They are important because unless something is done about rate support grant ordinary people and industry will face more increases in rates next year.

I shall conclude with three questions. The first relates to unemployment. The Chancellor has already made it plain in the document that accompanies his statement that the unemployment assumption is to increase from the 2·9 million of this year to no less than 3·2 million next year. As the Chancellor believes that he has reduced inflation to single figures, can he tell us when the economy will take on the predicted orderly, natural and spontaneous growth upon which the whole of the Government's policies are predicated?

Secondly, will the Chancellor confirm that personal living standards are now running at 3½ per cent. below what they were when he took office in 1979? What is his assumption or forecast for living standards for next year?

Thirdly, having examined the industrial forecasts that accompany the Chancellor's statement and having noted that the balance of trade is expected to deteriorate—although it is not quantified—I should like to know whether Britain, for the first time in recorded history, is importing more manufactured goods than it is exporting to the rest of the world?

This statement comes after three and a half years of Conservative Government, and covers the prospects for the last year of a five-year Parliament. It builds upon a record of failure, offers no prospect to the country, and shows that the Government have not even begun to understand what is needed to tackle the problem that they face.

Sir Geoffrey Howe: The right hon. Gentleman began with a caricature of the economic improvements that have taken place in recent years. Am I to take it that he brushes to one side the prospect of inflation down to 5 per cent.—a formidable and important achievement? Am I to take it that he brushes aside a fall in interest rates of 7 per cent., which would not have been achieved without firm control of public spending and borrowing for which we received little support from him?

The right hon. Gentleman drew attention to the unemployment assumptions that are set out in the autumn statement and the Government Actuary's report. They show an average increase next year of 300,000—from 2·9 million to 3·2 million. As I said in my statement, that rate of increase is likely to decrease as the year goes on.

The right hon. Gentleman asked about council house rents. The autumn statement shows that the Secretary of State for the Environment will be consulting the local authority associations on a rent increase of 85p per dwelling per week. If that figure is confirmed, it will mean no increase in real terms in 1983-84, and it will enable us to provide for a real increase in housing capital investment that year. I hope that the House will welcome that.

The right hon. Gentleman also asked about the rate support grant. The announcement of the provisional figure has already been made by my right hon. Friend the Secretary of State for the Environment. Consultation is taking place on that, and I have nothing further to add.

As to the adjustment in pensions, the pension increase provided for in this year's Budget not merely provided fully to make up for the 2 per cent. shortfall in the preceding year but also, as it turns out, for more generous provision for price increases than those that have taken place this year. If we are to maintain real value in that sense, it is bound to mean adjustments from year to year, just as we have experienced in successive years. There is nothing extraordinary about that, and I assure the right hon. Gentleman that the pledges are being maintained.

With regard to living standards, the right hon. Gentleman should by now understand that one of the causes of our economic difficulties was the substantial increase in real personal disposable income that took place between 1977 and 1980 as a result of the wage explosion that concluded the disasterous period of office of the Labour Government. To some extent, that increase has been reversed, but there is still further need, as the right hon. Gentleman pointed out, for improvements in our competitiveness if we are to expand our rate of growth and increase our share of the domestic market. In fact, in the current year, real demand in the economy has increased by 3 per cent. We shall get a larger share of that for British manufacturers and exporters by continuing to improve our costs. I hope that I shall have the unqualified support of the right hon. Gentleman for the need for continued moderation in pay settlements if that is to be achieved.

The last feature is the need to reduce the overall cost burden falling on employers. By wringing his hands in horror at the reduction in the rate of national insurance surcharge, the right hon. Gentleman astonished and amazed the House. As a result of the changes in national insurance contribution and national insurance surcharge, the total reduction in the cash burden on employers in the next year will be £686 million, about £450 million of which will be a reduction wholly to the benefit of the private sector.

I hope that the House will be struck by the contrast between this Government's record, who, by taking national insurance contribution and national insurance surcharge together, have effected a reduction in the combined burden of 1½ per cent., and the record of the Labour Government, who, in spite of the right hon. Gentleman's hypocrisy today, increased the joint burden of those taxes by 5 per cent.

Mr. Shore: The Chancellor replied in his own way to my question about what had happened to living standards and confirmed that they had fallen. I asked about the prospect for the coming year based on his own estimate. I should like an answer to that question.

The question of competitiveness relates very much to the national insurance surcharge. The case for getting rid of the national insurance surcharge is to increase the competitiveness of British industry. Will the right hon. and learned Gentleman confirm that the loss to Britain's international competitiveness since he took office is still 36 per cent., and what improvement will there be as a result of today's statement?

Sir Geoffrey Howe: The right hon. Gentleman is right to point out that there is still a significant loss of competitiveness now compared with some years ago. He must understand that a large component of that loss was due to the wage explosion that took place under the Labour Government.

As I have already said, real personal disposable incomes for people in work continued to rise almost regardless of economic trends for a number of years, perhaps until a year ago. If we are to secure a further sustainable advance in personal living standards and, at the same time, to achieve a reduction in the number of people out of work—which is surely what all hon. Members would like—it is of crucial importance to continue improving our competitiveness by achieving further moderation in the rate of pay settlements. I should like the right hon. Gentleman specifically to endorse that. I am grateful to him for his welcome for the reductions that we have been able to make in the national insurance surcharge burden that the Labour Government left on British industry.

Several Hon. Members *rose*——

Mr. Speaker: Order. As the content of this statement can and will be discussed today, tomorrow and the day after, I shall allow 20 minutes for questions, which will be very generous. We shall then move on to the next business.

Mr. Roy Jenkins (Glasgow, Hillhead): Does the Chancellor reject the London Business School's forecast that inflation, after falling in the second quarter, will thereafter begin to rise again? What is his own forecast for the fourth quarter of 1983? Would it not have been far more helpful to British industry to have abolished the national insurance surcharge now—a jobs tax clearly perverse in present circumstances—rather than to wait and hope to give personal income tax concessions in the Budget which, because of their unprecedentedly high import content, will have nothing like a similar benefit to the activity in the economy?

Sir Geoffrey Howe: I do not accept the London Business School's expectations for inflation at the end of next year. The right hon. Gentleman will find that my statement says that at the end of 1983 the inflation rate may still be around 5 per cent. I am sure that he will endorse the proposition that if we are to continue to achieve further progress in reducing the rate of inflation at the same time as enhancing employment prospects, it is important to take the main remedy to reduce costs to British industry, which is to achieve further moderation in pay settlements.

I accept that the national insurance surcharge represents an addition to those costs. It is for that reason that I have reduced it by a full percentage point in the current year and intend to do so in the next year. I intend to do that in a way that maintains effective control over the size of public sector borrowing, which is a crucial component in the reduction in interest rates, which in turn is an even more significant element in industrial costs.

Mr. Maurice Macmillan (Farnham): Could my right hon. and learned Friend tell the House how the total employers' share of the contributions to national insurance compares with the share paid by our competitor employers overseas?

Sir Geoffrey Howe: There are wide variations. Taking a very general average figure, it is my impression that employers overseas pay a rather larger sum in contributions of this kind than is paid in Britain in order to sustain social security programmes.

Mr. Jack Ashley (Stoke-on-Trent, South): As the Chancellor of the Exchequer's derisory statement makes it clear that he cannot or will not tackle the scandal of mass unemployment, will he at least provide funds for the payment of long-term supplementary benefit for people who are unemployed in the long term? Would not that be at least a crumb of comfort until we have a Government who are less sanguine about mass unemployment and who are prepared to do something about it?

Sir Geoffrey Howe: I understand the right hon. Gentleman's anxiety about unemployment, and I know that it is genuine and strongly felt. We have to make our choice as to the ways in which we contribute to reducing the burden imposed by unemployment. It is for that reason that I have announced today that £260 million will be devoted to the two employment programmes that I have identified.

Mr. Terence Higgins (Worthing): Will my right hon. and learned Friend note that on the Conservative Benches we do not take for granted the substantial reduction in the rate of inflation and in interest rates? The reduction in the rate of inflation will be very much welcomed, not least by pensioners. I suggest to him that it is essential now to give priority to cutting industrial costs. In that context, will he stress to the Labour Party and the TUC that excessive wage claims, particularly in the public sector—for example, in the water, gas and electricity industries—will further endanger the level of employment if they are persisted with? Therefore, we must take the strongest possible stand against claims for pay increases which are far above the level of inflation.

Sir Geoffrey Howe: I am grateful to my right hon. Friend for his support and welcome for what I have said, and underline the importance of his point. It is crucial to continue to secure a reduction in public sector costs as part of the process of reducing inflation, and a key contribution can be made to that if we achieve moderation in pay settlements within the public sector, in particular in the industries to which my right hon. Friend has referred.

I hope that the Labour Party will find it in its heart to underline and endorse the importance of that message. All too often it is given to complaining about high increases in prices in the public sector utilities, but it is important, if it makes that case, to join us also in arguing the case for a reduction in pay settlements.

Mr. Richard Wainwright (Colne Valley): Does the Chancellor of the Exchequer recall that as an integral part of his Budget statement in March he included a long passage about energy and fuel prices, including the announcement of a gas price freeze, which expires next month? Has he anything to tell the House today on that theme?

Secondly, when the Chancellor referred to modest increases in the housing programme and the community programme, he was wholly specific about the figures, but when he came to the other side of the account he merely said that he was securing economies elsewhere. Will he be equally specific in describing those economies?

Sir Geoffrey Howe: The hon. Gentleman will see the answer to his last point if he studies, as I know he will, the autumn statement produced in response to his representations, among others, as a member of the Select Committee on the Treasury and Civil Service.

With regard to energy prices, the British Gas Corporation has today confirmed that the freeze on the contract price of gas sold to industry will continue until October 1983. That is a matter for the corporation to decide, but it is a decision that it has been able to reach within the agreed external financing limits.

Dr. Jeremy Bray (Motherwell and Wishaw): In view of the omission from the statement of any reference to the exchange rate, is it a coincidence that the rate of reduction of interest rates has been such that the effective exchange rate has not changed? Is not the Chancellor of the Exchequer keeping British industry uncompetitive in order to protect the Government's claim that they have reduced inflation?

Sir Geoffrey Howe: The hon. Gentleman understands that the factors that influence the exchange rate are many and diverse. The assumption made in the autumn statement—it was, of course, presented as an assumption—was that there will be no significant variation in the exchange rate. The hon. Gentleman will appreciate that interest rates in Britain during the past 12 months have fallen by about 7 per cent. compared with an average fall of only 4 per cent. in other countries. He will also have noted the conclusion of the debate conducted by the CBI on the exchange rate in Eastbourne last week.

Sir William Clark (Croydon, South): Is my right hon. and learned Friend aware that all thinking people will not only congratulate the Government on their economic strategy in reducing inflation, interest rates and the national insurance surcharge, but will welcome it? Could he assure the House that he will keep a close watch on public expenditure? Although we welcome the fact that the proportion of GDP has gone down from 45 to 44 per cent., if the Government were to adopt the official Opposition's policy and to increase public expenditure that would put the whole of the economy into jeopardy.

Having given this assistance to industry, will my right hon. and learned Friend, between now and the next Budget, give urgent consideration to reducing the standard rate of income tax?

Sir Geoffrey Howe: I understand my hon. Friend's concern with personal taxation as well as with the tax burden on the industrial and commercial sector, and obviously have that in mind now, as at all times.

I am grateful to my hon. Friend for his support concerning the importance of controlling public expenditure. It is well worth emphasising that all the countries which find themselves facing increasing difficulties, as their public sector borrowing becomes increasingly difficult to control, and as their interest rates and inflation rates likewise become increasingly difficult to control, are those which have not committed themselves to the reduction of the public sector deficit in the way that we have done. It is important for us to maintain and sustain that achievement as a crucial part of the foundation for the restoration of sustainable growth.

I take this opportunity to pay tribute to my right hon. and learned Friend the Chief Secretary for his remarkable achievement on public expenditure, in co-operation and consultation with the rest of our colleagues.

Mr. Harry Ewing (Stirling, Falkirk and Grangemouth): The documents concerning the autumn statement published today contain a passage about old-age pensions. The Chancellor of the Exchequer states there that he is working on the basis of a 5 per cent. inflation rate for next year, less the 2 per cent. overpayment that he claims will be made to pensioners in the next few days. That leads one to the conclusion that the uprating of pensions for 1983-84 will be about 2½p to 3p in the pound. If that is the case, on what basis has the Cabinet taken a decision to make the old-age pensioners pay for the Prime Minister's bungling incompetence in leading us into the Falklands crisis?

Sir Geoffrey Howe: None of the hon. Gentleman's statements is correct. We do not yet know the final result concerning the rate of inflation. The inflation figure for November this year, which is one of the components, is not yet known. By definition, the inflation forecast for next year is not yet known. Those are two components essential to any decision that has to be taken in this respect, which will not be announced until Budget time. Therefore, it is wrong to suggest that the pensioners or any other group are bearing the cost of the necessary expenditure in achieving our national objectives, with the support of the nation, in the south Atlantic.

Mr. Anthony Nelson (Chichester): Does my right hon. and learned Friend agree that, while many of us hope there will be some scope for real improvement in pensions next year, the implications for public expenditure and the burden of taxation would be altogether unacceptable if pensions, benefits and allowances of all kinds were to be uprated only on the basis of forecasts and were unable subsequently to be readjusted when those forecasts proved too modest?

Sir Geoffrey Howe: I entirely agree with my hon. Friend. He underlines the point that I made in my statement.

Mr. A. W. Stallard (St. Pancras, North): Is the Chancellor aware that his statement on the clawback of benefits from pensioners and those on supplementary benefit will be greeted with anger and resentment by millions of people throughout the country? He says that he has been able to make arrangements to adjust the handout on the national insurance surcharge between now and December and January, but pensioners have been asking for many years that their pensions should be uprated nearer the date when the increase is announced so that they do not have to wait nine months for the extra money. Is the Chancellor aware that pensioners will not understand why there can be an adjustment for the national insurance surcharge but not for pensions? The Government have made considerable savings at the expense of pensioners and others in the past three and a half years, and the pensioners' index has been running four or five points ahead of the retail price index for some months. Will the Chancellor reconsider his decision to claw back pensions and to make pensioners pay for other handouts?

Sir Geoffrey Howe: The hon. Gentleman and the whole House must remember the point made by my hon. Friend the Member for Chichester (Mr. Nelson). Benefits to pensioners and others from the national insurance fund have to be paid for out of the fund. That principle was understandably endorsed by the Public Accounts Committee not long ago. Its effectiveness has been manifested by the need, that I have recognised today, for a 0·25 per cent. increase in employees' contributions. That represents a practical limit to the generosity of each member of the working population. Pensioners and other beneficiaries will receive an increase of 11 per cent. this month and will be better off in real terms for the whole of this year. The maintenance of the real value of benefits is bound to mean adjustments from year to year. When we came into office in May 1979 we adjusted the pension upwards by 1·9 per cent. to take account of the shortfall under the Labour Administration.

Mr. Nigel Forman (Carshalton): While welcoming the fact that my right hon. and learned Friend has felt able further to reduce the costs to British industry by about £600 million in a full year, may I ask him to bear in mind the increasingly strong case for further cuts in direct taxation, especially for the lower paid? I am convinced that that would not necessarily lead to a significant increase in the propensity to import.

Sir Geoffrey Howe: My hon. Friend makes the same point as was made by my hon. Friend the Member for Croydon, South (Sir W. Clark). It needs to be taken into account in our consideration of these matters.

Mr. George Foulkes (South Ayrshire): Is not the Chancellor aware that we heard him clearly say that he was adding to the defence budget a sum equivalent to the amount that he is taking away from old-age pensioners? Will he answer the question of my hon. Friend the Member for Stirling, Falkirk and Grangemouth (Mr. Ewing) and tell the House why he has picked on the pensioners to pay for the Falklands war?

Sir Geoffrey Howe: The hon. Gentleman may try as he likes to make a false connection and a false point, but they remain entirely false. The necessity to pay for the Falkland Islands expenditure was recognised by the House from the start to the finish of the campaign. The increase in expenditure in that area will, incidentally, lead to a significant increase in orders for the defence equipment industry, in Scotland as elsewhere. Aside from that, when I have discussed the position of pensioners, I have made it clear that the pattern of changes that we have made is maintaining the pledges that we have so far made to the House.

Mr. Jim Lester (Beeston): I congratulate my right hon. and learned Friend on his timely response with measures that will be helpful to the construction industry and to British manufacturing industry, about which there is considerable anxiety on both sides of the House. Like Oliver Twist, one is always tempted to ask for more and I should welcome an assurance from my right hon. and learned Friend at least on the principle of the restoration of the 5 per cent. abatement of unemployment benefit, if not on the practice.

Sir Geoffrey Howe: That is a matter on which I have nothing to add to what has already been said.

Mr. Barry Jones (Flint, East): Does not the Chancellor's statement signal a continuation of his and the Government's war on the unemployed? Why is he so reluctant to take urgent action on behalf of the communities that are suffering from mass unemployment?

Sir Geoffrey Howe: The Government are not engaged in a war on the unemployed. Like every other Government in the Western industrial world, we are engaged in the difficult and prolonged battle against rising unemployment. As my right hon. Friend the Prime Minister pointed out last week, unemployment has been rising significantly faster in other countries than in this country over the past year or so. The House must recognise, as I am sure that the majority of hon. Members do, that the most effective way of combating unemployment is to continue the success against inflation and high interest rates and, above all, to continue to improve our competitiveness, for which further moderation in pay settlements is crucial, and in that I still invite the support of the Opposition.

Mr. Chris Patten (Bath): May I follow up the question of my hon. Friend the Member for Beeston (Mr. Lester)? Do the public expenditure plans for the coming year include provision for restoring the 5 per cent. cut in unemployment benefit?

Sir Geoffrey Howe: That is a matter which, as I have said already, remains for consideration.

Mr. Michael Meacher (Oldham, West): Will the Chancellor confirm that, even after his package, unemployment will rise to more than 3½ million next year? If he believes that large personal tax cuts will be a significant source of extra demand for domestic industry, and not just an election bribe, how will he prevent more than two-thirds of the extra demand being dissipated on imports, which is exactly what happened last year?

Sir Geoffrey Howe: If that is the hon. Gentleman's analysis, it underlines the importance of improving the competitiveness of British industry and of further moderation in pay increases. I ask yet again whether the hon. Gentleman and the Labour Party endorse and emphasise the crucial importance of moderation in pay bargaining to deal with the problems that he raises.

Mrs. Shirley Williams (Crosby): The Chancellor repeated on several occasions during his statement that unemployment was due to the world recession. Is he aware that the most recent report of the International Monetary Fund says that the British Government have brough about a more restrictive shift in policy than any other Western Government and that one of the two factors responsible for our loss of competitiveness is the Government's restrictive monetary policy? Will he confirm that the reason why he can do so little is that the competitiveness of this country has been reduced by, among other things, the Government's own policies?

Sir Geoffrey Howe: I certainly do not confirm that. The IMF has been commending to all its members the crucial importance of achieving continued success in reducing the burden imposed on the world economy by public sector deficits. We have achieved considerable success in that direction, which is why we have been able to reduce the level of inflation and interest rates as we have. That is the general message which has come loud and clear from the IMF. Other countries ought to listen to the same proposition.

Mr. Hal Miller (Bromsgrove and Redditch): Will my right hon. and learned Friend agree that, contrary to the disappointment felt by the Opposition, the real value of pensions is still being indexed, the lie has been given to the false rumour put about during the Birmingham, Northfield by-election that council house rents would increase by about £2 a week, that inflation is coming down, that interest rates are coming down and that the wide welcome for his statement on this side of the House will be reflected in manufacturing industry? The Government have recognised the important principle of the cost competitiveness of our industry.

Sir Geoffrey Howe: I am grateful to my hon. Friend, particularly for reminding me of the gap between the untruth that council house rents were likely to go up by £2 a week—I know not where that came from—and the reality of what I have told the House, which is that the increase in rents on which consultation will take place will be 85p a week, representing no real increase.

Mr. Shore: The Chancellor still has to answer the question that I put to him about competitiveness, and it is of great importance. What change, resulting from the national reduction in the national insurance surcharge, does he expect in Britain's international competitiveness and what will the figure be, bearing in mind that it was minus 36 immediately before he made his statement? We are glad to hear that he is not engaged in warfare against the unemployed, but the best demonstration that he could give of that assertion is a clear and unequivocal pledge to restore the 5 per cent. that was taken away from the unemployed two years ago. It will not do for the right hon. and learned Gentleman to say that the Government have not thought about it and that it is inappropriate to give an answer. He has just made a statement about the uprating of pensions. Why cannot he do the same for the unemployed?

Sir Geoffrey Howe: I have said nothing about the uprating of pensions. I have told the right hon. Gentleman and the House that decisions about that will be announced at the time of my Budget.

In relation to the other matter about which the right hon. Gentleman asks, I shall go over the figures again. The changes in the national insurance contribution, the national insurance surcharge rates and the earnings limits that I have announced will save all employers £686 million in 1983-84, £450 million for the private sector, taking account of the effect of the rise in earnings between the two years. For all employers, after taking account of the reduction in contracted-out rebate announced in March this year, the total payments would have been about £12·8 billion. They will now be £12·1 billion. That represents a reduction of 5½ per cent. and therefore makes a significant contribution to the competitiveness of British industry. I reiterate that nothing can make as large a contribution to competitiveness as further success in achieving pay moderation. One day I hope to get that proposition endorsed by the Opposition.

Orders of the Day

Debate on the Address

[FOURTH DAY]

Order read for resuming adjourned debate on Question [3 November],

That an humble Address be presented to Her Majesty, as follows:

Most Gracious Sovereign,

We, Your Majesty's most dutiful and loyal subjects, the Commons of the United Kingdom of Great Britain and Northern Ireland in Parliament assembled, beg leave to offer our humble thanks to Your Majesty for the Gracious Speech which Your Majesty has addressed to both Houses of Parliament—*[Sir John Eden.]*.

Question again proposed.

Welfare State

4.20 pm

The Secretary of State for Social Services (Mr. Norman Fowler): I welcome the opportunity of this debate to set out again what the Government are doing in the fields of health, personal social services and social security, and to repeat our commitment to the development of the social service system, in particular the National Health Service. That commitment we have fulfilled and will continue to fulfil.

I should like first, however, to put the debate into context. That context as been provided earlier today in the statement by my right hon. and learned Friend, the Chancellor of the Exchequer. His announcement of the Government's decisions on next year's public spending plans demonstrated the essential connection between economic policy and the development of our social services. It is simply no good the Opposition declaring, as appears to be their policy, that they would increase spending on health and social security by anything between £10 billion and £20 billion. That would have intolerable implications for taxation, inflation and for the economy as a whole.

The social services and the Welfare State cannot be ring-fenced from the rest of the economy. Steadily improving services can be sustained only by steady improvements in industrial performance and competitiveness. In other words, to abandon the fight against inflation would hit first those who are most in need, particularly those on low and fixed incomes.

That is why the Government's achievement of the lowest inflation rate for over 10 years has important social implications as well. Between 1974 and 1979 prices rose in this country by 110 per cent. This Government have now brought inflation down to around 7 per cent. and the prospect is that over the coming months inflation will drop even further. That is vital to industry and therefore to social services policy generally because it is only with industrial recovery tha we can look ahead to developing social services.

It is for the same reason—that of helping industry and thereby the wealth-creating process—that the Chancellor's announcement of the reduction in the national insurance surcharge is also so welcome. The reduction in inflation,

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

PRIME MINISTER

NATIONAL INSURANCE SURCHARGE

We have agreed that I should announce on 8 November a reduction in the NIS from next April and also my proposals for further reductions in payments by private sector employers in 1982-83. This minute summarises these changes. I have already spoken to Patrick Jenkin and Norman Fowler and they are both content .

2. In my last Budget I reduced the NIS from 3½ per cent to 2½ per cent to take effect from August 1982, and to give the full year benefit of the 1 per cent reduction, I temporarily reduced the rate to 2 per cent between August and April 1983.

1983-84

3. For 1983-84 I now propose to consolidate the ½ per cent temporary reduction and to make a further reduction of ½ per cent, so bringing the rate down to 1½ per cent from April 1983. The net cost of this 1 per cent reduction, and the benefit to private sector business and industry, will be about £700 million in the first year.

4. It is not my intention that the public sector should benefit and, as last time, I propose that the reduction of about £400 million in the NIS liabilities of public sector employers should be cancelled out. In the case of the local authorities this will be done by amending the present proposals for the 1983-84 RSG; Michael Heseltine, George Younger and Nicholas Edwards are in the picture. In the case of cash limits and the external financing limits of the nationalised industries, my officials will be in touch with departments about the necessary measures.

1982-83

5. In addition I propose to give further help to private sector employers by bringing forward into 1982-83 the April reduction of ½ per cent over and above consolidation. This will be worth about a further £350 million in total to those private sector employers paying NIS.

6. Consistent with the arrangements when the rate was reduced from 3½ per cent, and with what I propose for 1983-84, public sector employers will not benefit from this change. The arrangements for them will be as earlier this year when the rate was reduced: the legislation will provide for local authorities and certain similar bodies not to make the special deduction; for the rest, cash limits and EFLs will have to be amended and the Treasury will be in touch with departments.

7. The 1982-83 scheme will operate broadly as follows. Individual employers' NIS payments cannot be separately identified, and it is too late in the year to issue revised NIC/NIS tables. To deal with this problem, qualifying employers will be issued in January with instructions asking them to deduct from their payments due in February 3 per cent of the total payments they have made in 1982-83 of employers' NIS and NIC and employees' NIC. They will make similar deductions of 3 per cent from those payments due in March and April. By this route private sector employers should pay around £350 million less in 1982-83 and that is broadly equivalent to a ½ per cent reduction in their NIS payments. There will be no question of encroaching on NIC contributions. The scheme will ensure that NIC payments, records and procedures are left intact.

8. We might be asked why, rather than reduce costs by £350 million in the last two months of 1982-83, it is not better to wait until 1983-84 and then, under the standard arrangements, reduce NIS to 1 rather than 1½ per cent. Our answer would be that, while we might wish to reduce NIS still further, it would be premature for me to go as far now as to make a permanent reduction to 1 per cent from the Spring. Moreover, £350 million to the private sector by March 1983 is clearly more helpful to them than the same sum spread out evenly over 1983-84.

Legislation

9. A short and urgent Bill will be necessary to give efect to these changes. I am discussing the arrangements for this separately with the Business Managers.

10. I am sending copies of this minute to all members of Cabinet, to the Chief Whip, and to Sir Robert Armstrong.

GH

(G.H.)
5 November 1982

- 8 NOV 1982

- 8 NOV 1982

Covering S E C R E T

PA

Prime Minister !
Michael asked me to let you have this advanced copy of the statement
Stephen Geary
Duty Clerk
5/11/82

6

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

5 November 1982

Michael Scholar, Esq.,
No.10 Downing Street

Dear Michael,

I told you that I planned to send you tonight an advance copy of the Statement which we shall be publishing on Monday. I accordingly enclose it. Further copies will go to the Private Offices of all members of the Cabinet on Monday morning. I also attach for your information a copy of the latest version of the draft of the statement which the Chancellor will make in the House on Monday afternoon. The Chancellor in fact showed an earlier version to the Prime Minister en route back from Paris this afternoon, and this version takes account of her comments.

under Secret cover clearly marked - I hope - more clearly than this.

Copies have been sent separately to the Private Offices of the Lord President, and those other Cabinet Ministers directly concerned.

Yours ever,

J.O. Kerr

J.O. KERR

With permission, Mr. Speaker, I should like to make a statement. As the House knows, it is customary at this time of year to publish outline public expenditure plans and proposed National Insurance changes for the year ahead, together with the economic forecast required under the Industry Act 1975. This year, as foreshadowed in the Government's reply to the Report of the Treasury and Civil Service Committee on Budgetary Reform, we are bringing these together, and publishing them in an Autumn Statement which I shall ~~have~~ today be laying ~~laid~~ before the House. I am grateful to my rt. hon. Friend the Member for Taunton, and to his fellow Members of the Treasury Committee, for the initiative which has led to this development.

During the past year

Monetary conditions have exerted downward pressure on price rises, and dramatic progress has been made against inflation. The rate, 12 per cent at the start of this calendar year,

/is now around

is now around 7 per cent, and we envisage a 5 per cent rate early in 1983. Bank base rates have fallen from 16 per cent to 9 per cent since their peak last year. The CBI have calculated that each percentage point benefits British industry by around £250 million in a full year. We shall continue to maintain downward pressure on the monetary aggregates, in order to achieve further success in the battle against inflation. Interest rates will of course reflect the indicators of monetary conditions which I described in my Budget Speech.

As the Statement explains, the growth in output this year in this country and throughout the Western world is now lower than was expected. For next year the Industry Act forecast now suggests a 1½ per cent increase in our GDP. This is close to what is expected for most other industrialised countries. Unemployment remains the nation's most serious problem. As in other

/countries,

countries, further rises are expected to continue into next year, although they should moderate as output picks up in response to the falls in inflation and interest rates now being achieved.

Public borrowing remains under firm control - which of course is one of the reasons for the fall in interest rates. We now expect the PSBR this year to be within the figure of £9½ billion expected at the time of the Budget. Final decisions about the level of next year's borrowing requirement will not of course be taken until my 1983 Budget. The forecast is necessarily always subject to a wide margin of error at this stage. But it suggests that the scope for possible tax reductions in 1983-84 could be of the same order as was indicated at the time of the last Budget, although there have been offsetting changes on both sides of the account. This is purely on the basis of conventional assumptions as to the revalorisation of direct taxes and excise duties, and it also assumes the same 1983-84 PSBR, as a percentage of GDP, as was assumed at the time of the last Budget. It also takes account of the public expenditure and other decisions which I am announcing today.

The public expenditure planning total for 1983-84 will be £120.06 billion. This is lower than the provisional figure for 1983-84 published on Budget Day this year. It is the first time since 1977 that ~~any~~ a Government has been able to stop expenditure plans rising with each annual review. Compared with the plans for the current year, the new total is a slight fall in cost terms (that is, in constant prices). The ratio of public expenditure to GDP will come down from 45 per cent to 44 per cent, ~~reversing an upward trend which has continued since 1977~~.

6. Details of the changes in individual programmes are summarised in the statement. Social Security Programmes have been adjusted to take account of the rapid reduction in inflation.

/This month's

This month's benefit uprating is 11 per cent. Even allowing for the 2 per cent extra to compensate for last year's shortfall, that is well over the current rate of inflation. We accordingly intend to make an adjustment to next year's uprating. Meanwhile those in receipt of benefits will of course continue to receive payment at a rate above that needed to reflect price rises in the last year. As is customary, the exact size of next year's uprating will not be decided until Budget time. However I can assure the House that our pledge to maintain the real value of pensions and associated benefits throughout this Parliament will be maintained.

XX

A number of high priority programmes have been increased:-

- For housing the provision of an extra £49 million, and the continuing high level of receipts from council house sales, will allow gross capital spending

/to be at least

to be at least 10 per cent higher than the expected level this year.

- Substantial increased provision will be made for the urban capital programmes, to support the new Urban Development Grant programme and the Urban Development Corporations in London Docklands and Merseyside.

- In the Health Service we are providing an extra £80 million in England, which should continue the growth in the level of services which has already taken place under this Government.

- Additional expenditure of £96 million has been allocated to law and order programmes, mainly on police and prisons.

- We plan additional gross expenditure of £260 million on two new special employment

/measures

measures - the Community Programme and the Job Splitting Subsidy - which were announced earlier this year.

- Finally, provision for defence in 1983-84 has been increased by £622 million, because of extra costs following the Falkland Islands action. This increase is additional to our commitment to meet the NATO 3 per cent per annum real growth target. It will fund purchases of equipment to replace losses this year, and will ensure the future security of the Islands.

To find room for these increases within an unchanged total, we have secured savings on a number of other programmes. We have also transferred to programmes part of the provisional Contingency Reserve set aside in the 1982 White Paper. But we have left a substantial Contingency Reserve of £1.5 billion, which we

/shall review

shall review again nearer the Budget.

Full details of the public expenditure plans for next year and for 198~~3-8~~4 4-5 and 1985-86 will be set out in the Public Expenditure White Paper which we expect to publish early in the New Year.

My rt. hon. Friend the Secretary of State for Social Services is this afternoon announcing details of changes in National Insurance Contribution rates and limits for next year, and will be publishing the Report of the Government Actuary on the National Insurance Fund. If we were fully to balance the Fund for next year, increases in employers' and employees' contributions of nearly 0.4 per cent each would be required. But we are concerned both to minimise additional burdens on industry, and to diminish the effects of contribution increases for employees. So we have decided that the increases should be limited to 0.25 per cent

/each for

each for employers and employees. The Upper Earnings Limit will go up only £235, rather than £245 which would be the maximum permitted by Statute. As compared with fully balancing the Fund, these measures mean that contributors will pay a little over £200 million less next year than would otherwise have been the case. The cost to the PSBR has been taken into account in the forecast.

I turn now to the National Insurance Surcharge, introduced, and then increased to 3½ per cent, by the previous Government. It has long been criticised, and rightly so, by commerce and industry. As I said in my last Budget, it raises production costs, it is not rebatable on exports, and it either puts up prices or cuts into profits. I was able in March to announce an effective reduction of 1 per cent in the rate for private sector employers, from 3½ per cent to 2½ per cent, for the year 1982-83. I am pleased to inform the House that we can now take another substantial

I.M.F.

Restrictive monetary policy

- Has been commended to all
its members

Hal Miller.

Redn in Nat. Ins. charge

Ch. N.I. Surcharge

N.I.

£686 -. 83-84

£450 - private sector

£12.8.

£12.1 -

step in the right direction, by reducing the rate for 1983-84 by a further 1 per cent, so bringing it down to 1½ per cent. The public sector will not gain from the change, but the benefit to private employers in 1983-84 will be around £700 million. The cost of this to the PSBR has been reflected in the forecast. A table showing the overall effect for employers and employees of the NIC and NIS changes for next year has today been put in the Vote Office.

In addition I intend that for private sector employers ½ per cent of the NIS reduction from April 1983 should be brought forward and made effective for 1982-83 also. Honourable Members will know that to change the NIS rate at this time of year presents considerable administrative problems. But we have found a way of overcoming them. The equivalent of a ½ per cent reduction for the whole year will be given by reductions in employers' payments of National Insurance Surcharge and National

/Insurance

Terence Higgins

Redn in inflation
& interest rates } not taken for granted

Excessive wage claims in public sector
will further change level of unemployment

Wainwright:

Energy & fuel prices. →
Freeze on control price
continued Oct 1983

Exchange rate.

Assumption - no significant change
Fall in inflation 7% compared with
4% elsewhere

45-44%

Inc. differential with public sector borrowing elsewhere.

O.A.P. 5% → 3%

Lower personal tax on lower paid

Jim Lester : - 5% unemployment
3½ million next year.

Insurance Contributions for January, February and March next year. Details and guidance will be sent in due course to employers.

This further benefit will be of the order of £350 million in the current year. Legislation will be needed, both for the 1982-83 arrangements and for the new rate applying from next April. A Bill will be introduced at an early date. I am sure it will commend itself warmly to the House as providing a substantial reduction in the costs faced by private sector commerce and industry.

Mr. Speaker, the House will want to study the Autumn Statement carefully. The format is new, and I ~~think~~ hope helpful, and the scope rather wider than before. And it demonstrates that we are determined, within the framework of our monetary and fiscal policies, to continue to do what we can to relieve the burden of taxation so as to move towards renewed growth and more employment.

/I hope to be able

S of L. - Wage increases

Improvements in

competitiveness

£ down.

N.I contribution - N.I.S.

£686-

£450 - to private sector

Increased in. by 5%.

Competitiveness: 3½ N.I.S.

36%.

RPDI -

1: 1:

Roy Jenkins.

76-80.

Falling 2nd - 4th quarter?

Abolish N.I.S.

Reduction interest rates.

Competitiveness. Employers share

Ashley. - Long term setbacks.

£260m

I hope to be able to say rather more if I am fortunate enough to catch your eye later in the course of our current debate.

12 mins.

Peter Shore.

½ GDP.

Massive recession

Cosmetic touches to N.I.S.

Adjustment. — £700 m

Pensioners. £500 m.

5% unemployed people

N.I.S. £175 m – cash flow improvement.

RSG. —

Commitments. —

Unemployment. — 2.9 to 3.2

Inflation: – spontaneous growth.

[redacted] NPDI.

B of Trade. Importing more manufactured goods than exporting:

G.H. Inflation of 5%.

85p. rent

Adjustment —

cc B Fopham
attachment only

5

FROM: J O KERR
4 November 1982

MR KEMP

cc Chief Secretary
Economic Secretary
Sir Douglas Wass
Sir Anthony Rawlinson
Mr Burns
Mr Middleton
Mr Quinlan
Mr Evans
Mr Kitcatt
Mr Monger
Mr Monck
Mr Moore
Mr Mountfield
Mr Hall
Mr Norgrove
Mr Ridley
Mr Harris

CHANCELLOR'S ORAL STATEMENT: 8 NOVEMBER

The Chancellor has done further work on the revised draft of his statement on 8 November which you submitted last night. I attach a new version, reflecting:-

(a) His reactions to the points raised in your covering minute;

(b) His view that the reference to monetary conditions in last night's draft was too brief; and

(c) His feeling that the PSBR paragraph - now paragraph 4 - was not quite right in last night's version.

The new language on monetary conditions, and the 1983-4 PSBR, has been prepared by Mr Burns and Mr Middleton.

2. The Chancellor would like to see a further version of the statement on his return from Paris at lunch-time tomorrow. Following consultation with Mr Hall, it has become clear that the final version will have to go to press by 9am on Monday morning. It follows that

it would be very helpful if copy addressees could let you have, early tomorrow morning, their reactions to the current draft, for incorporation in the version you prepare tomorrow.

3. The section about which the Chancellor is now most concerned is that dealing with public expenditure - ie paragraphs 5-7. He would be most grateful for the Chief Secretary's advice on:

(a) whether he could and should include some more positive "announcements", along the lines of the relevant passage in the Prime Minister's speech yesterday. In particular, is there not a case for saying something about increased capital expenditure?

(b) whether the Defence sentence could not be expanded a little; and

(c) whether it is right to say nothing about the expected public expenditure outturn this year? (The Chancellor thinks that it probably is right, but that the point deserves consideration.)

The Chancellor would also like to know when, before 1977, a Government was last able to hold public expenditure plans as is now being done.

4. The Chancellor would be most grateful if the Economic Secretary, and Mr Harris, could find time to check the text today for political flavour and "speakability", and let you have any suggestions for further improvements.

J O KERR

AUTUMN STATEMENT 1982 DRAFT 4 November 1982

With permission, Mr. Speaker, I should like to make a Statement. As the House knows, it is customary at this time of year to publish outline public expenditure plans and proposed National Insurance changes for the year ahead, together with the economic forecast required under the Industry Act 1975. This year, as foreshadowed in the Government's reply to the Report of the Treasury and Civil Service Committee on Budgetary Reform, we are bringing these together, and publishing them in an Autumn Statement which I have today laid before the House. I am grateful to my rt. hon. Friend the Member for Taunton, and to his fellow members of the Treasury and Civil Service Select Committee, for the initiative which has led to this development.

2. Monetary conditions have exerted downward pressure on price rises, and dramatic progress has been made against inflation. The rate, 12 per cent at the start of this calendar year, is now around 7 per cent, and we envisage a 5 per cent rate early in 1983. Interest rates have fallen from 16 per cent to 9 per cent since their peak last year. The CBI calculate that this has benefited British business by some £1.8 billion a year. We shall continue to operate monetary policy

//flexibly

flexibly consistent with achieving and maintaining low inflation. Interest rates will of course reflect the range of indicators which I described in my Budget Speech.

3. As the Statement explains, the growth in output this year in this country and throughout the Western world is now lower than was expected. For next year the Industry Act forecast now suggests a 1½ per cent increas in our GDP. This is close to what is generally expected for most other industrialised countries. Unemployment remains our serious problem. As in most other countries, a further rise next year has to be expected, although we look for this to moderate as output picks up in response to the falls in inflation and interest rates now being achieved.

4. Borrowing remains under firm control - which is of course one of the reasons for the fall in interest rates. We now expect the PSBR this year to be within the figure (£9½ billion) expected at the time of the Budget. Final decisions about the level and composition of next year's borrowing requirement will not, of course, be taken until my 1983 Budget. The forecast, necessarily subject to a wide margin of error at this stage, suggests that the scope for possible tax reductions in 1983-84 may be of much the same order as was indicated at the time of the last Budget, although there have been offsetting changes on both sides of the account. This is on the basis of conventional assumptions as to

/revalorisation

revalorisation of direct taxes and excise duties, and the same 1983-84 PSBR, as a percentage of GDP, as was assumed at the time of the last Budget. It also takes account of the public expenditure and other decisions which I am announcing today.

5. The public expenditure planning total for next year is within the plans for that year which were published at the time of the Budget. This is the first time since 1977 that a Government has been able to contain its planned spending in this way. The planning total for next year is just over £120 billion.

6. Within the total there are various changes of detail for individual programmes. These are summarised in the Statement. I mention three major changes. Provision for defence in 1983-84 has been increased by £622 million, to reflect defence costs in relation to the Falkland Islands. As already announced over £1 billion has been added to the provision for local authority current expenditure relevant for the Rate Support Grant. Finally, social security programmes have been adjusted to take account of the rapid reduction of inflation. It is now clear that the provision in this month's benefit uprating for the rise in prices over the last year has exceeded the actual rise. We intend to make an adjustment to next year's uprating to compensate for ~~an~~ the under-prediction of price increases last year. As is customary, the exact size of next

/year's uprating

year's uprating will not however be decided until Budget time. However, I can assure the House that our pledge to maintain the real value of pensions and benefits throughout this Parliament will of course be maintained.

7. Full details of the public expenditure plans for next year and for 1984-85 and 1985-86 will be set out in the Public Expenditure White Paper which we expect to publish early in the New Year.

8. My rt. hon. Friend the Secretary of State for Social Services is this afternoon announcing details of changes in National Insurance Contribution rates and limits for next year, and will be publishing the Report of the Government Actuary on the National Insurance Fund. If we were fully to balance the Fund for next year, increases in employees' and employers' contributions of around 0.4 per cent each would be required. [We have however noted the view of the Public Accounts Committee that balancing the Fund need not be an over-riding requirement.] We are also concerned both to lighten additional burdens on industry, and to diminish the adverse effects of contribution increases for employees on the poverty and unemployment traps. We have accordingly decided that these increases should be limited to 0.25 per cent for employers and employees. The Upper Earnings Limit will go up only to £235, rather than the £245 which would be the maximum permitted by

/Statute.

Statute. As compared with fully balancing the Fund, these measures cost some £[200] million against next year's PSBR, and have of course been taken into account in the forecast.

9. I turn now to the National Insurance Surcharge, I first introduced and then increased to 3½ per cent by the previous Government. It has long been criticised, and rightly so, by private commerce and industry. As I said in my last Budget, it raises production costs, it is not rebatable on exports, and it either puts up prices or cuts into profits. I was able in March to announce an effective reduction of 1 per cent in the rate for private sector employers, from 3½ per cent to 2½ per cent, for the year 1982-83. I am pleased to inform the House that we can take another substantial step in the right direction, by reducing the rate for 1983-84 by a further 1 per cent, so bringing it down to 1½ per cent. The public sector will not gain from the change, but the benefit to private sector employers in 1983-84 will be around £700 million, and the cost of this to the PSBR has been reflected in the forecast. A table showing the overall effects for employers and employees of the NIS and NIC changes for next year has today been put in the Vote Office.

10. I have one further piece of good news for private sector business and industry. I intend that ½ per cent of the NIS reduction from April 1983 should be brought forward and made effective for 1982-83

/also.

also. Hon. Members will know that to change the NIS rate at this time of year presents considerable administrative problems. But we have found a way of overcoming them. The equivalent of a ½ per cent reduction will be given by reductions in the total payments of National Insurance Surcharge and National Insurance Contributions which employers make for 1982-83; these reductions will be made in the last two months of this financial year. Details and guidance will be sent in due course to employers.

11. The benefit will be of the order of £350 million in the current year. Legislation will be needed, both for the 1982-83 arrangements and for the new rate applying for next April. A Bill will be introduced at an early date. I am sure it will commend itself warmly to the House as providing a substantial reduction in the costs faced by private sector commerce and industry.

12. Mr. Speaker, the House will want to study the Autumn Statement carefully. The format is new, and I think helpful, and the scope rather wider than before. And it demonstrates that we are determined, within the framework of our monetary and fiscal policies, to continue to do what we can to relieve the burdens of taxation so as to move towards renewed growth and more employment. I hope to be able to say rather more if I am fortunate enough to catch your eye later in the course of our current debate.

Econ Pol.

CHIEF SECRETARY TO THE TREASURY

Treasury Chambers, Parliament Street, SW1P 3AG

Dear Michael

You asked for a piece of paper you would put to the PM before her meeting on 'Clawback' on Monday. I hope this will do. The Whips Office may have more up to date information on the Parliamentary position. My impression is that it has got more difficult since the summer.

Yours sincerely

J.W. Gieve

Ministerial Promises

The two recent Ministerial promises on recovery of overshoot are Mr Rossi on 18 March:

> " My right hon. Friends on the Front Bench have promised to keep this matter under review. We have said that the abatement will not be a permanent reduction. It is equally clear that the abatement cannot be made good now, but it will be made good. My right hon. Friends have the matter under review. At the right time it will be made good."

And Mr Hayhoe on 13 May:

> "As my hon. Friend knows, we debated the matter at some length on 26 April. I have nothing to add to what I said then, which made it clear that the abatement will not be a permanent reduction. It will be made good at the right time."

Voting

The Government won the crucial amendment to the Finance Bill on 13 July by only 8 votes: 291 to 283. The following Conservatives voted with the Opposition:

Thomas Benyon
Patrick Cormack
Julian Critchley
David Crouch
Stephen Dorrell
Alan Haselhurst
Robert Hicks
~~Rt Hon D Howell~~
David Knox
Jim Lester
David Madel
Hon C Morrison
Richard Needham
Sir Brandon Rhys Williams
Robin Squire
Peter Tapsell
Cyril D Townsend
Sir W Van Straubenzee
Dennis Walters

The following ~~Conservatives~~ signed the amendment, but abstained:

Hugh Dykes
Sir Ian Gilmour
John Hunt
Kenneth Lewis
Sir Anthony Meyer

DEPARTMENT OF TRADE 1 VICTORIA STREET LONDON SW1H 0ET Telephone 01-215 7877

Econ. Pol. c/e JV

(2)

Prime Minister

An early bird!

MLS 29/10

From the Secretary of State

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

29 October 1982

Dear Geoffrey,

As in previous years, the tourism industry and particularly the holiday resorts will be looking for some encouragement in your 1983 Budget, all the more so because the money available for direct grant assistance is so very limited. I believe that it would be right, now, to consider their case. I am concerned that unless the Government pays heed to the tourism industry's call for more equitable treatment as between manufacturing and services (of which tourism is a major component) we shall lose goodwill in many tourism consitituences which it may be difficult to recover, even though the broad thrust of our policies can be seen to be succeeding.

You have over the years introduced a number of "packages" in your successive Budgets which have done a great deal at comparatively little cost. I will suggest that this coming year there would be real merit in the inclusion of a "holiday package" to help our holiday resorts and the tourist industry generally. Such a package would also be of help to the construction industry.

The industry has a strong claim to fiscal encouragement. Tourism is of growing importance as a long-term viable sector of the economy. It is an area to which we shall be looking increasingly for new jobs, including jobs for the young and the low skilled. The industry in this country is not, however, without its problems. Like other sectors, it is finding it hard to compete for business in a highly efficient international market. This situation is reflected all too clearly in the figures. Earnings from overseas visitors have dropped in real terms every year since 1977. In the same period there have also been substantial increases each year in the number and expenditure of UK residents going abroad. It cannot be right that an industry which will pay such a large role in our future economy should, on top of these

From the Secretary of State

considerable difficulties, be further handicapped by discriminating government policies. Indeed there would seem to be a case for a slight tipping of the balance in the other direction.

While the industry has argued strongly for a wide range of concessions, I concentrate in this letter on building allowances.

BUILDING ALLOWANCES

Various proposals have been put to you for improving the existing 20% initial allowance for hotels and extending allowances to other buildings where tourist or tourist-related activity takes place. For the accommodation sector these include lowering the 10 bedroom minimum requirement, removing the evening meal requirement and extending coverage to the self catering sector. All of these I commend for your consideration.

The primary case is for an increase in the initial allowance for hotels from the present 20%. Last year you increased the initial allowance for industrial buildings from 50% to 75%. But no corresponding increase was made for hotels. This not unnaturally has added to the grievance which already existed. Moreover it negated the stock answer that all these matters would have to await consideration of the Green Paper. If allowances for industrial buildings can be increased ad interim, there is no logical reason why allowances for hotels should not also be increased. An increase to 50% for new construction and developments - which would not be very expensive - would be the clearest indication of our concern for the tourist industry and for the holiday resorts in this country.

Extension of allowances to smaller establishments than 10 bedroom hotels would underline our support for smaller firms without adding significantly to the cost. I appreciate that this raises questions of definition and I would suggest that officials should consider where the line should be drawn.

While making these changes it would be anomalous not to widen coverage to fixed structure self catering establishments (at present the fastest growing segment of the market). Here again I would suggest that officials should consider the range of buildings which house or constitute tourist attractions which might be brought within the scope of the allowances.

From the Secretary of State

VAT

I realise that singling out one sector for VAT relief poses singularly difficult problems. It is for this reason I make no specific recommendations to you despite the fact that this is an area in which the tourist industry, and hotels in particular, have very strong feelings. I would only say that if at any time you would be disposed to make VAT concessions, you should keep the tourist industry and the related activities very much in mind.

These matters are of course also of particular interest to George Younger and Nicholas Edwards, in view of their tourism responsibilities and of the economic importance of tourism in Scotland and Wales. I am copying this letter to the Prime Minister, the Secretaries of State for Industry, the Environment, Scotland, Wales, Education, Employment, to the Minister of Agriculture, Fisheries and Food and to Sir Robert Armstrong.

Yours
Arthur

LORD COCKFIELD

PRIME MINISTER

For your meeting at 12 o'clock on Monday, you might like to be reminded of the furthest extent to which the Government is committed on recovery of the 5 per cent abatement.

Mr. Rossi said on 18 March:

> "My right hon. Friends on the Front Bench have promised to keep this matter under review. We have said that the abatement will not be a permanent reduction. It is equally clear that the abatement cannot be made good now, but it will be made good. My right hon. Friends have the matter under review. At the right time it will be made good."

And Mr. Hayhoe on 13 May:

> "As my hon. Friend knows, we debated the matter at some length on 26 April. I have nothing to add to what I said then, which made it clear that the abatement will not be a permanent reduction. It will be made good at the right time."

/You will

You will also remember that the Government won the crucial amendment to the Finance Bill on 13 July by only 8 votes: 291 to 283. The following Conservatives voted with the Opposition:

Thomas Benyon

Patrick Cormack

Julian Critchley

David Crouch

Stephen Dorrell

Alan Haselhurst

Robert Hicks

Denis Howell

David Knox

Jim Lester

David Madel

Charles Morrison

Richard Needham

Sir Brandon Rhys Williams

Robin Squire

Peter Tapsell

Cyril Townsend

Sir William van Straubenzee

Dennis Walters

The following signed the amendment, but abstained:

Hugh Dykes

Sir Ian Gilmour

John Hunt

Kenneth Lewis and Anthony Meyer

29 October 1982

MS

Econ Pol. 4

File

10 DOWNING STREET

From the Private Secretary 28 October 1982

NIC AND NIS

The Prime Minister was grateful for the Chancellor of the Exchequer's minute of 27 October.

She has agreed the proposals in paragraphs 2, and 4 to 6. She has commented that the necessary legislation should be brought forward as quickly as possible.

I am sending copies of this letter to Jonathan Spencer (Department of Industry), David Clark (Department of Health and Social Security), David Heyhoe (Lord President's Office), Murdo Maclean (Chief Whip's Office) and Richard Hatfield (Cabinet Office).

M. C. SCHOLAR

Miss Margaret O'Mara,
H.M. Treasury.

SECRET

Econ Pol

10 DOWNING STREET

Prime Minister

0900 : 28/10/82

The Chancellor wishes to discuss

(1) NIC/NIS

(2) forthcoming announcements.

MCS 27/10

2. 3

PRIME MINISTER

FORTHCOMING ANNOUNCEMENTS

We have discussed the timing of various announcements due shortly, viz the Industry Act Forecast, outline Public Expenditure plans for the year immediately ahead, and National Insurance Contribution (and where appropriate Surcharge) rates to take effect for next year. This year, following our reply to the Treasury and Civil Service Committee on Budgetary Reform, these announcements are to be brought together within a single "Autumn Statement".

2. Assuming all the necessary decisions are taken before or at Cabinet on 2 November, the earliest time for full publication is Monday 8 November. This is not just because of the work involved in getting the Autumn Statement into proper form, but more importantly because it would clearly be inappropriate to publish this material on 3 November - the day Parliament Opens - nor would it be right to do so on the 4 or 5 November, when you and I will both be abroad. That is not to say that you could not, if you so wish, refer in your Speech on 3 November to the position on public expenditure: indeed I would welcome this.

3. Looking at it from the other end, 8 November is also the latest publication date, for two reasons. First, I have consulted the Secretary of State for Energy, who believes it essential, on merchant bank advice, to be in a position to float Britoil in that week. This would mean pricing no later than 9 November. But we would have to allow the markets at least 24 hours, before the pricing, to assess the Autumn Statement. Secondly, publication of the Autumn Statement should precede the "economic" day in the Queen's Speech debate. This too points to 8 November, and suggests that in contacts through the usual channels we should try to ensure that the Opposition choose 9 November for the economic day.

4. I have consulted the Secretary of State for Social Services about any NHS dispute factor affecting timing: he is content with 8 November.

5. I propose, therefore, that we should go firm on publication on 8 November. I have also spoken to the Lord President and the Chief Whip about whether I need make an accompanying oral statement: the consensus is that I should, though I would make it clear that the substantive debate would follow on the economic day of the Queen's Speech debate.

6. In sum, the proposed timetable, on which I would welcome your reactions, is 8 November for publication of the Autumn Statement, 9 November for pricing the Britoil sale, and, if it can be so arranged, for the economic debate, and 10 November for announcing Britoil.

7. Copies of this minute go to the Lord President, the Secretaries of State for Energy and Social Services, the Chief Whip and Sir Robert Armstrong.

GH

(G.H.)

27 October 1982

1
2

PRIME MINISTER

NIC AND NIS

Following our discussion of possible changes in NIC and NIS rates in 1983-84, and in NIS rates in the current year, I have talked to Patrick Jenkin and Norman Fowler.

National Insurance Contributions

2. On NIC Norman Fowler and I now propose that the full Class 1 rates should be increased by 0.25% each for employees and employers to 9.0% and 10.45% respectively. The lower earnings limit will rise to £32.50 in line with the single rate retirement pension, and we propose that the upper earnings limit should be raised to £235, some way below the statutory maximum of £245.

3. These increases fall short of what would be required to balance the National Insurance Fund; for this, the Government Actuary estimates that increases of 0.45% each for employers and employees would be required. In my judgement, it would be wrong at this time to add significant extra burdens to industry, which in any case will pay higher contributions than in 1982-83 as a result of the increase in earnings; and I would not wish to repeat our action of the last two years in loading the full increase necessary to balance the Fund on to employees. I would also wish to avoid primary legislation for NICs; the increases we propose are the maximum that can be made by Order.

National Insurance Surcharge

4. In my last Budget I reduced the NIS from 3½% to 2½% to take effect from August 1982, and to give the full year benefit of the 1% reduction, I temporarily reduced the rate to 2% between August and April 1983. For 1983-84 I now propose to consolidate the ½% temporary reduction and to make a further reduction of ½%, so bringing the rate down to 1½% from April 1983. The net cost of this 1% reduction, and the benefit to private sector business and industry, will be about £700 million. The benefit to the public sector will be offset by reductions in programmes.

5. In addition I propose to give further help to private sector employers by bringing forward into 1982-83 the April reduction of ½% over and above consolidation. This will be worth about £350 million in total to those private sector employers paying NIS. Consistent with the arrangements when the rate was reduced from 3½%, and with what I propose for 1983-84, the public sector will not benefit from this change.

6. Officials are still working on the details of the scheme but it will operate broadly as follows. Individual employers' NIS payments cannot be separately identified, and it is too late in the year to issue revised NIC/NIS tables. To deal with this problem, we propose that in December and January employers would be issued with instructions asking them to deduct from their payments due in February 3% of the total payments they have made in 1982-83 of employers' NIS and NIC and employees' NIC. They will make similar deductions of 3% from those payments due in March and April. By this route private sector employers should pay around £350 million less in 1982-83 and that is broadly equivalent to a ½% reduction in their NIS payments. There will be no question of encroaching on NIC contributions. The scheme will ensure that NIC payments, records and procedures are left intact.

7. Because these arrangements are inevitably different from the normal arrangements for NIS collection they may attract some complaints. For example, employers with contracted-out pension schemes, and/or employing pensioners and married women who have opted out of paying full rate NICs, may point out that - because they pay less NIC - they will not do as well relatively as other employers. Against that all firms paying NIS will benefit from the scheme and it is impracticable to base calculations on NIS payments alone or to add to the administrative costs and complications by introducing different percentages for different circumstances. Spokesmen for the self-employed and for charities

too may complain at not being allowed to make deductions. But the answer to them would be simple. As they do not pay NIS they cannot expect to benefit from a scheme intended to reduce NIS payments.

8. We might of course also be asked why, rather than reduce costs by £350 million in the last two months of 1982-83, it is not better to wait until 1983-84 and then, under the standard arrangements, reduce NIS to 1 rather than 1½%. Our answer would be that, while we might wish to reduce NIS still further, it would be premature for me to go as far now as to make a permanent reduction to 1% from the Spring. Moreover, £350 million to the private sector by March 1983 is clearly more helpful to them than the same sum spread out evenly over 1983-84.

9. Overall I am satisfied that we have good answers to the inevitable questions, and I am in no doubt at all that the injection of £350 million into private sector business and industry in this financial year will be widely welcomed.

10. Patrick Jenkin is content with these proposals.

Announcement

11. As you know, I propose that these changes should be announced on 8 November.

Legislation

12. Under these arrangements we avoid the need for an NIC Bill similar to last year's. But we still have to have a short NIS Bill (which will be the responsibility of Treasury Ministers).

13. Subject to confirmation by Parliamentary Counsel, I am advised that this will be a Money Bill. To give cover for the preparation of instructions to employers in December on the 1982-83 arrangements it would be desirable for the Bill to have made substantial progress by mid-December.

14. I realise that this will add to the burdens of managing the legislative programme but I hope that, given the attractions of the proposals, which I am sure will be widely welcomed both by our own supporters and by industry, the business managers will be able to find the necessary time, and that John Biffen will agree to the employment of Parliamentary Counsel on the drafting of the Bill. I shall pursue this separately with him and the Chief Whip.

15. I am sending copies of this minute to Patrick Jenkin, Norman Fowler, John Biffen, Michael Jopling, and Sir Robert Armstrong.

G.H.

(G. H)

27 October 1982

PRIME MINISTER

Autumn Statement

What the Treasury are intending to publish on 8 November will certainly be described as an Autumn Statement. It will consist of:-

1. The Industry Act forecast
2. Information about public expenditure plans
3. Ready-reckoners showing the revenue effects of illustrative changes in major taxes
4. The NIS and NIC decisions
5. The Government Actuary's Report

They are planning to produce a single book with all this information in it.

There is no way round this. The Government's reply to the TCSC in July commits the Government to no less than this. When you agreed to the Government's reply you did so in the knowledge that it would cement us into having what would be described as an Autumn "mini-budget", for all that we shall strenuously say that it is not a mini-budget.

MCS

25 October 1982

Econ Pol.

10 DOWNING STREET

(1) Mr ~~Butler~~ RB to see

(2) Note for file

cMr

I asked the Chancellor's office to restrict as far as possible the circle of those who see my letter to JO Kerr of 21/10 about the 1982/83 borrowing requirement.

They will do so (they haven't yet adopted Budget - Secret): it is being very tightly restricted anyhow.

MCS 25/10

File SW 1
cc Mr Walters
cc

10 DOWNING STREET

From the Private Secretary

21 October, 1982

The Prime Minister and the Chancellor have had several conversations about, inter alia, the issues raised in the Chancellor's minutes to the Prime Minister of 19 October on economic assumptions and the 1982/83 borrowing requirement.

The Prime Minister broadly endorses the Chancellor's approach on both matters. She agrees that, on the measures designed to correct a PSBR undershoot for 1982-83, the best course would be to make a number of announcements in the debates following the Queen's Speech, and that this would be preferable to gathering up all these measures into a single announcement. Mrs. Thatcher is content with the measures listed in paragraphs 2 and 4 of the Chancellor's minute, and in addition has suggested that the Secretary of State for Industry might be asked whether he wished to put forward candidates for addition to the list, for example further measures like the Small Engineering Firms Investment Scheme.

The Prime Minister is content with the economic assumptions listed in paragraph 2 of the Chancellor's minute on this subject.

In a discussion about the national insurance issues on which decisions will soon be required, the Prime Minister suggested that the Chancellor explore the possibility of reducing the national insurance surcharge to 1½ per cent, and at the same time increasing national insurance contributions upon both employees and employers by 0.25 per cent (with an estimated aggregate PSBR cost of around £900 million) as an alternative to the proposal to consolidate the national insurance surcharge at 2 per cent, together with increases in the national insurance contribution of 0.25 per cent on employees and nil on employers (with an estimated aggregated PSBR cost of £850 million). The Chancellor said that he would be discussing these possibilities

/with

SECRET

with the Secretaries of State for Industry and Health and Social Services, and he would also be considering what proposal to make about the upper earnings limit and whether it should be increased to £245 or to some lesser figure. The Prime Minister, as you know, remains concerned to preserve as much room as possible in the Budget for income tax threshold increases.

M. C. SCHOLAR

John Kerr, Esq.,
H.M. Treasury

SECRET

Personal

Budget L10

21 Oct 82 Econ Pol

Michael Scholar

I do not see how we can avoid the minimum of consolidation of the NIS at 2% decrease - and ~~this~~ would lead to a cost of £350 m.

But suppose we did a little more i.e. reduce to 1½%, and at the same time increase both employers and employees contribution to NIC by 0.25%. - the cost of the joint NIS (B) and NIC (C) would be £900.

If you opt for NIS (A) and NIC (B) ~~the~~ cost would bee 350 + 500 = £850.

There is nothing in it - but you could claim another reduction in NIS - politically quite attractive

AW

VER 200 245 ~ 235

do 0.25 m employees

1½ 700 0.25 200
each end

up to 245 VER?

Discuss with PJ + NF

Hayes to DoT

Rawlinson to DoT

PSBR 1983-84

Personal

Michael

With John Kerr's compliments,

Jim Rutter

20 · X · 82

MCS Say this should go on the 1983 Budget file.

JR

NIS and NIC

1983-84

1. The forecast assumes $2\frac{1}{2}\%$ NIS and 0.4% on each of employers' and employees' NICs and an Upper Earnings Limit of £235 per week.

2. The following table shows three options for NIS and NIC. The figures are broad brush at this stage: the Government Actuary's figures are not yet available; they are based on provisional assumptions; the PSBR costs will be lower than shown because of second round effects.

	NIS decreases		NIC increases		£ million Total cost
A	Consolidate at 2%	350	Employees : nil Employers : nil UEL to £235	850	1200
B	Reduce to $1\frac{1}{2}\%$	700	Employees : 0.25 Employers : nil UEL to £245	500	1200
C	Reduce to 1%	1050	Employees : 0.25 Employers : 0.25 UEL to £245	200	1250

(1) NIS costs are for the private sector only. The changes would apply to the public sector but would be clawed back before publication of cash limits, EFLs and the RSG

(2) The NIS changes would require legislation before Christmas. The NIC changes would not require any legislation.

1982-83

3. If Option B or C were adopted, it might be possible, in a rough and ready way, to backdate the reduction in NIS over and above consolidation as if it had effect throughout 1982-83, so as to help reduce the expected PSBR shortfall in that year. Option B might be made to provide some £350 million for this purpose, and Option C £700 million. But if consolidation only is adopted (Option A) no help with current PSBR undershoot by this route would be appropriate since it would lead to an apparent increase in the NIS rate in 1983-84.

PERSONAL AND CONFIDENTIAL

dc FM

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

PRIME MINISTER

Agreed

? engineering grant - for equipment for small businesses? MT

1982-83 BORROWING REQUIREMENT

I told you last week that I was looking into how we might reduce the shortfall we now expect on the 1982-83 PSBR. The forecast is necessarily uncertain at this stage, but it looks as though the outturn figure could be of the order of £8 billion, against the Budget forecast of £9½ billion. I would like to adopt measures which would add roughly £1 billion to this £8 billion.

2. I have identified the following steps which in my view we should decide to adopt forthwith:-

(a) We should end the current deferment of Regional Development Grant payments. This would cost £150 million which will be charged to the Contingency Reserve. It will right a much criticised anomaly.

(b) As you know from your meeting with the Group of Eight the local authorities are likely this year to underspend their capital allocation substantially. Within these allocations we should encourage them to spend more both on capital works in general and on Home Improvement Grants. The extra, within existing cash limits, might amount to £100 million. My officials are discussing with DOE how far we can reinforce the message in the letter you propose to send to the authorities.

(c) As we discussed tonight, the Electricity Supply Industry (ESI) could bring forward bills from suppliers which would otherwise fall due next year; Nigel Lawson thought this might amount to some £200 million.

(d) We should take the opportunity, which the forecast PSBR shortfall affords us, to correct, as I repeatedly urged in Opposition, an anomaly by bringing the payment of excise duty on wine and spirits in line with the companies' receipts from their customers. The Scotch whisky and the wine trade have for years been pressing for this: they rightly argue that they should be treated in the same way as the beer and tobacco trade. But the reform has always had to be sacrificed at Budget time. The cost would be £200 million, all in 1982-83.

(e) We should provide an additional £15 million for road maintenance, and spend some £5-10 million more than previously expected in certain other areas, notably the PSA programme.

These measures are estimated to add in total some £700 million to this year's PSBR. No legislation will be required immediately (though (d) would eventually have to be validated by a clause in the Finance Bill).

3. Following your meeting with the Group of Eight you plan to write to the Chairmen of the Nationalised Industries, urging them to speed up their capital allocations this year. It is impossible to quantify the financial impact of this, but it could be significant.

4. I am still examining certain other measures, e.g.:-

(a) If the Department of Industry reach the view that the BP investment in their Sullom Voe terminal is eligible for Regional Development Grant, a payment of about £100 million in 1982-83 would be in order.

(b) A further possibility would be to inject up to £75 million Government equity into the balance sheet of British Nuclear Fuels Limited, which is heavily over-geared, and worsening as their borrowing increases. This would help with eventual privatisation. I am exploring this urgently.

(c) Conceivably we might provide some £10 million, to be charged to the Reserve, for additional maintenance of hospital buildings, on condition that it is used for that purpose and not added to what is available for pay. I should like to discuss with Norman Fowler whether this might be helpful: it could of course only be announced when the current dispute is settled.

5. The bulk of these measures would require announcements, but I envisage that these would be low key and fragmented. They would certainly not be associated with the clutch of Autumn announcements which, as usual, we shall have to make shortly - Public Expenditure, National Insurance Contributions, etc. for next year, and the Industry Act Forecast. (But the published forecast would show a PSBR figure closer to £9½ billion, since the new measures would have been taken into account.) I would propose so far as possible that the measures should be announced by the responsible Minister, e.g. Patrick Jenkin in respect of RDGs or Michael Heseltine in respect of local authority expenditure. There would of course be no question of any of these measures being justified by reference to a potential PSBR shortfall this year; rather the stance would be that these are worthwhile measures, angled in general to helping industry, which can be accommodated with our on-going fiscal and monetary policies. And this is indeed true.

6. If you agree, I shall proceed, consulting where necessary

with the responsible Minister, with the measures set out in paragraph 2 above, and arrange to get them announced - individually - and implemented as soon as possible.

7. I hope that we can have a word about this tomorrow. I also hope then to discuss how we should approach the National Insurance issues on which we have to take decisions very soon.

John Kerr.

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

pp. G.H.

19 October 1982

CONFIDENTIAL

cc Mr. Mount
Mr. Vereker

MR. SCHOLAR

ECONOMIC ASSUMPTIONS: CHANCELLOR'S MEMORANDUM OF 19 OCTOBER

Although the Chancellor's figures, reported in his paragraph 2, seem superficially to be eminently "reasonable", the Prime Minister should be aware that they also suggest that little or nothing is being done about the need to reduce wages costs per unit of output in order to promote employment.

Real wages, in RPI terms, increase about 2½% or 3% in 1982/83 and by 1½% in 1983/84. Thus we shall have no assistance at all from real wages, in terms of retail prices, for reducing the level of unemployment. The whole weight of reducing wage costs per unit of output is thrown on to the increase in productivity, or possibly the depreciation of the exchange rate. Assuming the exchange rate does not change over these years, and assuming that productivity relaxes back to its inherent 1% or so which we experienced during the 1970s, this implies that real wages per unit of output are expected to increase over this period. This indeed provides a rationalisation for not merely the same level of unemployment, but an increasing number. Of course, we may be rescued by continuation of the dramatic increase in productivity which we have recently observed in the manufacturing sector. Perhaps so, but we ought to know that we are leaning very heavily on this particular hope.

These results may well be what the Chancellor's advisers expect to occur. But if it does, it's a confession of failure. Our dramatic success in achieving a 5% inflation rate in 1983 will be nullified by the lack of adjustment of wages. And this will be reflected in the high unemployment figures.

I suspect that the forecasters may have got it wrong. I believe wages came down last year faster than anyone thought. I suspect that this issue might be taken up with the Chancellor.

19 October 1982

Dictated but not signed by ALAN WALTERS

CONFIDENTIAL

cc JU

Prime Minister (1)

Alan Walters thinks the earnings assumptions too pessimistic (too high) – see his note, attached. Agree these assumptions or will you discuss with the Chancellor?

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

PRIME MINISTER

ECONOMIC ASSUMPTIONS

We need early decisions on certain assumptions to be used for three related purposes:-

(a) In the Chief Secretary's Cabinet paper about public expenditure for discussion on 28 October, and in subsequent announcements;

MCS 19/10

(b) for the Industry Act Forecast, to be published, along with our decisions on public expenditure next year, early in November;

(c) by the Government Actuary for his half-yearly revaluation of the National Insurance Fund. His report too will be published in November.

2. The assumptions I intend to authorise are set out in the following table:

	1982-83	1983-84	1984-85	1985-86
Unemployment (GB, narrow basis, millions)	2.9	3.2	3.2	3.2
Average earnings (% increase)	9	6½	-	-
RPI (annual % increase to November)	6 to 6½	5	-	-

3. My reasons are as follows:-

(a) Unemployment

The latest short-term economic forecast suggests unemployment (on the present basis) of about 3.1

/million

million next March. For 1983-84, the forecasts point to some further increase - perhaps by another 0.2 million throughout the year, giving an annual average of about 3.2 million. This profile is broadly in line with most outside economic forecasts.

For the year ahead the recent practice has been to use the forecast average figure. For later years the practice has varied, but we last year used a conventional assumption of no further increase. I believe that we should stick to this, and use the 3.2 million figure for the three years in question: the 1983-84 figure would be published this autumn; the two later years' figures would appear in the White Paper in January or February. To go for a lower figure would be implausible. Although it is proposed to change the basis of count, which is expected - but not certain - to lead to a lower recorded figure, this will not affect the Government Actuary's calculations, and the uncertainty about the new series means that we cannot use it for the assumptions we give him now. We can consider later the form of presentation in the PEWP publication and the GA's report.

This will again lead to accusations that you are planning on high unemployment for years; but there is no way round the problem.

(b) Average earnings

The forecasts indicate a rate of increase of about 7½ per cent next year, which would be consistent with settlements in the new pay round of about 5½ per cent or less. But to publish a figure as high as 7½ per cent would weaken the message on pay which we have to get across, and could become a self-fulfilling prophecy. I therefore propose to use a figure of 6½ per cent.

(c) Prices

The forecasters believe that at the end of 1983 the RPI will be increasing at an annual rate of just below 5½ per cent. I propose to shade this down to 5 per

/cent.

cent. This will be helpful in conditioning expectations, and it will have very little effect on public expenditure programmes, though it will of course lead the Government Actuary to propose a smaller benefit uprating in November 1983, and this may in turn increase the difficulty of clawing back this year's overshoot, as described in the Chief Secretary's minute of 5 October. But I believe this is a risk we must take, given the importance of giving the right signals on prices and so having the right impact on pay negotiations.

..... 4. I attach a note explaining which of these assumptions are published, how they are presented, and when and where they appear. If you would be unhappy about any of the figures I plan to use, perhaps we might have a word tomorrow.

G.H.

19 October 1982

ANNEX A

HOW THE ECONOMIC ASSUMPTIONS APPEAR IN PUBLICATIONS

	AUTUMN STATEMENT (inc Industry Act Forecast)	GOVERNMENT ACTUARY'S ANNUAL REPORT	PUBLIC EXPENDITURE WHITE PAPER
DATE DUE	Early November	Early November	Jan/Feb
UNEMPLOYMENT	Not shown in IAF, but in AS figures for 1982-83 and 1983-84 used as basis for estimates of expenditure for social security. May be stated in AS as they will be in GA report	Financial year averages for 1982-83 and 1983-84 shown	Financial year averages up to 1985-86 shown.
AVERAGE EARNINGS	Not shown. Internal forecast used to derive published estimates of government revenue	Average growth rates to 1982-83 and 1983-84 shown	Not shown
RPI	Annual percentage changes to 1982 Q4 and to 1983 Q4 shown.	Annual percentage increases to November 1982 and November 1983 shown	Annual percentage increases to November 1983 shown, then price uprating in line with cash factors.

PART 8 ends:-

MCS to HMT of 1/10/82

PART 9 begins:-

Ch of Ex to PM + att of 19/10/82

END

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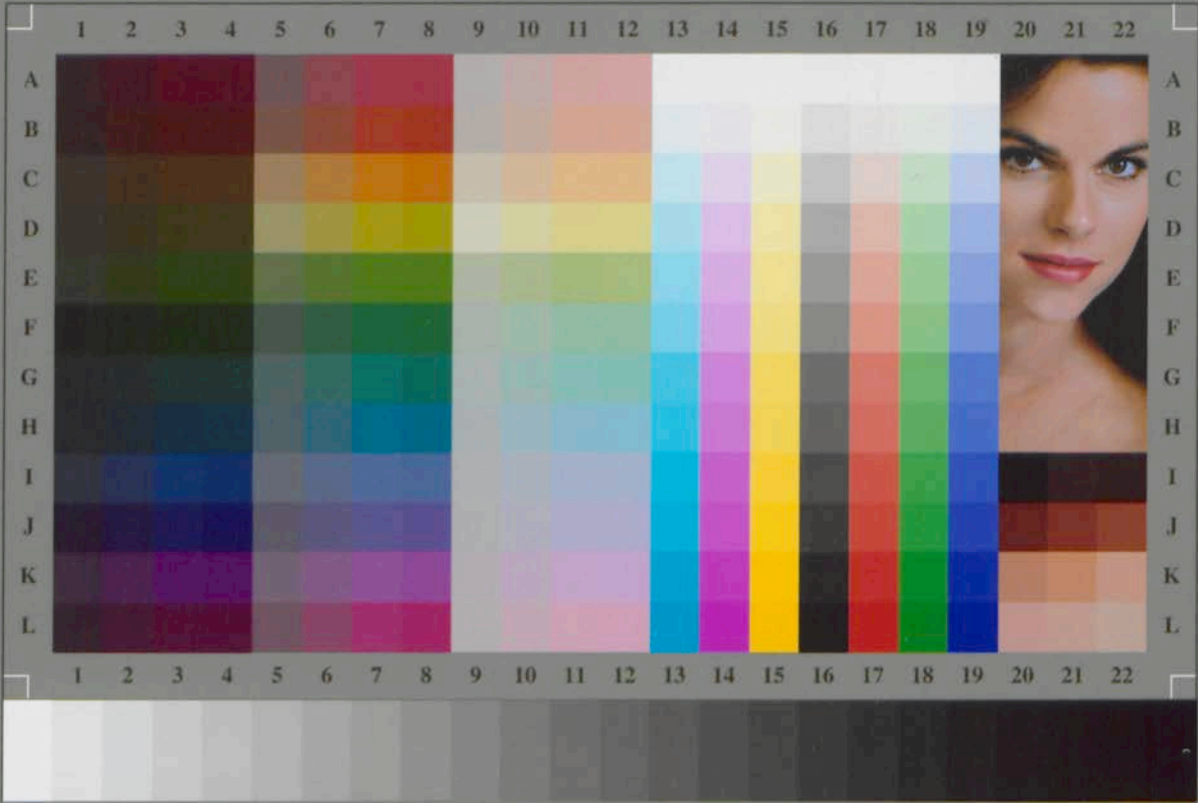

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