



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

PRIME MINISTER

A handwritten signature in blue ink, appearing to be 'M. J. G.', written over the 'PRIME MINISTER' text.

FORWARD LOOK

In your letter to Willie Whitelaw of 16 September you asked for the preparation of Departmental reports on programmes for the next five years. I now attach my report for the Treasury and the other Departments for which I am responsible.

2. I should like to add four points:-

- i. As you asked, the report covers only major matters. It should not be taken as an exhaustive list of everything which might be initiated from within my Departments over the next 5 years!
- ii. Second, it deals for the most part only with matters which are the direct responsibility of my Departments. But the areas of responsibility of other colleagues can - and frequently do - impinge on our overall economic objectives - and the Treasury often has a co-ordinating role. It is important that colleagues should not propose ideas which cut across our overall objectives, eg by involving new public expenditure commitments. I should therefore like to see copies of the other reports to you, though, given the sensitivity of some of the material in it, I am sending out no copies of mine.

/Third



- iii. Third, it is important for our prospects over the next 5 years that none of us should now close options unnecessarily, or create new pledges, or renew old and troublesome ones. We have seen the trouble we have had with (for example) our commitments on health and social security, on defence spending, and our undertakings in respect of Clegg. Particular options that I want to keep open in my own field concern the VAT base, mortgage relief ceilings, life assurance premium relief, fringe benefits and perks, and the abolition (as distinct from reduction) of any significant tax. But other colleagues will have other subjects, possibly more important in political and economic terms, where commitments, negative or positive, ought if possible to be avoided - or at least given only after very careful consideration.
- iv. Finally, as you will see from my response I have not restricted myself solely to "good news", but have also included other initiatives which, although worthwhile and necessary, may not be particularly popular. Examples of these are my proposal to review life assurance premium relief and the taxation of the pensions industry, and to examine the relationship of the personal tax system with the National Insurance Contribution system. I think this approach is in keeping with what you want from this particular exercise, though something different might be necessary in other contexts. We should want in other words, to retain freedom to act in both areas, but not in any way to proclaim our intentions.



3. If you would like to discuss any of this, I should be delighted.

G.H.
23 December 1982

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FORWARD LOOK

NOTE BY THE CHANCELLOR OF THE EXCHEQUER

This note responds to the request set out in the letter to the Home Secretary of 16 September 1982.

2. It covers the Treasury and other Departments for which I am responsible. It does not cover matters where the primary responsibility lies with other Departments, but it is possible that I shall wish to comment on some of the suggestions put forward in other Ministers' responses.

Broad objectives

3. The broad aims of my Departments over the next 5 years should be to develop and build on the groundwork laid over the past 3½ years. During that period we have introduced prudent and responsible financial policies encapsulated in an authoritative Medium-Term Financial Strategy, made major structural changes in the tax system designed to encourage enterprise, started to bring public expenditure under control, and begun to remove a large number of controls and rigidities which inhibit our economic performance and frustrate personal choice.

4. Our task over the next 5 years will be to carry forward and develop these policies so as to secure a sustained recovery in the economy, bringing with it improved standards of living and above all a lasting reduction in the level of unemployment.

5. So far as my Departments go, this should be achieved principally through:-

- continuing our responsible monetary and fiscal disciplines so as to secure further reductions in inflation and interest rates;
- containing and restraining public expenditure;
- reducing the total tax burden so that businesses and individuals may prosper;

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- further reducing the size and improving the efficiency of the public sector, including the Civil Service, the NHS and Local Government.

6. These lie mainly within my present responsibility. But we shall also continue to take a very close interest in progress in certain other important areas, including:-

- continued pursuit of privatisation and contracting-out, with a view to encouraging competition, efficiency and choice;
- the pensions system, including in particular transferability of pension rights, solvency of pension funds and reconciling both with the need to ensure that undue burdens are not placed on future generations.
- further action to reduce rigidities in the social and industrial structure, with particular reference to Trade Union reform; and the encouragement of deregulation where appropriate in all its forms;
- development of regional policy to shift the emphasis away from capital investment towards employment creation;
- easing so far as possible of the effects of transition on those adversely affected, notably the unemployed;
- continued regard for the needs of the family as an essential element of social cohesion.

Detailed response

7. A note on progress on our 1979 commitments is attached.

8. So far as major new proposals and major new initiatives go, the main field in which I have direct responsibility is that of taxation. In most other fields the formal initiative lies with other Departments, though we shall continue to take a strong interest in their overall economic affect. For present purposes, I set out below matters relevant to immediate Treasury responsibilities, divided between non-taxation matters and taxation matters.

Non-taxation matters

9. We should look to the following major developments or initiatives over the next 5 years :-

a. Public spending and the public services.

To help achieve the goal already described of containing public spending and reducing its share of GDP, particular attention will be paid to the new targets for the reduction of manpower; promotion of efficiency; contracting-out suitable services to the private sector; and the further improvement of financial management in Government Departments. I foresee significant manpower savings in all this, and little legislation.

b. Civil Service pay and public service pensions.

We need new and stable long-term arrangements for determining the pay of the Civil Service (both industrial and non-industrial), and implementation of decisions on pensions following Scott. These should be generalised throughout the public sector, which will be no easy task. Manpower implications should be minimal, though legislation might be needed.

c. Building Society reform.

New legislation is needed to give building societies more scope, within prudential limits, to extend home ownership by increasing the range of flexibility of the housing finance services they are able to provide. Expenditure and manpower implications are not expected to be significant.

d. NEDC

I would like to find ways of developing NEDC and its sector Committees into a more effective apparatus for promoting practical measures to improve industrial performance. Some SWPs are achieving useful results, but the Council needs to give them a stronger lead and a better framework for their efforts. There are no manpower or expenditure effects.

e. International Finance

We face a difficult and perhaps long process of world-wide recovery from recession. We need to promote international action and influence other major countries, to stave off some dangers and encourage robust recovery. The first and major initiative will be the intended IMF replenishment package (a substantial increase in quotas, accelerated implementation and enlarged General Arrangements to Borrow). Other developments will be needed to strengthen and deepen the cooperation between the IMF and other international institutions, leading creditor countries, and countries in difficulties, during the period of transition from high inflation. We shall also wish to influence the development of economic policies in all leading countries, in the balanced way best calculated to open up prospects for recovery, whilst making secure the gains which we are achieving and aiming for in reducing inflation. There are no manpower implications but some modest legislation will be involved in 1983 to cover IMF and related developments, including contingent liabilities for loan assistance. So long as it lasts, my own position as recently-elected Chairman of the IMF Interim Committee will provide valuable opportunities in all these fields.

f. European Community Budget

We need to continue the hitherto unsuccessful search for a durable solution to the problem of imbalance in the British contribution to the EC budget, through wider restructuring of the Community's expenditure patterns and financing system; we shall also seek improvements in the present unsatisfactory divisions and conflicts of

authority in the Community between Parliament, the Commission and the Council.

Taxation matters

10. Initiatives in this field will develop the aims set out in paragraph 5 above. Thus we must :-

- a. Further reduce the inhibiting effects of taxation on workers, managers, investors and wealth creators.
- b. Spread the burden of taxation as fairly as possible over all the different groups in our society.
- c. Make the system as simple and intelligible for the taxpayer, and as cheap to administer, as possible.

11. The main specific objectives are as follows :-

a. Incentives for people

- i. Reduce the burden of income tax and also reduce the poverty and unemployment traps in the first instance by raising thresholds (which will also help to reduce staff numbers) and then, as resources permit, by further reducing tax rates.
- ii. Ensure a proper balance between taxes on earning and taxes on spending.

b. Incentives for enterprise and risk taking

- i. Reduce the general burden of tax.
- ii. Further develop measures to promote a healthy and expanding small firms sector - in particular the Business Start-Up Scheme, insofar as it is not developed further in this Parliament.

- iii. Further ease the burden of capital taxes.
- iv. Move towards abolition of the Investment Income Surcharge.
- v. Encourage the spread of profit sharing and employee share schemes.
- vi. Encourage the individual saver to invest directly in equities rather than to save through institutions. To this end, review life assurance premium relief and the taxation of the pensions industry.
- vii. Encourage "portable pensions" by tax sanctions if appropriate.

c. Incentives for business

- i. Move towards abolition of the National Insurance Surcharge.
- ii. Continue to review and to adapt Corporation Tax to meet the changing needs of business. [Note: the main structure may be settled in this Parliament.]
- iii. Keep under review the burden on business of indirect taxes, and also their impact on individual incomes.
- iv. Keep under review the North Sea fiscal regime to ensure that it continues to provide sufficient incentives for new developments while securing a fair share of revenues for the Exchequer.

d. Simplification of the tax system

- i. Implementation of computerisation of PAYE by 1988 will improve efficiency, with staff savings of several thousands, and facilitate possible future changes in the administration of personal tax.

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- ii. Further examine the scope for simplifying the personal tax structure, including its relationship with the National Insurance Contribution system.
 - iii. Depending on progress in current trials, introduce more economical methods of collecting taxes from companies, including the possibility of self-assessment for Corporation Tax.
 - iv. Consult on reform of arrangements for taxing the self-employed, partnerships and unincorporated businesses, so possibly opening the way to income tax self-assessment.
- e. Fairness in the tax system
- i. Ensure a balanced approach to countering abuse in the tax system and the burden of compliance on the taxpayer, taking account of the recommendations of the Keith Committee.
 - ii. Bring forward proposals on the taxation of husband and wife.

12. The timing of fiscal changes must depend on developments in the economy over the next 5 years. In some cases specific manpower implications are noted; in general the Revenue Departments' manpower objectives over this period will be considered in the context of the Government's manpower objectives for the Civil Service as a whole. Most of the measures mentioned above will require legislation, generally in Finance Bills.

PROGRESS ON OUR 1979 COMMITMENTS

Our fundamental aims were to reverse our relative economic decline, restore the health of the economy and sound growth, and to master inflation. Our policies were almost all means to those ends. This note covers all our significant 1979 commitments.

Relative decline

2. No firm view is yet possible; but our output performance this year and next - probably as good as or better than the OECD average - could be a harbinger of success.

Restoration of the economy

3. The rot has been stopped and most adverse trends reversed. But there is still some way to go :-

- inflation and inflationary expectations are dramatically down, with further progress still possible;
- output is poised for gentle if fragile growth;
- productivity is rising fast and wage claims are still moderating;
- but unemployment remains disturbingly high and is still rising;
- competitiveness is about 20 per cent better than its worst but still weak by past standards;
- real profitability is rising but still very low;
- many encouraging "supply-side" responses with overall private sector investment still very high and rising despite weakness in the manufacturing sector;

Major policy objectives

4. Our record is patchy in fulfilling most major specific policy objectives :

- Public Sector Borrowing, Expenditure and Taxes

We have cut the GDP burden of public borrowing, but not prevented the shares of spending and taxes from rising, despite major economies.

- Incentives

The cuts in higher income tax rates and changes in Capital Gains Tax, Development Land Tax and Capital Transfer Tax have transformed incentives for entrepreneurs, managers, self-employed and the better paid. But we have had no resources to raise thresholds, or simplify the tax/social security tangle. The poverty and unemployment traps remain serious problems. And although we have much simplified some taxes, shortage of resources has forced us to hedge many concessions with further legal complexity.

- Pay bargaining

A start has been made with Megaw and the NHS, abolition of Clegg, liaison with employers, cultivation of public awareness, and employment legislation. But we have not moved to negotiate "no-strike agreements in a few social services".

- Regional assistance

Is not yet related to jobs created.

- The Earnings rule

Is not yet eliminated, though we were pledged to do so by the end of this Parliament.

- The EC Budget

Still calls for lasting reform.

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