10 DOWNING STREET

Prime Minister

Budget Speech

The attached draft is incomplete and will be extensively revised tonight. But I think it will be worthwhile for you to look at it tonight (since you won't be able to tomorrow night).

Robin and I have made a few suggestions. It is very long.

MCS 9/3

13

MORTGAGES AND THE BUDGET

1. Effects of the Budget

		per month
(i)	married man, $1\frac{1}{2}$ x average earnings, contracted-in	gains 53p
(ii)	married man, $1\frac{1}{2}$ x average earnings, contracted-out	loses £1.28p
(iii)	single, £12,000 a year, contracted-in	loses £1.10p
(iv)	single, £12,000 a year, contracted-out	loses £3.30p

NIC increases affect April payslip. Tax reductions affect May.

2. Mortgage effects on payslip

Assuming each of the above has £15,000 mortgage the effects of the following are the same for each on the April pay packet.

A. Coding change

Loses £5.82 per month
But this offsets the interest free loan enjoyed in 1982-83 when codes were not changed following interest fall.
"Loan" recovered over 12 months.

B. MIRAS

(a) With loan of 10% - £37.50 per month loss in pay packet.
But for endowment mortgages and for those exercising statutory right to maintain old profile of payments this is offset in reduced payments to building society

for those choosing to go to constant net repayment method payment to building society is £29.65 less.

C. There is a loss of tax relief in 1983-84 of £13.12 per month frompaying 10% rather than $13\frac{1}{2}$% (i.e. from benefit of reduced payments).

There will be a letter to all MPs post Budget explaining these changes.

FP Group
HM Treasury
9 March 1983

MCS

10 DOWNING STREET

Please copy to Michael Scholar.

PM has top copy.

FERB

Personal Income Taxation

Main rates - including basic rate of 30 per cent - remain unchanged. Allowances and thresholds increased by about 14 per cent as follows:

	1983-84 (proposed)	1982-83
	£	£
Married	2,795	2,445
Single (and wife's earned income)	1,785	1,565
Basic rate limit (starting point for higher rates)	14,601	12,801

Higher rate thresholds and bands increased correspondingly

Social Security and Other Benefits, Aged, Children, Widows and Charities

Uprating of social security benefits will be based on the outturn figure of inflation to May 1983. Next November's uprating will therefore be announced in June. May's inflation figure expected to be in the region of 4 per cent. Linked public service pensions to be increased by same amount.

Income tax age allowance up from £3,295 to £3,755 (married) and from £2,070 to £2,360 (single); and age allowance income limit raised from £6,700 to £7,600.

Threshold/investment income surcharge raised from £6,250 to £7,100.

for

Child Benefit increased by 65p to £6.50 from November 1983; one parent benefit up 40p to £4.05. (Gross cost £122 million in 1983-84 as compared with no increase at all £340 million in 1984-5).

Additional personal allowance for one parent families and widows' bereavement allowance raised from £880 to £1,010.

Five per cent abatement of unemployment benefit to be restored from November 1983 (cost £22 million in 1983-4, £60 m. in a full year).

A number of measures to provide substantial help to the sick, disabled, war pensioners and the less well off. Main changes:

/a.

a. Amount the severely disabled can earn before benefit is up from £20.00 to £22.50.

b. "Invalidity trap" to be ended - people under 60 on incapacity benefit for a year will qualify for long term rate of Supplementary Benefit. Over 60s will qualify immediately.

c. Capital disregard for entitlement to Supplementary Benefit increased from £2,500 to £3,000. Additional disregard of £1,500 for life assurance policies.

Entitlement to widow's bereavement allowance extended to cover year after husband's death. (Cost £30 million in a full year.)

£250,000 ceiling for CTT exemption on bequests to charities abolished: outright bequests to charities will not be taxed.

Annual ceiling for tax relief at higher income tax rates for payments under deeds of covenant to charities raised by £2,000 to £5,000.

Companies to be able to deduct for tax purposes costs of staff seconded to charities.

/Help to construction,

Help to construction, other forms of industry and employment (including North Sea)

The NIS is to be cut by another ½ per cent to 1 per cent from 1 August. Benefit to be confined to private sector. (Cost £215 million in 1983-84, £390 in full year).

Ceiling for mortgage interest relief up from £25,000 to £30,000 (cost £50 million in 1983-84). Relief extended to self-employed in tied accommodation buying houses elsewhere.

Limit on expenditure eligible for home repair grants increased by 20 per cent. Additional resources to "enveloping" schemes - external repairs to whole streets or terraces in inner city areas. (Cost of these 2 measures ~ £60 million in 1983-84.)

Stock relief available on houses accepted by builders in part exchange.

Industrial buildings allowance - permitted proportion of office space up from 10 per cent to 25 per cent (full year cost £25 million).

Development Land Tax deferment scheme on developments for owners' own use extended from April 1984 to April 1986.

Total North Sea revenues expected to be about £8 billion in 1983-84 similar to 1982-83 estimated outturn. A package of reliefs totalling £800 million over four years for existing fields, together with a substantially more favourable regime for future fields. Total cost of Budget tax reductions estimated at £115 million in 1983-84:-

Advance petroleum revenue tax (APRT), 20 per cent rate from 1 July 1983 cut to 15 per cent; to be phased out completely by the end of 1986.

PRT relief for expenditure incurred in searches or appraisal of discovered reserves, other than in existing oil fields or developments.

/ New

New fields (consent given after 1 April 1982) will get double existing oil allowance of ½ million tonnes each six months (total limit 10 million tonnes) and will not pay royalties. (Does not apply to onshore and Southern Basin oil fields).

Abolition of restriction on PRT relief for expenditure on shared assets (e.g. pipelines).

90,000 men between 60 and 65 no longer required to register solely in order to protect pension rights.

42,000 unemployed men on Supplementary Benefit will no longer need to wait a year (or to reach 65) to qualify for long term rate of SB.

New scheme for part-time job release.

Small Firms, Enterprise, Technology and Wider Share Ownership

Measures to foster growth of small and medium sized enterprises and improve their competitive environment. The new VAT registration limit and the changes in capital taxation will also help small firms.

Enterprise allowances to help unemployed people set up their own businesses extended to the whole country.

Business Expansion Scheme extends and improves the Business Start-up Scheme. The life of the scheme is extended to April 1987, it will now be applied to new and established unquoted trading companies and the maximum yearly investment limit will be raised from £20,000 to £40,000.

Corporation Tax - small companies rate cut from 40 per cent to 38 per cent; profits limits raised - lower limit up £10,000 to £100,000 - upper limit up £275,000 to £500,000. (Cost £40 million 1983-84; £70 million in full year.)

/ Interest

Interest relief extended to share purchases in employee buy-outs.

Deep-discounted stock - borrowers to get relief for accrued discount; investors to pay tax only on redemption and sale.

Profit Sharing and share options:-

a. profit share limit - £1,250 annual limit plus alternative of 10 per cent of salary to maximum of £5,000;

b. save-as-you-earn monthly limits raised by £25 to £75;

c. for other share options, 3 year instalment period over which income tax can be spread extended to 5 years.

Loan guarantee scheme - ceiling for total lending raised from £300 million to £600 million.

Small Industrial Workshop Scheme - averaging of size requirement for conversions of old buildings.

Freeports - legislation to be introduced; a few experimental locations to be authorised.

Small Engineering Firms Investment Scheme re-opened.

First year allowances for rented teletext receivers extended to June 1984, and for British films until March 1987.

Also includes help with information technology, innovation linked investment and extension of science parks. (Total costs of technology and innovation measures package - £240 million over three years).

115/10

BUDGET CONFIDENTIAL
until after Budget Speech on 15.3.83
then UNCLASSIFIED

C3

C3 MEDIUM TERM FINANCIAL STRATEGY

Factual

Fourth MTFS, updated and extended to 1985-86 provides:-

(i) Statement of Government's objectives:- "to continue reducing inflation and to secure a lasting improvement in the performance of the UK economy, so providing the foundations for sustainable growth in output and employment."

(ii) Description of financial framework Control of money supply is central part of the strategy, but in judging appropriate rate of monetary growth, Government will continue to take account of all the available evidence, including the exchange rate.

Ranges for monetary growth apply to narrow (M1) and broad (£M3 and PSL2) aggregates, though more rapid growth in M1 could be appropriate for a time (as interest rates come down).

% Change	1983-84	1984-85	1985-86
1983 MTFS	7-11	6-10	5-9
1982 MTFS	7-11	6-10	n.a.
1981 MTFS	4-8	n.a.	n.a.

Target for 1983 applies to 14 months between mid February 1983 and mid April 1984, at an annual rate. Ranges for later years are illustrative.

As last year, ranges are constructed on the assumption of "no major change in the exchange rate from year to year".

(iii) Fiscal projections illustrating how fiscal policy can be made consistent with financial framework, given public expenditure plans.

PSBR		1982-83	1983-84	1984-85	1985-86
		Estimate	MTFS Projections		
1983 MTFS*					
	£ bn	7½	8	8(½)	7(4)
as %	GDP	2¾	2¾	2½	2
Autumn Statement					
	£bn	9	8	n.a.	n.a.
as %	GDP	3¼	2¾	n.a.	n.a.
1982 MTFS					
	£bn	9½	8½	6½	n.a.
as %	GDP	3½	2¾	2	n.a.

*Figures in brackets show implied fiscal adjustment.

Detailed revenue and expenditure assumptions based on following assumptions:-

% Change	1983-84	1984-85	1985-86
Real GDP	←	2½% p.a.	→
GDP deflator	5½	5½	5
Money GDP	←	8% p.a.	→

Positive

(i) Continuity of stable financial framework. Monetary guidelines and PSBR projections virtually the same as in the 1982 MTFS.

(ii) MTFS has made important contribution to reducing inflation well into single figures.

(iii) Continued decline in monetary ranges consistent with keeping inflation on a downward trend.

(iv) Lower inflation means monetary ranges leave plenty of room for recovery in real activity.

(v) Success in reducing PSBR has contributed to reduction in interest rates, while keeping within 1982-83 target for monetary growth. PSBR fallen from 5 per cent GDP in 1979-80 to less than 3 per cent in 1982-83 (estimated).

(vi) Tax cuts in Budget possible without raising PSBR above figure suggested in last year's MTFS.

(vii) Declining path of PSBR over medium term should leave room for lower interest rates, as monetary growth comes down.

Defensive

(i) Monetary targets too high? Raised monetary targets last year to reflect apparent shift between broad monetary aggregates and inflation, caused by structural changes to financial markets and effect of high real interest rates on saving behaviour. Nothing has happened to change that view. Inflation has come down fast, and monetary growth within higher target range was consistent with appropriately restrictive monetary conditions last year. (Money GDP grew more slowly than expected.)

(ii) Has there been a change of view on velocity? Not for M1. Last year's MTFS warned that M1 velocity could fall as inflation and interest rates come down. This year's MTFS says fall could go further. £M3 is a bit different. Velocity of £M3 fell last year (whereas MTFS projections last year implied velocity would be stable with growth in the middle of the range); but change is relatively small. Forces that led us to revise targets up have continued, and seem likely to continue a little longer. New MTFS projections assume restoration of broad money velocity after recent fall starts in 1984-85 instead of 1983-84. Uncertainty about velocity is key reason why other indicators are used to interpret monetary conditions, and why ranges for later years are provisional. No intention of allowing velocity to return to trend via a rise in inflation.

(iii) Why not set a separate target for M1? Could be a lasting fall in M1 velocity as we move to lower inflation and interest rates (was a shift in the opposite direction when inflation rose in early '70s); if so, faster M1 growth, for a time, would not damage inflation prospects. But scale and timing very uncertain. Faster growth in M1 only appropriate if other indicators suggest this is consistent with maintaining moderately restrictive conditions.

BUDGET CONFIDENTIAL
until after Budget Speech on 15.3.83
then UNCLASSIFIED

C3 Cont

(iv) Why has inflation prospect improved (despite unchanged monetary ranges)?

	1982-83	1983-84	1984-85
GDP deflator (% change)			
1982 MTFS	7½	7	6½
1983 MTFS	7	5½	5½
Money GDP (% change)			
1982 MTFS	←	9½	→
1983 MTFS	←	8	→

- Changes are fairly small, especially relative to width of target ranges. Never claimed a very precise relationship between inflation, money GDP and monetary growth over 2-3 years.

- Prospects for inflation have improved because world prices (especially oil) and domestic costs may grow more slowly. Fall in exchange rate will affect RPI path (as noted in FSBR) but, providing monetary conditions are kept moderately restrictive, effect on inflation should be temporary (and may be less pronounced on GDP deflator).

- Outside forecasts of inflation have come down a lot since last year too.

(v) Lower money GDP (actual and forecast) suggests policy is unduly restrictive. Money GDP is not a target. Slower growth not primarily due to domestic pressures but depth of world recession. Monetary ranges leave room for recovery.

(vi) Role of exchange rate? Response to exchange rate movements depends on overall assessment of domestic monetary conditions. Recent fall not interpreted as symptom of policy laxity. But exchange rate will continue to be one of the financial indicators taken into account in interpreting monetary conditions.

(vii) MTFS says that "monetary ranges are constructed on the assumption of no major change in the exchange rate." What does this mean?

- difficult to define a major change precisely. But assumption applies to year to year movements in the effective exchange rate

- even if there is a major change (as last year) correct response depends on overall assessment of domestic monetary conditions

- as Chancellor has made clear, no reason to expect domestic policy stance to cause large change in the exchange rate in foreseeable future. (Short term forecast in FSBR assumes rate will remain at around present levels over the period of forecast.)

(viii) Shift of emphasis from monetary targets to PSBR? No. MTFS always emphasised the need for consistent fiscal and monetary policies.

(ix) Fiscal policy far too restrictive (eg OECD etc) Lower PSBR makes room for lower interest rates; PSBR alone not a measure of overall stance of policy. Lower inflation eases fiscal stance, for any given nominal PSBR (ie raises inflation adjusted or 'real' PSBR).

BUDGET CONFIDENTIAL
until after Budget Speech on 15.3.83
then UNCLASSIFIED

(x) Cyclically adjusted PSBR?

- no single correct way of calculating cyclical adjustment (not enough just to take out direct "cost of unemployment" - cyclical effects on PSBR depend on why employment and output are low)

- acid test is pressure on interest rates. Actual not hypothetical PSBR that has to be financed (and affects spending)

- objective is to secure trend reduction in PSBR relative to GDP

- PSBR was adjusted in 1981 to take account of recession though principle that path should be on declining trend was adhered to. Estimated PSBR outturn in 1982-83 likely to be about ½ per cent of GDP higher than envisaged in 1980 FSBR.

(xi) Real PSBR?

- may be a useful indicator of stance of policy. But not sensible to fine-tune nominal PSBR to achieve targets for real PSBR, (could involve raising nominal PSBR when inflation rises, effectively accommodating higher inflation).

- lower inflation has meant some easing in fiscal stance in 1982-83, despite low outturn for nominal PSBR; real PSBR has risen slightly, compared with 1981-82, (one way in which lower inflation helps to raise real demand, within given nominal framework).

(xii) PSBR interest rate link discredited? PSBR not only influence on interest rates. But we cannot do much about world interest rates. Responsible fiscal policy has helped to keep our interest rates towards bottom of the international range.

(xiii) Fiscal adjustment in 1984-85 depends on undershooting PEWP planning total?

[Table 2.3 shows underspending £1½ billion - described as differences due to economic assumptions; table 2.5 shows fiscal adjustment of only £½ billion.]

Fiscal adjustment subject to very large margin of error (same as PSBR). But scope for tax cuts always depends critically on success in controlling public expenditure. Planning total for 1984-85 will be reviewed nearer the time, in the normal way.

(xiv) Balanced Budget? Government aims to reduce PSBR as share of money GDP over medium term. Illustrative profile in 1982 MTFS shows figure of 2 per cent in 1984-85. Nothing has been said about later years.

(xv) Why is the 1984-85 PSBR higher than in 1982 MTFS?

PSBR projections are illustrative and are reviewed every year. Current level of PSBR (ie 2¾ per cent of GDP) close to averages in 1950s and 1960s, and not surprising that progress from now on is slower than that in recent years. But we are looking for some further trend decline. [Not for use: oil prices are not a good excuse: oil revenues in 1984-85 are unchanged from last year's MTFS.]

Contact point: Mrs R Lomax (MP1) 233-7901

12

SOME COMMENTS ON THE PROPOSED MEASURES

Personal Allowances

1. The proposal is to increase all thresholds and allowances (including the higher rate and IS thresholds) by 14 per cent, or 8½ per cent above the statutory minimum. This follows the increase of 2 per cent above the statutory minimum of last year. This year's increase will for the great majority, but not all, people more than outweigh the increased National Insurance Contributions which come into effect next April.

Social Security etc

2. The main proposal is to increase child benefit to £6.50 per week, taking its value well above the level inherited in 1979. There will be a parallel increase in one-parent benefit. Other proposals are to restore the 5 per cent abatement in unemployment benefit effected in 1980, to extend the widows bereavement allowance to make it more effective, and to remove the so-called invalidity trap. These measures comprise an attractive package which should go some way to offset the criticism likely to arise over the question of the social security upratings generally.

Corporation Tax

3. The proposal is to reduce the small companies rate from 40 per cent to 38 per cent, and to alter the limits so as to reduce the transitional marginal rate.

Oil

4. Comprised here is a package of proposals designed in particular to encourage the development of the next generation of North Sea oil fields.

National Insurance Surcharge

5. The Government inherited a 3½ per cent NIS rate, and has already brought this down by steps to 1½ per cent from 1983-84. Complete abolition of the Surcharge is the one single measure most frequently and forcefully pressed in industrial representations. It is proposed to meet these pressures, in part for political and presentational reasons, by a further ½ per cent for the private sector only, to take effect from next August.

Small Firms, Enterprise and Wider Share Ownership

6. The main proposal here is a major extension of the Business Start-Up Scheme, to be called the Business Expansion Scheme. The principal change is the extension of the present scheme so that there will be tax relief for equity investment not just in new companies but in all qualifying established unquoted trading companies. Other changes are being made to make the scheme less restrictive. Other proposals under this head include further measures to encourage wider share ownership, some real improvements in the Capital Transfer Tax regime, an extension of the Loan Guarantee Scheme, and an increase in the VAT registration threshold.

Technology and Innovation

7. The principal proposal here is a re-opening, at a cost of £100 million over the next three years, of the Small Engineering Firms Investment Scheme (SEFIS). Also included in the total technology package of £240 million over three years is to help with Information Technology, Innovation Linked Investment and a provision for extension of Science Parks. It is hoped that this package will particularly benefit the West Midlands.

Construction

8. The principal proposal here is the increase in the Mortgage Interest Relief ceiling from £25,000 to £30,000. Also included are proposals to provide more for Home Improvement Grants, and also to provide money for so-called "enveloping" schemes, under which local authorities repair the external fabrics of complete streets or terraces, as part of helping counter the problems of housing decay.

Unemployment

9. The measures here include the proposals in respect of early retirement, a nationwide extension of the Enterprise Allowance Scheme, and making the Job Release Scheme available to part-timers from the age of 62.

Specific Duties

10. These will be increased generally in line with inflation, though with some small real decreases in cigarettes, petrol and derv, and, largely due to rounding, some small real increases in beer, cider and VED. The Chancellor's minute to the Prime Minister of 24 February set out details of the proposals for petrol, derv and VED.

Other

11. The measures here comprise mainly action on personal fringe benefits and corporate anti-avoidance. On fringe benefits :-

- proposals in respect of employers scholarships were explained in the Chancellor's letter of 23 February to the Secretary of State for Education and Science.

- car and car fuel scales for company cars used privately by higher paid employees will be increased from 1984-85 by 14 per cent on average. These scales will still be less than justified by a realistic estimate of the costs of running a car.

- on Directors PAYE tax it is necessary to deal with cases in which close companies pay directors or higher paid employees a sum without deduction of tax from him and so account for insufficient tax to the Revenue. To do this, tax accounted for by the company will be deemed to be a benefit in kind of the director.

- where companies provide expensive accommodation(the "Marks & Spencer" device)to employees it will be taxed as a benefit.

Two other proposals will give help :-

- removal of special "deemed domicile" CTT rule applying to those emigrating to the Channel Islands and the Isle of Man.

- allowing the tenant self-employed (publicans and farmers) to have interest relief on second home mortgages.

12. The main anti-avoidance proposals are :-

- countering the "British Leyland" device for avoidance through groups relief; on this Treasury Ministers are satisfied that the proposals will not hamper genuine business transactions.

- legislation on tax havens <u>but</u> with the measures to take effect from 1984 and to provide for Double Taxation Relief to be allowed from the same date against the full corporation liability <u>before</u> ACT is deducted. Taken together these two changes do not represent an increase in the burden of tax on international business but a switch in the burden away from those who remit profits to the UK towards those who accumulate surplus cash balances in tax havens overseas.